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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
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Date:
January 20, 2023

LEGEND

X =

A =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

State =

Dear _____ :

This responds to a letter dated July 22, 2022, and additional correspondence, submitted on behalf of X by X's authorized representative, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

FACTS

The information submitted states that X was formed on Date 1 under the laws of State and elected to be treated as an S corporation effective Date 3. Trust 1, Trust 2 and Trust 3 acquired shares in X on Date 2; Trust 4 acquired shares in X on Date 4; and Trust 5 acquired shares in X on Date 5. X represents that Trust 1, Trust 2 and Trust 3 qualified to elect to be treated as Qualified Subchapter S Trusts (QSSTs). However, the sole income beneficiaries of each of Trust 1, Trust 2 and Trust 3 failed to make timely QSST elections within the meaning of § 1361(d)(2), thereby causing X's S corporation election on Date 3 to be ineffective.

Trust 4 and Trust 5 were treated as a wholly-owned grantor trusts under §§ 671 and 676 as to A from Date 4 (as to Trust 4) and Date 5 (as to Trust 5). On Date 6, Trust 4 and Trust 5 ceased to be wholly-owned grantor trusts as to A. X represents that Trust 4 and Trust 5 qualified to elect to be treated as Electing Small Business Trusts (ESBTs) as of Date 6. However, the trustees of Trust 4 and Trust 5 failed to make timely ESBT elections under § 1361(e)(e), thereby causing X's S corporation election, if it were valid, to be ineffective as of Date 6. On Date 7, Trust 4 was once again treated as a wholly-owned grantor trust as to A. A died on Date 8.

X represents that the circumstances resulting in the failure to file QSSTs election for Trust 1, Trust 2 and Trust 3 and the failure to file ESBT elections for Trust 4 and Trust 5 were inadvertent and not motivated by tax avoidance or retroactive tax planning. X further represents that it has filed income tax returns consistent with having a valid S election in effect for all taxable years since its election to be an S corporation, and each of the trusts have filed income tax returns consistent with having a QSST or ESBT

election in effect, as applicable. Further, X represents that X and its shareholders agree to make any adjustments required by the Secretary as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f).

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1 of the Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(ii) provides that a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death may be an S corporation shareholder, but only for the 2-year period beginning on the day of the deemed owner’s death.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), an electing small business trust (ESBT) may be an S corporation shareholder.

Section 1361(d)(1) provides, in part, that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2) the trust is treated as a trust described in § 1361(c)(2)(A)(i) and, for purposes of § 678(a), the beneficiary of the trust is treated as the owner of that portion of the trust which consists of stock in a S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply.

Section 1361(d)(3) defines a QSST as a trust, (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death or the termination of the trust, and (iv) upon the termination of the trust during the

life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1361(e)(1)(A) provides that an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(1)(B) provides that the term “electing small business trust” shall not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the QSST election under § 1361(d)(2) by signing and filing, with the service center with which the S corporation files its income tax return, the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(m)(2)(iii) provides that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a QSST election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2) provides that an S corporation election will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in

such ineffectiveness or termination, steps were taken so that the corporation for which the election was made or termination occurred is a small business corporation; and (4) the corporation for which the election was made or termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's initial S corporation election was ineffective on Date 3 because the sole income beneficiaries of Trust 1, Trust 2 and Trust 3 failed to file timely elections under § 1361(d)(2). Further, were X's initial S corporation election effective on Date 3, it would have terminated on Date 6 because the trustees of Trust 4 and Trust 5 failed to file timely elections under § 1361(e)(3). We conclude, however, that the ineffectiveness of X's initial S corporation election, Trust 1, Trust 2, and Trust 3's QSST elections, and Trust 4 and Trust 5's ESBT elections were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as an S corporation from Date 3 and thereafter, provided X's S corporation election is not otherwise terminated under § 1362(d).

This letter ruling is subject to the condition that within 120 days from the date of this letter, the sole income beneficiaries of Trust 1, Trust 2 and Trust 3 must file QSST elections with respect these trusts effective Date 3 with the appropriate service center. A copy of this letter should be attached to each QSST election. This letter ruling is also subject to the condition that within 120 days from the date of this letter, the trustees of Trust 4 and Trust 5 must file ESBT elections with respect to these trusts effective Date 6 with the appropriate service center. A copy of this letter should be attached to each ESBT election. If these conditions are not met, then this letter ruling is null and void.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation, Trust 1, Trust 2 and Trust 3's eligibility to be QSSTs, or Trust 4 and Trust 5's eligibility to be ESBTs.

This ruling is directed only to the taxpayer that requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed

by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

/s/

Laura C. Fields
Branch Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

Copy of this letter for Section 6110 purposes

cc: