

**Internal Revenue Service**

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, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:3  
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Date:  
April 01, 2024

Legend

X =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

A =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear \_\_\_\_\_ :

This letter responds to a letter dated September 19, 2023, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### FACTS

According to the information submitted, X, a State corporation, elected to be an S corporation effective Date 1. Trust 1 owned shares of stock in X. Trust 1 was treated under subpart E of part I of subchapter J of chapter 1 as entirely owned by A, and, thus, a permissible shareholder under § 1361(c)(2)(A)(i). On Date 2, A died and Trust 1 ceased to be a permissible shareholder under § 1361(c)(2)(A)(i). Under § 1361(c)(2)(A)(ii), Trust 1 remained an eligible shareholder for a 2-year period beginning on the day of A's death. Following the expiration of the 2-year period on Date 3, Trust 1 continued to hold shares of X stock. X represents that Trust 1 qualified as an electing small business trust (ESBT) within the meaning of § 1361(e), but the trustee of Trust 1 failed to make an ESBT election under § 1361(e)(3) for Trust 1 effective Date 3. Thus, Trust 1 became an ineligible shareholder of X on Date 3 which caused X's S corporation election to terminate on Date 3.

On Date 4, Trust 1 transferred its shares of X stock to Trust 3 and Trust 4, and Trust 2, a shareholder of X, transferred its shares of X stock to Trust 5 and Trust 6. X represents that Trust 3, Trust 4, Trust 5, and Trust 6 (collectively, the Trusts) qualified as ESBTs within the meaning of § 1361(e), but the trustees of the Trusts failed to make ESBT elections under § 1361(e)(3) for the Trusts effective Date 4. Therefore, had X's S corporation election not terminated on Date 3, it would have terminated on Date 4 when shares of X stock were transferred to ineligible shareholders.

X represents that the circumstances resulting in the termination of its S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X also represents that (1) X and its shareholders have filed their tax returns consistent with X being an S corporation since Date 1, (2) Trust 1 has filed its income tax returns consistent with being an ESBT effective Date 3, and (3) the Trusts have filed their income tax returns consistent with being ESBTs effective Date 4.

Finally, X and its shareholders have agreed to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

### 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 one 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) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

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

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term “electing small business trust” 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)-(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)(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 subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides, in relevant part, that the trustee of an ESBT must make the ESBT election by signing and filing,

with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-2(m)(2)(ii).

Section 1362(a) provides that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) 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(d)(2)(B) provides that any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the termination, the 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 S corporation election terminated on Date 3 when Trust 1 became an ineligible shareholder under § 1361(b)(1)(B). In addition, had X's S corporation election not terminated on Date 3, we conclude that it would have terminated on Date 4 when the trustees of the Trusts failed to file ESBT elections for the Trusts effective Date 4. We further conclude that the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided that X's S corporation election was valid and has not otherwise terminated under § 1362(d) for reasons not addressed in this letter.

This ruling is contingent on the trustees of the Trusts filing within 120 days from the date of this letter ESBT elections effective Date 4 for the Trusts with the appropriate service center. A copy of this letter should be attached to each ESBT election.

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 and the regulations thereunder. Specifically, we express or imply

no opinion regarding X's eligibility to be an S corporation or Trust 1's and the Trusts' eligibility to be ESBTs.

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 requested ruling, it is subject to verification on examination.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representatives.

Sincerely,

*Mary Beth Carchia*

Mary Beth Carchia  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure:

Copy of this letter for § 6110 purposes

cc: