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Person To Contact:
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Telephone Number:

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Date:
April 5, 2024

Legend:

X =

Y =

A =

B =

C

State 1 =

State 2 =

Trust 1 =

Trust 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to a letter dated September 21, 2023, and subsequent correspondence, submitted on behalf of X by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted and representations within, prior to formation of X, Y was formed on Date 1, under the laws of State 1. Effective Date 2, Y elected to be treated as an S corporation. X was incorporated on Date 3 under the laws of State 2. Y merged into X pursuant to a reorganization and was treated as succeeding Y's election to be an S corporation.

A, then a principal shareholder of Y and current shareholder of X, established Trust 1 and Trust 2 on Date 4. Trust 2 had two beneficiaries, B and C. Trust 2 was divided into two equal separate and independent trusts for the beneficiaries.

A initially funded Trust 1 with shares of Y. On Date 5, the shares that A previously transferred to Trust 1 was transferred to Trust 2. X represents that each of the separate trusts under Trust 2 were eligible to make a Qualified Subchapter S Trust (QSST) election under § 1361(d)(3) as of Date 5. Each Trust 2 share was treated as a separate share under § 663(c). However, B and C failed to timely make the QSST election effective Date 5 causing X's S corporation election to terminate on Date 5.

X represents that both trusts under Trust 2 has met all the requirements for qualifying as a QSST under § 1361(d)(3), other than filing of a timely QSST election under §1361(d)(2).

X further represents that the circumstances resulting in the termination of X's S election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed all returns consistent with X's status as an S Corporation. X and its shareholders agree 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) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1) provides that the term "small business corporation" means 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)0 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 1 of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States is a permitted S corporation shareholder.

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

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 the 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 that 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. A substantially separate and independent share of a trust within the meaning of § 663 shall be treated as a separate trust for purposes of this § 1361(d)(3) and § 1361(c).

Section 1.1361-1(j)(7)(i) of the Income Tax Regulation provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

Section 1.1361-1(j)(6)(iii) provides that the QSST election must be filed within the time requirements of § 1.1361-1(j)(6)(ii)(A) through (E).

Section 1362(a) of the Code provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination under § 1362(d)(2)(A) shall be effective on and after the date of cessation.

Section 1362(f) provides relevant part, that if (1) an election under § 1362(a) by any corporation (A) 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 to obtain shareholder consents, or (B) 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 event resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such 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 such ineffectiveness or 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 5 because beneficiaries of separate shares of Trust 2 failed to file a timely QSST election under § 1361(d)(2).

We further conclude that the termination of X's S election on Date 5 was inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as continuing to be an S corporation on and Date 1, and thereafter, provided X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d).

This ruling is contingent on the beneficiaries of separate shares of Trust 2 filing a QSST election for each respective shares of Trust 2 effective Date 5, with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the QSST elections. In addition, each of the separate trusts under Trust 2 must file within 120 days from the date of this letter amended returns for all years consistent with the requested relief to properly reflect the treatment of each separate shares of Trust 2 as a QSST and attach a copy of this letter to such returns.

If the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the service center with which it filed its S corporation election that its election terminated on Date 5.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provisions of the Code and the regulations thereunder, including whether X was otherwise a valid S corporation and whether each separate shares of Trust 2 are a valid QSST within the meaning of § 1361(d)(3). Specifically, we express or imply no opinion concerning Y's eligibility to be an S corporation. Further we express or imply no opinion concerning the validity or tax consequences of the merger of Y and X.

The rulings contained in this letter are 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.

These rulings are directed only to the taxpayer requesting them. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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

Sincerely,

Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:
Copy of this letter for § 6110 purposes

cc: