

Internal Revenue Service

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Person To Contact: _____, ID No.

Telephone Number:

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Date:
April 26, 2024

Legend

X =

State =

A =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trustees =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Year 1 =

Dear _____ :

This letter responds to a letter dated September 28, 2023, and subsequent correspondence submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X was incorporated under the laws of State and elected to be treated as an S corporation effective Date 1. On Date 2, A became the sole shareholder of X. On Date 3, A's shares in X were transferred to Trust 1, which qualified as an eligible shareholder of an S corporation under § 1361(c)(2)(A)(i). On Date 4, A died and Trust 1 qualified as an eligible shareholder of an S corporation under § 1361(c)(2)(A)(ii) until Date 5.

Trustees are the trustees of Trust 1, Trust 2, Trust 3, and Trust 4. X represents that Trust 1 was eligible to make an election to be treated as a qualified subchapter S trust (QSST). However, an election to be treated as a QSST was not timely made for Trust 1. The failure to make a timely QSST election for Trust 1 made Trust 1 an ineligible shareholder of X on Date 5, and X's S corporation status terminated on Date 5.

On Date 6, Trust 1 transferred all the shares of X to Trust 2, Trust 3, and Trust 4. The respective income beneficiary of Trust 2, Trust 3, and Trust 4 elected to treat each trust as a QSST effective Date 6.

In Date 7, X learned that Trust 1 became an ineligible shareholder on Date 5, and X's election to be an S corporation terminated on Date 5. X represents that the termination of its S corporation election was inadvertent and was not motivated by tax avoidance or retroactive tax planning. 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 & 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 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 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(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), the beneficiary of such trust will be treated as the owner (for purposes of § 678(a)) of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made, and for purposes of applying sections 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust will be treated as a disposition by the beneficiary.

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 will 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 will terminate on the earlier of such beneficiary's death or the termination of the trust; and (iv) upon termination of the trust during the life of the current income beneficiary, the trust will 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.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation. A termination of an S corporation under § 1362(d)(2) is 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 the termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the 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 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 the termination, such corporation will be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 5 when Trust 1 became an ineligible shareholder. We further conclude that the termination of X's S corporation 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 Date 5, and thereafter, provided X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d)(2).

This ruling is contingent on the beneficiary of Trust 1 filing a QSST election for Trust 1 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 election. In addition, Trust 1 must file amended returns using the calendar year as the taxable year within 120 days from the date of this letter for Year 1 through the year that includes Date 6 consistent with the treatment of Trust 1 as a QSST and attach a copy of this letter to such amended 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 Trust 1, Trust 2, Trust 3, and Trust 4 are valid QSSTs within the meaning of § 1361(d)(3).

This ruling is directed only to the taxpayer requesting 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 your authorized representatives.

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.

Sincerely,

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

Enclosure

Copy of this letter for § 6110(k)(3) purposes

cc: