

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **202438003**
Release Date: 9/20/2024

Third Party Communication: None
Date of Communication: Not Applicable

Index Numbers: 1361.01-02, 1361.03-02,
1361.03-03, 1362.00-00,
1362.02-02, 1362.04-00

Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-113224-23

Date:
June 04, 2024

LEGEND

X =

State =

A =

B =

Trust 1 =

Trust 2 =

Trust 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =
n =

Dear :

This letter responds to a letter dated May 24, 2023, and subsequent correspondence submitted on behalf of X by its authorized representative, 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 X stock. Trust 1 was a revocable living trust that was treated under subpart E of part I of subchapter J of chapter 1 of the Code as entirely owned by spouses, A and B, and, thus, was an eligible S corporation shareholder under § 1361(c)(2)(A)(i). A died on Date 2. Relative to A's shares of X stock, Trust 1 continued to be an eligible S corporation shareholder for 2 years beginning on Date 2 under § 1361(c)(2)(A)(ii). Pursuant to the terms of Trust 1, Trust 1 was divided into Trust 2 and Trust 3 upon the death of A and shares of X stock were to be allocated to Trust 2 for the benefit of B.

X represents that Trust 2 was eligible to be a qualified subchapter S trust (QSST) under § 1361(d) and that B, the income beneficiary of Trust 2, filed tax returns consistent with Trust 2 being a QSST effective Date 3. However, B failed to make an election under § 1361(d)(2) to treat Trust 2 as a QSST effective Date 3. Consequently, X's S corporation election terminated on Date 3.

On Date 4, B died. Under § 1.1361-1(j)(7)(ii) of the Income Tax Regulations, Trust 2, had it been a QSST, would have been an eligible S corporation shareholder for a 2-year period beginning on Date 4. X represents that Trust 2 was eligible to be an electing small business trust (ESBT) under § 1361(e)(1) effective Date 5. However, the trustee of Trust 2 failed to make an election under § 1361(e)(3) treating Trust 2 as an ESBT effective Date 5. Therefore, X's S corporation election would have terminated on Date 5, had it not previously terminated on Date 3.

X represents that the circumstances resulting in the termination of its S corporation election were inadvertent and 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 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 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 of the Code) 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(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 an 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)(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)(i) provides, in part, that a QSST election must be made separately with respect to each corporation whose stock is held by the trust.

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

Section 1.1361-1(j)(6)(iii) provides, in part, that a QSST election must be filed within the time requirements of § 1.1361-1(j)(6)(iii)(A) through (D).

Section 1.1361-1(j)(7)(ii) provides that if, upon the death of a QSST income beneficiary, the trust continues in existence and continues to hold S corporation stock but no longer satisfies the QSST requirements, is not a grantor trust or an ESBT, then, solely for purpose of § 1361(b)(1), as of the date of the income beneficiary's death, the estate of that income beneficiary is treated as the shareholder of the S corporation for two years or the transfer of the stock by the trust. If, after the 2-year period, the trust continues to hold S corporation stock and does not otherwise qualify as a permitted shareholder, the corporation's S election terminates.

Section 1.1361-1(m)(2)(i) provides, in part, that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center for which the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii). Generally, only one ESBT election is made for the trust, regardless of the number of S corporations whose stock is held by the ESBT.

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

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(d)(2)(B) provides that any termination under § 1362(d)(2)(A) 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 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 the termination occurred is a small business corporation; and (4) the corporation for which the election was made or 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 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 S corporation election terminated on Date 3 when X had an ineligible S corporation shareholder under § 1361(b)(1)(B) and would have terminated on Date 5 when the trustee of Trust 2 failed to make an ESBT election under § 1361(e)(3) for Trust 2 effective Date 5, had it not otherwise terminated on Date 3. We also 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 continue to be treated as 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 conditioned on the trustee of Trust 2 filing an ESBT election for 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 ESBT election.

Also, as an adjustment under § 1362(f)(4), X must send a payment of \$n, with a copy of this letter within 45 days from the date of this letter to the following address:

Internal Revenue Service
Kansas City Submission Processing Campus
333 W. Pershing Road
Kansas City, MO 64108
Stop 7777
Attn.: Manual Deposit

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 3.

Except as specifically ruled on 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 and Trust 2's eligibility to be a QSST or an ESBT.

The ruling contained in this letter is based on 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 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.

Sincerely,

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

PLR-113224-23

7

Enclosure:

Copy of this letter for § 6110 purposes

cc: