

Internal Revenue Service

Department of the Treasury
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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PLR-104166-24

Date:
August 23, 2024

Legend

X =

A =

Trust 1 =

Trust 2 =

Trust 3 =

State =

Date 1 =

Date 2 =

Date 3 =

n =

m =

Dear :

This letter is in response to a letter dated November 30, 2023, and subsequent correspondence, submitted on behalf of X by its authorized representatives 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 on Date 1 and elected to be an S corporation effective Date 1. On Date 1, A, an individual, was the sole shareholder of X.

On Date 2, A transferred shares of X stock to Trust 1. Pursuant to the terms of Trust 1, Trust 2 and Trust 3 were established as subtrusts of Trust 1 and were allocated n% and m%, respectively, of all property assigned, conveyed, transferred and delivered to Trust 1. X represents that Trust 1, Trust 2, and Trust 3 were all eligible S corporation shareholders under § 1361(c)(2)(A)(i).

On Date 3, the terms of Trust 1 were amended, thereby causing Trust 1, Trust 2, and Trust 3 to no longer qualify as eligible S corporation shareholders under § 1361(c)(2)(A)(i). X represents that beginning on Date 3, Trust 1, Trust 2, and Trust 3 were eligible to be electing small business trusts (ESBTs) within the meaning of § 1361(e)(1). The trustee(s) of Trust 1 made a timely election under § 1361(e)(3) to treat Trust 1 as an ESBT effective Date 3. However, the trustee(s) of Trust 2 and Trust 3 failed to make elections under § 1361(e)(3) treating Trust 2 and Trust 3 as ESBTs effective Date 3. Consequently, X's S corporation election terminated on Date 3.

X represents that the circumstances resulting in the termination of its S corporation election were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that it and its shareholders (including Trust 2 and Trust 3) have filed federal income tax returns consistent with X being treated as an S corporation effective Date 1. Finally, X and its shareholders agree to make any adjustments required as a condition of obtaining relief 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)(B) provides that the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not, among other requirements, 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.

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)(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, for purposes of § 1361, 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 all 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 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).

Section 1.1361-1(m)(2)(iii) provides that the ESBT election must be filed within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a qualified subchapter S trust election.

Section 1362(a) 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) is 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 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 (B) was terminated under § 1362(d)(2), (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 of 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 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 the representations made, we conclude that X's S corporation election terminated on Date 3 when Trust 2 and Trust 3 became ineligible S corporation shareholders under § 1361(b)(1)(B). We further conclude that the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Accordingly, 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).

This ruling is conditioned on the trustee(s) of each of Trust 2 and Trust 3 filing an ESBT election for Trust 2 and Trust 3, respectively, effective Date 3 with the appropriate service center within 120 days from the date of this letter. 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. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation and Trust 1's, Trust 2's, and Trust 3's 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 requesting it. Section 6110(k)(3) of the Code provides that they 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)

Enclosure:

Copy of this letter for § 6110 purposes

cc: