

Trust 3 =

Trust 4 =

A =

Dear _____ :

This letter responds to a letter dated May 21, 2024, 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 on Date 1, under the laws of State. On Date 1, A, an individual, owned all shares of stock in X. On Date 2, A transferred all shares of X to Trust 1. Effective Date 3, X elected to be taxed as an S corporation. 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 of X under § 1361(c)(2)(A)(i). A died on Date 4. Trust 1 no longer owned any shares of X at the end of the 2-year period beginning on Date 4 described in § 1361(c)(2)(A)(ii).

On Date 5, the trustee of Trust 1 transferred shares of X to Trust 2. As of Date 5, X represents that Trust 2 qualified as an electing small business trust (ESBT) within the meaning of § 1361(e), but the trustee of Trust 2 failed to make a timely ESBT election under § 1361(e)(3) for Trust 2.

On Date 5, the trustee of Trust 1 transferred shares of X to Trust 3. As of Date 5, X represents that Trust 3 met the requirements to be treated as a qualified subchapter S trust (QSST) as described in § 1361(d)(1), but the beneficiary of Trust 3 failed to make a timely QSST election for Trust 3.

On Date 5, Trust 3 sold shares of X to Trust 4. X represents that, as of Date 5, Trust 4 qualified as an electing small business trust (ESBT) within the meaning of § 1361(e), but the trustee of Trust 4 failed to make an ESBT election under § 1361(e)(3) for Trust 4. Therefore, Trust 2, Trust 3, and Trust 4 were ineligible S corporation shareholders and as a result, X's S corporation election terminated on Date 5.

X represents that the circumstances resulting in the termination of its S corporation election were inadvertent and were not motivated by tax avoidance.

Additionally, X represents that X and its shareholders filed all returns consistent with X's status as an S corporation. X and its shareholder 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) provides that a "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)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 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 a shareholder of an S corporation. Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the 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 pertinent part, that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1361(d)(2) applies.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or their legal representative) may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), the election will be effective up to 15 days and two months before the date of the election.

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 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.

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(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(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 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)(1) 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) 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) or (3); (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 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 of the corporation at any time during the period specified under § 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 for that period, then, notwithstanding the circumstances resulting in such 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 terminated on Date 5, when ineligible shareholders Trust 2, Trust 3, and Trust 4 received shares of X. We further conclude that the termination of X's S election was inadvertent within the meaning of § 1362(f). Therefore, pursuant to the provisions of § 1362(f), X will be treated as an S corporation effective Date 5, and thereafter, provided X's S corporation election is valid and not otherwise terminated under § 1362(d).

This relief is contingent on the trustees of Trust 2 and Trust 4 filing within 120 days from the date of this letter ESBT elections effective Date 5 and Date 7 for Trust 2 and Trust 4 respectively with the appropriate service center. A copy of this letter should be attached to each ESBT election.

This relief is also contingent on the beneficiary of Trust 3 filing a QSST election with the appropriate service center within 120 days from the date of this letter effective Date 6. A copy of this letter should be attached to the 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, the eligibility of Trust 2 or Trust 4 to be ESBTs, or Trust 3's eligibility to be a QSST.

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,

Richard T. Probst

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

Enclosure

Copy for § 6110 purposes

cc: