

Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 =
Date 10 =
Date 11 =
Date 12 =
Date 13 =

Dear _____ :

This letter responds to a letter dated March 29, 2021, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted, X was incorporated under the laws of State on Date 1 and elected S corporation status effective Date 2. Shares of X were transferred to Trust 1 on Date 3. Trust 1 was a grantor trust described in § 1361(c)(2)(A)(i) of which A and B were the deemed owners. A died on Date 4. Relative to A's shares of X stock, Trust 1 qualified under § 1361(c)(2)(A)(ii) as an eligible shareholder for two years from A's death. Pursuant to the terms of Trust 1, all of A's shares of X stock were distributed to Trust 2 on Date 5. X represents that Trust 2 satisfies the requirements to be a qualified sub-chapter S trust (QSST) within the meaning of § 1361(d) effective Date 5. However, the sole beneficiary of Trust 2 did not make a QSST election under § 1362(d)(2). Therefore, Trust 2 was not a permissible shareholder on Date 5 and thereafter.

On Date 2, shares of X stock were held by Trust 3. Trust 3 was a grantor trust described in § 1361(c)(2)(A)(i) of which C and D were the deemed owners. D died on Date 6. Relative to D's share of X stock, Trust 3 qualified under § 1361(c)(2)(A)(ii) as an eligible shareholder for two years from D's death. Pursuant to the terms of Trust 3, shares of X stock were distributed to Trust 4 on Date 7. X represents that Trust 4 satisfies the requirements to be a QSST within the meaning of § 1361(d)(1) effective Date 7. However, the sole beneficiary of Trust 4 did not make a QSST election under § 1362(d)(2). Therefore, Trust 4 was not a permissible shareholder of Date 7 and thereafter.

Also on Date 7, and pursuant to the terms of Trust 3, shares of X stock were distributed to Trust 5. Trust 5 was a grantor trust described in § 1361(c)(2)(A)(i) of which C was the deemed owner. C died on Date 8. Trust 5 qualified under § 1361(c)(2)(A)(ii) as an eligible shareholder for two years from C's death. On Date 9, pursuant to the terms of Trust 5, the shares of X stock were distributed to C and D's children or their revocable trusts.

On Date 10, shares of X stock were transferred to Trust 6. X represents that Trust 6 satisfies the requirements to be a QSST within the meaning of §1361(d)(1) effective Date 10. However, the sole beneficiary of Trust 6 did not make a QSST election under § 1362(d)(2). Therefore, Trust 6 was not a permissible shareholder of Date 10 and thereafter.

On Date 11, shares of X stock were transferred to Trust 7. X represents that Trust 7 satisfies the requirements to be an electing small business trust (ESBT) within the meaning of §1361(e)(1) effective Date 11. However, the trustee of Trust 7 did not make an ESBT election under § 1361(e)(3). Therefore, Trust 7 was not a permissible shareholder of Date 11 and thereafter.

On Date 12, shares of X stock were transferred to Trust 8. X represents that Trust 8 satisfies the requirements to be an electing small business trust (ESBT) within the meaning of § 1361(e)(1) effective Date 12. However, the trustee of Trust 8 did not make an ESBT election under § 1361(e)(3). Therefore, Trust 8 was not a permissible shareholder as of Date 12 and thereafter.

Trust 9 owns shares of X stock. X represents that Trust 9 made an election to be a QSST within the meaning of § 1361(d)(1) effective Date 13. However, the trustee of Trust 9 failed to distribute all of the income to its sole beneficiary as required by the trust instrument. Therefore, Trust 9 was not a permissible shareholder as of Date 13 and thereafter.

X represents that the cumulative amount of taxes paid with respect to the trusts is more than the tax that would have been required if the correct and timely trust elections had been made.

X and its shareholders who have held shares of X since Date 2, the effective date of X's S corporation election represent that they did not intentionally terminate the S corporation election and its shareholders have intended for X to be treated as an S corporation since Date 2. X and its shareholders also represent they did not knowingly terminate X's S corporation election and the events that resulted in the termination of the S election were inadvertent and were 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 with respect to

that period. X and its shareholders represent that S otherwise is a valid S corporation for federal income tax purposes.

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)(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 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)(1)(B) provides that an ESBT does not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

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 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 § 1.1361-1(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 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(d)(1) provides that in the case of a QSST for 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 shall be treated as the owner of that portion of the trust that 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 may elect to have § 1361(d) apply. Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of a QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

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 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 section 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) provides that (A) 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 the corporation is an S corporation) such corporation ceases to be a small business corporation; and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by a 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 the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or termination occurred is a small

business corporation or (B) to acquire the shareholder consents, and (4) the corporation for which the election was made or 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 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 the ineffectiveness or termination, the 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 12 when the trustees of Trust 8 failed to make an election under § 1361(e)(3) to treat Trust 8 as an ESBT effective that date. In addition, had X's S corporation not terminated on Date 12, it would have terminated on Date 10 when the beneficiary of Trust 6 failed to make an election under § 1361(e)(3) to treat Trust 6 as a QSST under § 1361(d)(2)(A) effective that year. X's S corporation election would have terminated in subsequent years due to the failure of the trustees and beneficiaries, as relevant, of Trust 2, Trust 4, and Trust 7, to make QSST or ESBT elections to be treated as eligible S corporation shareholders of X. Notwithstanding that the trusts in this letter also indicate inconsistent reporting with being eligible S corporation shareholders, X's S election nonetheless terminated due to the trusts' failure to make the necessary elections to be treated as eligible S corporation shareholders.

We further conclude that the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Therefore, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d) for reasons not addressed in this letter.

This ruling is contingent on (1) the trustees or beneficiaries, as applicable, of Trust 2, Trust 4, Trust 6, Trust 7, Trust 8, filing within 120 days from the date of this letter either an ESBT or QSST election, as appropriate, effective the dates each trust became a shareholder of X or otherwise became ineligible shareholders of X, as the case may be, on behalf of their respective trusts with the appropriate service center, and (2) Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, and Trust 9, filing within 120 days from the date of this letter any amended returns for all taxable years required to properly reflect the treatment of the trusts as an ESBT or QSST, as appropriate. A copy of this letter should be attached to each QSST or ESBT election. In addition, this ruling is contingent on Trust 9 making all necessary distributions to its sole beneficiary as required by the Trust 9 trust instrument for all years since Date 13.

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 12.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation. In addition, we express or imply no opinion as to whether any trust subject to this ruling, including Trust 2, Trust 4, Trust 6, Trust 7, Trust 8, and Trust 9 are eligible to elect or continue to be treated as ESBTs or QSSTs. Further, we express or imply no opinion regarding whether any other trusts who held shares of X at any time are eligible S corporation shareholders of X.

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 upon examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, we are sending copies of this letter to X's authorized representatives.

Sincerely,

Adrienne M. Mikolashek
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

A copy for § 6110 purposes

cc: