

Internal Revenue Service

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Date:
April 15, 2022

LEGEND

X =

Y =

A =

B =

C =

D =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

State 1 =

State 2 =

Year =

Dear :

This responds to a letter dated October 15, 2021, and supplemental correspondence, submitted on behalf of X by X's authorized representative, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

FACTS

The information submitted states that X was incorporated under the laws of State 1 on Date 1. X filed a timely election under § 1362(a) of the Code to be taxed as an S corporation effective Date 1. In Year, Y was formed under the laws of State 2 as a limited liability company. Effective Date 2, X merged into Y in what is described as a § 368(a)(1)(F) reorganization with Y surviving the merger. Y then changed its name to X and elected under § 301.7701-3 of the Procedure and Administration Regulations to be treated as an association taxable as a corporation for federal tax purposes effective Date 2.

On Date 3, Trust 1, Trust 2, Trust 3, and Trust 4 acquired shares of X stock. X represents that Trust 1, Trust 2, Trust 3, and Trust 4 each met the requirements of a qualified subchapter S trust (QSST) within the meaning of § 1361(d)(3). However, the income beneficiaries of Trust 1, Trust 2, Trust 3, and Trust 4 (A, B, C, and D, respectively) each failed to timely file an election under § 1361(d)(2) for their respective trust to be a QSST. Consequently, Trust 1, Trust 2, Trust 3, and Trust 4 were ineligible shareholders of X and X's S corporation status was terminated.

On Date 4, the trustees of Trust 1, Trust 2, Trust 3, and Trust 4 each distributed all of their shares X stock to a separate respective trust, each of which is treated (under

subpart E of part I of subchapter J of chapter 1 of the Code) as a grantor trust owned by A, B, C, and D, respectively.

X represents that the circumstances resulting in the termination of X's S corporation election were not motivated by tax avoidance or retroactive tax planning considerations. Additionally, X represents that X and its shareholders have filed their federal income tax returns consistent with having a valid S corporation election in effect for X. X represents that from Date 3 until Date 4, A, B, C, and D have each filed federal income tax returns consistent with being treated as the owner (for purposes of § 678(a)) of the portion of Trust 1, Trust 2, Trust 3, and Trust 4, respectively, which consists of the X stock. X and its shareholders have agreed to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

LAW AND ANALYSIS

Section 1361(a)(1) of the Code 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 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 1 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.

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) and the beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) of that portion of the QSST which consists of S corporation stock to which an election under § 1361(d)(2) applies. Section 1361(d)(2) provides that a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and 2 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 beneficiary in the trust shall terminate on the earlier of the 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 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 1.1361-1(j)(6)(ii) of the Income Tax Regulations, provides that the current income beneficiary of the trust must make the election by signing and filing with the service center with which the corporation files its income tax the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election 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 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 termination occurred is a small business corporation; and (4) the corporation for which the election was made or 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.

Rev. Rul. 64-250, 1964-2 C.B. 333, concludes that when an S corporation merges into a newly formed corporation in a transaction qualifying as a reorganization under § 368(a)(1)(F), and the newly formed surviving corporation also meets the requirements of an S corporation, the reorganization does not terminate the S election. Thus, the S election remains in effect for the new corporation.

Rev. Rul. 73-526, 1973-2 C.B. 404, concludes that the identifying number previously assigned to the transferor corporation should be used by the surviving corporation in a statutory merger qualifying as a reorganization under § 368(a)(1)(F).

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation status inadvertently terminated within the meaning of § 1362(f) on Date 3 when Trust 1, Trust 2, Trust 3, and Trust 4 became ineligible shareholders. Pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 3 and thereafter, provided X's S corporation election is otherwise effective and not terminated under § 1362(d). In addition, Trust 1, Trust 2, Trust 3, and Trust 4 will be each be treated as a QSST from Date 3 until Date 4.

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. We also express no opinion on whether X's merger into Y qualifies as a § 368(a)(1)(F) reorganization.

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

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.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

_____/s/_____

Jennifer N. Keeney
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:

Copy of this letter for § 6110 purposes

cc: