

Internal Revenue Service

Department of the Treasury
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Person To Contact:
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Date:
June 30, 2022

LEGEND

X =

A =

B =

C =

D =

E =

F =

G =

TrustA =

TrustB =

TrustC =

TrustF =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

Date9 =

Date 10 =

State =

Dear _____ :

This letter responds to a letter dated December 17, 2021, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

FACTS

According to the information submitted and representations within, X was incorporated under the laws of State on Date1. X filed an election under § 1362(a) of the Code to be treated as an S corporation effective Date2.

A, an individual, owned shares of X stock and died on Date3. On Date 4, A's estate transferred shares of X stock to TrustA and TrustB pursuant to the terms of A's will. TrustA and TrustB each qualified as an eligible S corporation shareholder for the two-year period beginning on the day the shares of X stock were transferred to them and ending Date5 under § 1361(c)(2)(A)(iii).

X represents that TrustA and TrustB each met the requirements of a qualified subchapter S trust (QSST) within the meaning of § 1361(d)(3). However, B, the income beneficiary of both TrustA and TrustB, failed to timely make an election under § 1361(d)(2) to treat TrustA and TrustB as a QSST. Consequently, TrustA and TrustB were ineligible shareholders of X and X's S corporation status was terminated on Date5. Nevertheless, X represents that B has federal income tax returns consistent with having valid a QSST election in effect for TrustA and TrustB since Date5.

On Date7, C, an individual, transferred shares of X stock to TrustC. TrustC established two separate shares for beneficiary D and beneficiary E. Each TrustC share is treated as a separate share under § 663(c). X represents that it was intended that each share of TrustC qualify as a QSST under § 1361(d)(3). However, neither share of TrustC was a valid QSST because its terms did not meet the requirements of § 1361(d)(3) and D and E failed to timely make an election under § 1362(d)(2) to treat their respective share of TrustC as a QSST effective Date 7. Consequently, each share of TrustC was an ineligible shareholder of X and X's S corporation status would have terminated on Date7, had it not already terminated on Date5. Nevertheless, X represents that D and E have each filed federal income tax returns consistent with having valid a QSST election in effect for TrustC since Date7. Further, X represents that effective Date10, the governing instrument of TrustC was amended such that TrustC's terms met the requirements of a QSST under § 1361(d)(3).

F, an individual, transferred shares of X stock to TrustF. TrustF was treated (under subpart E of part I of subchapter J of chapter 1 of the Code) as a grantor trust owned by F until Date6 when F died and TrustF ceased to qualify as a shareholder under § 1361(c)(2)(A)(i). The trustee of TrustF failed to distribute the shares of X stock to G, an individual, until Date9, two days after the eligibility period provided in § 1361(c)(2)(A)(ii) expired on Date8. Consequently, TrustF was an ineligible shareholder of X and X's S corporation status would have terminated on Date8, had it not already terminated on Date5.

X represents that X and its shareholders have filed tax returns consistent with being an S corporation for all relevant periods. X further represents that the circumstances resulting in the termination of its S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make 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 the term “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 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 a shareholder.

Section 1361(c)(2)(A)(ii) provides that, for purposes of § 1361(b)(1)(B), a trust which was described in clause § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death may be a shareholder, but only for the 2-year period beginning on the day of the deemed owner’s death.

Section 1361(c)(2)(A)(iii) provides that, for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will may be a shareholder, but only for the 2-year period beginning on the day on which such stock is transferred to it.

Section 1361(d)(1) provides 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 such trust shall be 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 may elect to have § 1361(d)(1) 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. A substantially separate and independent share of a trust

within the meaning of § 663(c) shall be treated as a separate trust for purposes of § 1361(d)(3) and § 1361(c).

Section 1.1361-1(j)(7)(i) of the Income Tax Regulations provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

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(a)(2) provides that an election to be an S corporation shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1362(d)(2)(A) provides that 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. 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 to obtain shareholder consents or 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 or to acquire the required shareholder consents, 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 information submitted and the representations made, we conclude that X's S corporation election terminated on Date5, when TrustA and TrustB became ineligible shareholders. We also conclude X's S corporation election would have terminated on Date7 when the separate shares of TrustC became ineligible

shareholders, had it not already terminated on Date5. Additionally, we conclude that X's S corporation would have terminated on Date8, when TrustF became an ineligible shareholder, had it not already terminated on Date5.

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, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date5, 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.

We further conclude that: (1) TrustA and TrustB will be treated as QSSTs from Date5 and thereafter provided B files a QSST election for both trusts effective Date5 with the appropriate service center within 120 days of this ruling;(2) each separate share of TrustC will be treated as a QSST from Date7 and thereafter provided D and E each file a QSST election with respect to their share of TrustC effective Date7 with the appropriate service center within 120 days of this ruling; and (3) TrustF will be treated as an eligible S corporation shareholder for the period beginning on Date8 and ending on Date9. A copy of this letter should be attached to each QSST election.

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 Date5.

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 TrustA, TrustB, and the separate shares TrustC are eligible to elect to be treated as QSSTs.

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 representative.

Sincerely,

Holly Porter
Associate Chief Counsel
(Passthroughs & Special Industries)

/s/

By: _____
Jennifer N. Keeney
Senior Counsel, Branch 1
Office of the Associate Chief Counsel

Enclosure
Copy for § 6110 purposes

cc: