

**Internal Revenue Service**

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Person To Contact:  
, ID No.

Telephone Number:

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July 27, 2022

LEGEND

Trust 1 =

Trust 2 =

Trust 3 =

X =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

K =

L =

Date 1 =

Date 2 =

Date 3

Date 4

Date 5 =

Date 6 =

Dear :

This responds to a letter dated September 8, 2021, and subsequent correspondence, submitted on behalf of X and its shareholders by their authorized representatives, requesting rulings under section 1362(f) of the Internal Revenue Code as well as rulings under sections 1.1361-1(m)(6) and 301.9100-3 of the Procedure and Administration Regulations.

#### FACTS

X was formed as a C corporation on Date 1 and made an election to be treated as an S corporation effective Date 2. On Date 2, Trust 1 and Trust 2 were the only shareholders of X. The trust instrument for Trust 1 provides for substantially separate and individual shares in the trust for each of beneficiaries A, B, C, D, and E. The trust

instrument for Trust 2 provides for substantially separate and individual shares in the trust for each of beneficiaries F, G, and H.

X represents that it understood that each separate trust share was to be treated as a Qualified Subchapter S Trust (QSST) effective Date 2. The instruments for Trust 1 and Trust 2 include the terms required of a QSST described in section 1361(d)(3)(A). X's attorneys, however, erroneously prepared and had the trustees sign elections for each of the trusts to be treated as an Electing Small Business Trust (ESBT) effective Date 2. X's tax preparers, however, believed that the QSST elections had been made and prepared the tax returns for X, the trusts, and their beneficiaries as if QSST elections were made.

Trust 3 was formed on Date 3. The trust instrument for Trust 3 provides for substantially separate and individual shares in the trust for each of beneficiaries F, G, and H.

On Date 4, the trustees of Trust 2 distributed the shares of X from the separate trust shares of Trust 2 for the benefit of F, G, and H to the separate trust shares of Trust 3 for the benefit of F, G, and H, respectively. This distribution was structured so that Trust 3 would satisfy the requirements of section 1361(d)(3)(A). The attorneys who prepared Trust 3's trust instrument did not advise X, the trustees, or the trust beneficiaries to make any elections with respect to Trust 3 or the separate trust shares of Trust 3. Consequently, neither a QSST election nor an ESBT election was made with respect to Trust 3 or its separate trust shares.

On Date 5, F died, and on Date 6, the executor of F's estate distributed F's separate share in Trust 3 to new substantially separate and individual shares in Trust 3 for each of beneficiaries I, J, K, and L. Each of the separate shares for I, J, K, and L made a timely QSST election. It was then that X discovered that the other separate trust shares of Trust 1, Trust 2, and Trust 3 had inadvertently failed to make QSST elections as they had intended. Because Trust 1 and Trust 2 were eligible to elect to be treated as ESBTs and did so effective Date 2, X's election to become an S corporation on Date 2 was effective. Trust 1 and Trust 2, however, seek instead to be treated as QSSTs effective Date 2. Furthermore, if Trust 3 is a new trust following the distribution of all of Trust 2's assets to Trust 3, then X's status as an S corporation terminated on Date 4 since a new ESBT election or QSST elections were not made.

X therefore requests consent under section 1.1361-1(m)(6) for Trust 1 and Trust 2 to revoke their ESBT elections effective Date 2; relief under section 301.9100-3 for the beneficiaries of Trust 1 and Trust 2 to file late QSST elections effective Date 2; and, in the event that Trust 3 is a new trust, relief under section 1362(f) for X to continue to be treated as an S corporation as of Date 4.

#### 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 section 1362(a) is in effect for the year.

Section 1361(b)(1)(B) provides that a “small business corporation” is a domestic corporation which is not an ineligible corporation and which does not, among other things, have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of section 1361(b)(1) a trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under section 1361(d)(2) will be treated as a trust described in section 1361(c)(2)(A)(i)

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 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 1361(d)(3) (flush language) provides that a substantially separate and independent share of a trust within the meaning of section 663(c) shall be treated as a separate trust for purposes of section 1361(c) and section 1361(d).

Section 663(c) provides that, for the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts.

Section 1361(c)(2)(A)(v) provides that for purposes of section 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(e) 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 section 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 section 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under section 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 1362(d)(2)(A) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the 1st day of the taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) further provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under section 1362(a) by any corporation was not effective for the taxable year made (determined without regard to section 1362(b)(2)) by reason of failure to obtain shareholder consents, or was terminated under section 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 the discovery of the circumstances resulting in the 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 the termination occurred, and each person who was a shareholder in such corporation at any time during the period of inadvertent ineffectiveness or termination of the S election, agrees to makes 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 is treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(m)(6) provides that an ESBT election may be revoked only with the consent of the Commissioner. The application for consent to revoke the election must be submitted to the Internal Revenue Service in the form of a letter ruling request under the appropriate revenue procedure.

Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of a QSST must make the election under section 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 section 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(6)(iii) provides, in part, that if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 301.9100-1(c) provides that the Commissioner may grant a reasonable extension of time to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I. Section 301.9100-1(b) provides that the term "regulatory election" includes an election whose due date is prescribed by a regulation published in the Federal Register.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides the standards the Commissioner will use to determine whether to grant an extension of time for regulatory elections that do not meet the requirements of section 301.9100-2.

Under section 301.9100-3, a request for relief will be granted when the taxpayer provides evidence (including affidavits described in section 301.9100-3(e)) to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government.

Rev. Proc. 2022-3 § 5.01(8) provides that the Service will not issue a ruling on whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a “decanting”) resulting in a change in beneficial interests is a distribution for which a deduction is allowable under section 661 or which requires an amount to be included in the gross income of any person under section 662.

### CONCLUSION

Based on the facts submitted and the representations made, we conclude that Trust 1 and Trust 2 may revoke their ESBT elections effective Date 2. We further conclude that the requirements of section 301.9100-3 have been satisfied. As a result, the beneficiaries of Trust 1 and Trust 2 are granted an extension of time of 120 days from the date of this letter to file QSST elections with respect to their separate trust shares effective Date 2 with the appropriate service center. A copy of this letter should be attached to the QSST elections.

Under Rev. Proc. 2022-3, § 5.01(8), we will not issue a ruling on whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust resulting in a change in beneficial interests is a distribution for purposes of sections 661 or 662. We therefore make no determination for purposes of this ruling whether Trust 3 is a new trust for which the beneficiaries were required to make QSST elections. If X determines that Trust 3 is a new trust, then we conclude that X's status as an S corporation terminated because of the failure of the beneficiaries to elect that their separate and individual shares in Trust 3 be treated as a QSST or the failure of Trust 3 to elect to be treated as an ESBT. However, we also conclude that if X's status as an S corporation did terminate, such termination was inadvertent within the meaning of section 1362(f) and X will be treated as continuing to be an S corporation as of Date 4. If necessary, the beneficiaries of Trust 3 are granted an extension of time of 120 days from the date of this letter to file QSST elections with respect to their separate trust shares effective Date 4 with the appropriate service center and, if necessary, for Trust 3 to amend its returns. A copy of this letter should be attached to the QSST elections and any such amended returns.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X is a small business corporation under section 1361(b), or whether the separate trust shares are QSSTs within the meaning of section 1361(d)(3). In addition, no opinion is expressed as to whether the distribution of the shares of X from Trust 2 to Trust 3 resulted in a change of beneficial interests or was a distribution for which a deduction is allowable under section 661 or which requires an amount to be included in the gross income of any beneficiary under section 662.

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.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) 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 your authorized representatives.

Sincerely,

Holly Porter  
Associate Chief Counsel  
(Passthroughs & Special Industries)

by:

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Laura C. Fields  
Branch Chief, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

Copy of this letter for section 6110 purposes

cc: