

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:03
PLR-107447-22

Date:
September 06, 2022

Legend

X =

A =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

m =

Dear _____ :

This letter responds to a letter dated April 7, 2022, and subsequent correspondence submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

Facts

The information submitted states that X was incorporated under the laws of State on Date 1 and elected to be an S corporation effective Date 2. On Date 3, A, a shareholder of X, transferred shares of X stock to Trust 1. Trust 1 was treated (under subpart E of part I of subchapter J of chapter 1 of the Code) as a grantor trust owned by A until Date 4 when A died, and Trust 1 ceased to qualify as a shareholder under § 1361(c)(2)(A)(i). Trust 1 continued to qualify as an eligible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2-year period beginning on the day of A's death. Following the expiration of the 2-year period on Date 5, Trust 1 continued to hold shares of X stock. It is represented that Trust 1 qualified as an electing small business trust (ESBT) within the meaning of § 1361(e), but the trustee of Trust 1 failed to make an ESBT election under § 1361(e)(3) effective Date 5. As a result, X's S corporation election terminated on Date 5.

On Date 6, pursuant to the terms of Trust 1, after the administration of A's estate had ended, Trust 1 transferred shares of X to Trust 2, Trust 3, and Trust 4. It is represented that Trust 2, Trust 3, and Trust 4 qualified as ESBTs within the meaning of § 1361(e) effective Date 6, but the trustee of Trust 2, Trust 3, and Trust 4 failed to make timely elections under § 1361(e)(3) to treat Trust 2, Trust 3, and Trust 4 as ESBTs effective Date 6. Therefore, had X's S corporation election not terminated on Date 5, it would have terminated on Date 6 when shares of X stock were transferred to ineligible shareholders.

X represents that at all relevant times, X and its shareholders have filed federal tax returns consistent with X being an S corporation and Trust 2, Trust 3, and Trust 4 as ESBTs. X represents that the termination of its S corporation election was inadvertent and was 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.

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)(i) provides that 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 an S corporation shareholder.

Section 1361(c)(2)(A)(ii) provides that 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, but only for the 2-year period beginning on the day of the deemed owner’s death, may be an S corporation shareholder.

Section 1361(c)(2)(A)(v) provides that an ESBT may be an S corporation 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 § 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)(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 qualified subchapter S 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) provides that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) 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, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (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 such 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 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 termination, such corporation shall 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 5 when Trust 1 became an ineligible shareholder. In addition, had X's S corporation election not terminated on Date 5, we conclude that it would have terminated on Date 6 when the trustee of Trust 2, Trust 3, and Trust 4 failed to make elections timely under § 1361(e)(3) to treat Trust 2, Trust 3, and Trust 4 as ESBTs effective Date 6. 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 provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 5 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 the trustee of Trust 2, Trust 3, and Trust 4 filing within 120 days from the date of this letter ESBT elections effective Date 6 on behalf of Trust 2, Trust 3, and Trust 4 with the appropriate service center. A copy of this letter should be attached to each ESBT election.

Furthermore, as an adjustment under § 1362(f)(4), X must send a payment of \$m with a copy of this letter within 45 days from the date of this letter to the following address: Internal Revenue Service, Kansas City Submission Processing Campus, Attn.: Manual Deposit, 333 W. Pershing Road, Stop 7777, Kansas City, MO 64108.

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 5.

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 or Trust 2's, Trust 3's, or Trust 4's eligibility to be ESBTs.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3) of the Code, this ruling 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 a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:

Copy of this letter for § 6110 purposes

cc: