

**Internal Revenue Service**

Department of the Treasury  
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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:03  
PLR-111038-22

Date:  
November 18, 2022

Legend

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

A =

Trust =

Dear :

This letter responds to a letter dated June 6, 2022, and subsequent correspondence submitted on behalf of X by its authorized representatives, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

### Facts

According to the information submitted and representations made, X was incorporated on Date 1, under the laws of State. Effective Date 2, X elected to be taxed as an S corporation. However, X's election was not effective as X was owned by A, an ineligible shareholder at the time of the election and because no eligible shareholder consented to X's S corporation election. A continued to hold the X shares until Date 3, when the shares were transferred to a permissible shareholder.

On Date 4, Trust acquired shares in X. However, a timely election to treat Trust as an Electing Small Business Trust (ESBT) was not made, which if not for X's ineffective election, would have caused X's S corporation election to terminate effective Date 4. Trust continued to hold the X shares until Date 5, when the shares were transferred to a permissible shareholder. X represents that Trust, has at all times, met the requirements of an ESBT within the meaning of § 1361(e), except that the trustee of Trust, did not make a timely ESBT election under § 1361(e)(3).

X represents that the circumstances resulting in its invalid S corporation election were not motivated by tax avoidance or retroactive tax planning. X additionally represents that, if its S corporation election were effective, the circumstances that would have resulted in the termination of its S corporation election were not motivated by tax avoidance or retroactive tax planning. Further, X represents that it and its shareholders have filed tax returns consistent with the treatment of X as an S corporation and Trust as an ESBT. Finally, 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 the 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 1 class of stock.

Section 1361(c)(2)(A)(v) provides that for purposes of § 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 paragraph (2), (3), (4), or (5) of § 170(c), 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) 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 trust election (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 an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

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 by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or 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 facts submitted and representations made, we conclude that X's S corporation election was ineffective on Date 2 because an ineligible S corporation

shareholder owned shares of X stock on Date 2. In addition, we conclude that had X's S corporation election been effective, it would have terminated on Date 4 when shares of X's stock were transferred to Trust, an ineligible S corporation shareholder. We conclude, however, that the ineffectiveness and termination described in this paragraph were inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation effective Date 2 and thereafter, provided that its S corporation election was otherwise valid and has not terminated under § 1362(d) other than as discussed in this letter.

This ruling is contingent on X filing a corrected Form 2553, Election by a Small Business Corporation, with the appropriate service center, within 120 days from the date of this letter, effective Date 2. A copy of this letter should be attached to the election.

Except as specifically set forth 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 and the regulations thereunder. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation or Trust's eligibility to be an ESBT.

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) of the Code provides that this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to X's authorized representatives.

Sincerely,

Associate Chief Counsel  
(Passthroughs & Special Industries)

*/s/ Margaret Burow*

By: \_\_\_\_\_  
Margaret Burow  
Senior Counsel, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure  
Copy for § 6110 purposes

cc: