

**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:B03

PLR-100866-23

Date:

June 08, 2023

Legend

X =

A =

Trust 1 =

Trust 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

\$m =

Dear \_\_\_\_\_ :

This responds to a letter dated December 22, 2022, submitted on behalf of X by X's authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### FACTS

According to the information submitted and representations within X was formed on Date 1 under the laws of State. Effective Date 1, X elected to be taxed as an S corporation.

A, a shareholder of X, transferred a number of shares of X to Trust 1 on Date 2. After A's death on Date 3, an election was made to treat Trust 1 as part of A's estate. X represents that following the closing of the A's estate, Trust 1 was eligible to make an Electing Small Business Trust (ESBT) election under § 1361(e)(3), effective Date 4. However, the trustee for Trust 1 failed to make the ESBT election in order for it to be an eligible S corporation shareholder of X. Thus, Trust 1 became an ineligible shareholder of X on Date 4 because it did not timely file an ESBT election, thus causing X's S election to terminate effective on Date 4.

On Date 5, Trust 1 transferred shares of X to Trust 2. X represents that Trust 2 was eligible to make a Qualified Subchapter S Trust (QSST) election under § 1361(d)(3) as of Date 5. However, the beneficiaries of Trust 2 failed to timely make the QSST election effective Date 5.

X represents that Trust 1 has at all times met the requirements of an ESBT within the meaning of § 1361(e), except that the trustees of Trust 1 did not make a timely ESBT election under § 1361(e)(3). X also represents that Trust 2 has met all the requirements for qualifying as a QSST under § 1361(d)(3), other than the filing of a timely QSST election under § 1361(d)(2).

X further represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed all returns consistent with X's status as an S corporation. X and its shareholders agreed 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 1362(b)(1)(B) defines a “small business corporation,” in part, as a domestic corporation that is not an ineligible corporation and that does not 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.

Section 1361(c)(2)(A)(i) provides that, for the purposes of § 1362(b)(1)(B), 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 is a permitted S corporation 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 trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

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 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 1361(e)(1)(A) provides that, for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term “electing small business trust” 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)-(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 it is made and 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, in part, that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center for which 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 ESBT election must be filed within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a QSST election.

Section 1.1361-1(j)(6)(ii) 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 return the applicable form or a statement that meets the requirements of § 1.1361-1(j)(6)(ii)(A) through (E).

Section 1.1361-1(j)(6)(iii) provides that the QSST election must be filed within the time requirements of § 1.1361-1(j)(6)(ii)(A) through (E).

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) will 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 terminated under § 1362(d)(2) or (3); (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 the 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 of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the 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 terminated on Date 4 because Trust 1 became an ineligible shareholder due to the failure to file an ESBT election. Further, we conclude that the failure to file an QSST election for Trust 2 effective Date 5 would have caused X's S corporation election to terminate effective Date 5 had X's S corporation election not previously terminated on Date 4.

We further conclude that the termination on Date 4 was inadvertent within the meaning of § 1362(f). X will be treated as continuing to be an S corporation from Date 4 and thereafter, provided that X's S corporation election is valid and not otherwise terminated under § 1362(d).

This relief is contingent on Trust 1 filing an ESBT election with the appropriate service center, within 120 days from the date of this letter effective Date 4. A copy of this letter should be attached to the ESBT election. Additionally, Trust 2 must file a QSST election with the appropriate service center, within 120 days from the date of this letter effective Date 5. Likewise, a copy of this letter should be attached to the QSST 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 Service Center  
333 W. Pershing Road  
Kansas City, MO 64108  
Stop 7777  
Attn: Manual Deposit

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 4.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code and the regulations thereunder, including whether X was otherwise a valid S corporation, whether Trust 1 is a valid ESBT within the meaning of § 1361(e)(3), or whether Trust 2 is a valid QSST within the meaning of § 1361(d)(3).

The rulings contained in this letter are 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.

These rulings are directed only to the taxpayer requesting them. § 6110(k)(3) of the Code provides that it 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,

*Robert D. Alinsky*

Robert D. Alinsky  
Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure

Copy for § 6110 purposes

cc: