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Department of the Treasury
Washington, DC 20224

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Person To Contact:
                    , ID No.

Telephone Number:

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LEGEND

X   =

State =

Trust A =

A   =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Trust B =

Trust C =

Trust D =

B   =

C   =

D   =

Dear   :

 This letter responds to a letter dated January 11, 2023, and subsequent correspondence, submitted on behalf of X, requesting rulings under §§ 1361(d) and 1362(f) of the Internal Revenue Code (the 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 as of formation. On Date 2, Trust A became a shareholder of X. From Date 2 until Date 3, Trust was grantor trust described in § 1361(c)(2)(A)(i). As of Date 3, Trust A ceased to be a grantor trust, but A, the income beneficiary of Trust A, timely made an election to treat Trust A as qualified subchapter S trust (QSST).

 On Date 4, A died. Under the terms of Trust A, upon A's death, Trust A's trustees were required to divide Trust A into three separate trusts, one each for the benefit of B, C, and D. The actual division of Trust A into three separate trusts did not occur until Date 5. From Date 4 until Date 5, the trustees of Trust A created separate shares within Trust A, one share each for the benefit of B, C, and D. Each share of Trust A was eligible to have been a QSST. The income from one share was required to be paid to B, the income from the second share was required to be paid to C, and the income from the third share was required to be paid to D. During the life of each of B, C, and D (the income beneficiaries), the income and principal from one beneficiary's share could only be paid to that income beneficiary. No income beneficiary had a claim against the income and principal of another beneficiary's share. Between Date 4 and Date 5, the income from each share of Trust A was distributed to the income beneficiary

of that share. B, C, and D did not affirmatively refuse to consent to the QSST election made for Trust on Date 3.

On Date 5, Trust A formally split into three separate trusts, each of which was newly formed under local law. The X stock from B's share of Trust A was transferred to Trust B, the beneficiary of which is B. The X stock from C's share of Trust A was transferred to Trust C, the beneficiary of which is C. The X stock from D's share of Trust A was transferred to Trust D, the beneficiary of which is D. Trust B, Trust C, and Trust D each have been eligible to be a QSST since Date 5, but failed to timely make QSST elections.

Rulings are requested that (1) from Date 4 to Date 5, each share of Trust A qualifies as a substantially separate and independent share under § 663(c) and, therefore, each share is treated as a separate trust for purposes of § 1361(d); (2) each share qualifies as a QSST within the meaning of § 1362(d)(3); (3) provided that Trust A's QSST election is valid and not otherwise terminated, B, C, and D are successive income beneficiaries under § 1361(d)(2)(B)(ii) of the Code such that B, C, and D are not required to file QSST elections for Trust A's QSST election and X's S corporation status to continue from Date 4 to Date 5, and; (4) the termination of X's S corporation election on Date 5 was inadvertent within the meaning of § 1362(f).

X represents that it has filed tax returns consistent with being an S corporation since Date 5. 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. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

LAW AND ANALYSIS

Section 1362(a) of the Code 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 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1) provides that a small business corporation means a domestic corporation which is not an ineligible corporation for such year and which does not, among other limitations, 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(d)(1) provides that, in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), such trust shall be 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 the S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(B)(ii) provides that if a QSST election is made with respect to any beneficiary, an election under this paragraph shall be treated as made by each successive beneficiary unless such beneficiary affirmatively refuses to consent to such election.

Section 1361(d)(3) defines a QSST as a trust 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. In addition, the terms of the trust must 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.

Section 1361(d)(3) further provides that 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) and (c).

Section 663(c) provides that for the sole purpose of determining the amount of distributable net income in the application of §§ 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. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts, including the application of subpart D, shall be determined in accordance with regulations prescribed by the Secretary.

Section 1.663(c)-1(a) of the Income Tax Regulations provides that if a single trust has more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts for the sole purpose of determining the amount of distributable net income allocable to the respective beneficiaries under §§ 661 and 662 (the separate share rule). The regulations further provide, in § 1.663(c)-1(c), that the separate share rule may be applicable even though separate and independent accounts are not maintained and are not required to be maintained for each share on the books of account of the trust, and even though no physical segregation of assets is made or required. Section 1.663(c)-3(a) provides that the applicability of the separate share rule generally depends on whether trust distributions are to be made in substantially the same manner as if separate trusts had been created.

Section 1.1361-1(j)(9)(i) provides that if the income beneficiary of a QSST who made a QSST election dies, each successive income beneficiary of that trust is treated as consenting to the election unless a successive income beneficiary affirmatively refuses to consent to the election. For this purpose, the term successive income beneficiary includes a beneficiary of a trust whose interest is a separate share within the meaning of § 663(c), but does not include any beneficiary of a trust that is created upon the death of the income beneficiary of the QSST and which is a new trust under local law.

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 a corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in pertinent 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 terminated under § 1362(d)(2) or (3), (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 event resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make 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 such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based on the information submitted and the representations made, we conclude that the three shares of Trust A created on Date 4 upon the death of A are substantially separate and independent shares within the meaning of § 663(c) of the Code and, therefore, that each share is treated as a separate trust for purposes of § 1361(d). We also conclude that each share of Trust A will qualify as a QSST under § 1361(d)(3) from Date 4 until Date 5. In addition, provided that Trust A's QSST election was valid and not otherwise terminated, the income beneficiary of each share of Trust A was a successive income beneficiary under § 1361(d)(2)(B)(ii) of the Code, and, therefore, was not required to file a QSST election with respect to his or her respective separate share for Trust A's QSST election and X's S corporation election to continue from Date 4 to Date 5.

We also conclude that X's S corporation election terminated on Date 5 when Trust B, Trust C, and Trust D became ineligible shareholders of X. We conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning on and after Date 5, unless X's S corporation election is otherwise terminated under § 1362(d).

This letter ruling is subject to the condition that within 120 days from the date of this letter, the income beneficiaries of Trust B, Trust C, and Trust D must file QSST elections effective Date 5 with the appropriate service center. A copy of this letter should be attached to the QSST elections.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be an S corporation or whether Trust A, its separate shares, and Trust B, Trust C, and Trust D are otherwise eligible to be QSSTs.

This ruling is directed only to the taxpayer that requested it. According to § 6110(k)(3), 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, a copy of this letter is being furnished to the authorized representatives for X.

Sincerely,

_____/S/_____
Laura C. Fields
Branch Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure
        Copy for § 6110 purposes

cc: