

**Internal Revenue Service**

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
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Date:  
August 28, 2023

Legend:

X =

Y =

A =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Trust 1 =

Trust 2 =

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

This letter responds to a letter dated February 22, 2023, and subsequent correspondence, submitted on behalf of X by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### FACTS

According to the information submitted, X was formed under the laws of State on Date 1 and elected to be an S corporation effective Date 2. Effective Date 2, Trust 1, an eligible S corporation shareholder under § 1361(c)(2)(A)(i), owned shares of X directly and through Y, a State limited liability company that was disregarded as an entity separate from its owner for federal tax purposes. A, an individual, was the deemed owner of Trust 1 under § 1361(c)(2)(B)(i).

On Date 3, Trust 1 sold an interest in Y to Trust 2, a grantor trust of A. Following the sale, Y continued to be disregarded as an entity separate from its owner, A, for federal tax purposes. On Date 4, A died thereby causing Y to be classified as a partnership for federal tax purposes and an ineligible S corporation shareholder under § 1361(b)(1)(B). Thus, X's S corporation election terminated on Date 4. Before X learned that its S corporation election had terminated, the trustee of Trust 1 made an election to treat Trust 1 as an electing small business trust (ESBT) under § 1361(e)(3) effective Date 4.

On Date 5 shortly after X learned that its S corporation election had terminated on Date 4, Trust 2 purchased the remaining interest in Y from Trust 1 causing Y to be disregarded as an entity separate from its owner for federal tax purposes. Subsequently, the trustee of Trust 2 made an election to treat Trust 2 as an ESBT under § 1361(e)(3) effective Date 5. Effective Date 6, X made an election to be classified as a partnership for federal tax purposes.

X represents that the circumstances resulting in the termination of its S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Further, X represents that prior to Date 6, it has always filed its tax returns consistent with the treatment of X as an S corporation. 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) 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, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1 of the Code) 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)(v) provides that, for purposes of § 1361(b)(1)(B), an ESBT may be an S corporation shareholder.

Section 1361(e)(1)(A) defines an ESBT as 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 a 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 1362(d)(2)(A) provides that an election under § 1362(a) will 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. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2) is 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) 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 once more a small business corporation, and (4) the corporation for which the termination occurred and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the

circumstances resulting in the termination, the corporation will 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 4 when Y became an ineligible shareholder. We also 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 the provisions of § 1362(f), X will continue to be treated as an S corporation from Date 4 through Date 7, provided that X's S corporation election was valid and has not otherwise terminated under § 1362(d).

This ruling is contingent on Trust 1 and Trust 2 filing returns, including amended returns, with the appropriate service center within 120 days from the date of this letter to properly reflect the treatment of Trust 1 and Trust 2 as ESBTs effective Date 4 and Date 5, respectively. A copy of this letter should be attached to the returns.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation, or Trust 1's or Trust 2'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 requesting it. Section 6110(k)(3) of the Code 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 X's authorized representatives.

Sincerely,

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

Enclosure:

Copy of this letter for § 6110 purposes

cc:

eFax