

**Internal Revenue Service**

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

Telephone Number:

Refer Reply To:  
CC:PSI:3  
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Date:  
September 13, 2023

Legend:

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

State =

QTIP =

Trust 1 =

Trust 2 =

A =

B =

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

This letter responds to a letter dated March 7, 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 incorporated under the laws of State and elected to be an S corporation effective Date 1. A, a shareholder of X, died and pursuant to A's will shares of X stock were subsequently transferred to QTIP, Trust 1 and Trust 2.

X represents that Trust 1 and Trust 2 qualified under § 1361(c)(2)(A)(iii) as eligible S corporation shareholders for the two-year period ending Date 3. Effective Date 2, both Trust 1 and Trust 2 elected to be treated as qualified subchapter S trusts (QSSTs) under § 1361(d)(2), despite not meeting the requirements under § 1361(d)(3). Consequently, X's S corporation election terminated on Date 3 because the elections by Trust 1 and Trust 2 to be treated as QSSTs were invalid. X represents that Trust 1 and Trust 2 qualified as electing small business trusts (ESBTs) within the meaning of § 1361(e)(1)(A). However, the trustees of Trust 1 and Trust 2 failed to timely file elections under § 1361(e)(3) to treat Trust 1 and Trust 2 as ESBTs.

B, the sole income beneficiary of QTIP, elected to treat QTIP as a QSST under § 1361(d)(2). On Date 4, B died and QTIP ceased to qualify as a QSST. QTIP remained an eligible S corporation shareholder of X for two years after the death of B, until Date 5, at which time QTIP became an ineligible S corporation shareholder of X. Consequently, X's S corporation election would have terminated on Date 5, had it not already terminated on Date 3. X represents that QTIP has at all times since Date 4 met the requirements to be an ESBT within the meaning of § 1361(e)(1)(A), but the trustee of QTIP failed to timely file an election under § 1361(e)(3) to treat QTIP as an ESBT.

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 it and its shareholders have always filed tax returns consistent with X being an S corporation, Trust 1 and Trust 2 being ESBTs effective Date 3, and QTIP being an ESBT effective Date 5. 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)(ii) provides that for purposes of § 1361(b)(1)(B), 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 may be an S corporation shareholder, but only for the 2-year period beginning on the day of the deemed owner’s death.

Section 1361(c)(2)(A)(iii) provides that for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will may be a shareholder, but only for the two-year period beginning on the day on which such stock is transferred to it.

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) — (A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i), (B) 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 an S corporation with respect to which the election under § 1361(d)(2) is made, and (C) for purposes of applying §§ 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

Section 1361(d)(2) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply.

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 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, 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(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 1.1361-1(j)(7)(ii) of the Income Tax Regulations provides that if, upon the death of the QSST income beneficiary, the trust continues in existence and continues to hold S corporation stock but no longer satisfies the QSST requirements, is not a grantor trust or an ESBT, then, solely for purposes of § 1361(b)(1), as of the date of the income beneficiary's death, the estate of that income beneficiary is treated as the shareholder of the S corporation for 2 years or until the transfer of the stock by the trust.

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 QSST election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

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)(A) 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 3 when Trust 1 and Trust 2 became ineligible shareholders and would have terminated on Date 5 when QTIP became an ineligible shareholder, had it not otherwise terminated on Date 3. We also conclude that in both cases the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Therefore, X will be treated as continuing to be an S corporation effective Date 3 and thereafter, provided that X's S election was otherwise valid and has not otherwise terminated under § 1362(d).

This ruling is conditioned on: (1) the trustees of Trust 1 and Trust 2 filing ESBT elections for each respective trust, effective Date 3, with the appropriate service centers within 120 days from the date of this letter, and (2) the trustee of QTIP filing an ESBT election for QTIP, effective Date 5, with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the ESBT elections.

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, Trust 2 or QTIP'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,

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

Enclosure:

Copy of letter for § 6110 purposes

cc: