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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:B01

PLR-111805-23

Date:

November 03, 2023

LEGEND

X =

Trust 1 =

Trust 2 =

A =

B =

C =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Year 1 =

Year 2 =

State =

Dear :

This letter responds to a letter dated May 4, 2023, and subsequent correspondence, submitted on behalf of X, by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation effective Date 2. Each of Trust 1 and Trust 2 was created on Date 3, and each owned A shares of X stock as of Date 3.

An election was made for each of Trust 1 and Trust 2 to be an electing small business trust ("ESBT") effective Date 3. The trustees and beneficiaries of Trust 1 and Trust 2 subsequently elected to convert each trust from an ESBT to a qualified subchapter S trust ("QSST") pursuant to § 1.1361-1(m)(7) of the Income Tax Regulations, effective Date 4 and Date 5, respectively. Both before and after Trust 1 and Trust 2 converted to QSSTs, each trust acquired additional shares of stock in X, such that as of Date 7, Trust 1 and Trust 2 owned B and C shares of X stock, respectively.

X represents that Trust 1 and Trust 2 satisfy the requirements of a QSST set forth in § 1361(d)(3)(A). In addition, the trust agreements for each of Trust 1 and Trust 2 provide that, during each beneficiary's lifetime, the trustees have discretionary authority to distribute income and principal of each trust solely for that beneficiary's benefit. In Year 1 and all subsequent taxable years, the trustee of Trust 1 failed to distribute all income (within the meaning of § 643(b)) currently. In Year 2 and all subsequent taxable years, the trustee of Trust 2 failed to distribute all income (within the meaning of § 643(b)) currently.

X represents that X and the trustees and beneficiaries of Trust 1 and Trust 2 intended that each of the trusts be treated as a QSST and that the inadvertent failure to distribute each trust's income (within the meaning of § 643(b)) was neither motivated by tax avoidance or retroactive tax planning, nor part of a plan to terminate X's election as an S corporation.

X has represented that X has been treated as an S corporation since Date 2. Furthermore, X has represented that the beneficiaries of Trust 1 and Trust 2 treated each of their respective trusts as QSSTs effective as of Year 1 and Year 2, the first years for which their elections to be treated as QSSTs were effective. Additionally, X represents that the beneficiaries of Trust 1 and Trust 2 reported their respective shares of X's income on their individual tax returns from the effective date of their election to be classified as QSSTs and all subsequent taxable years.

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 § 1361(a) is in effect for such 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 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 a shareholder.

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), the trust is 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 an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1.1361-1(j)(7)(i) provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one (1) 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 (1) individual who is a

citizen or resident of the United States. 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)(3) and § 1361(c).

Section 1361(d)(2)(A) provides that a beneficiary of a QSST may elect to have § 1361(d) apply. Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of a QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(m)(7) provides that, for a trust seeking to convert from an ESBT to a QSST, the Commissioner is granted authority to revoke the ESBT election as of the effective date of the QSST election if (i) the trust meets all of the requirements to be a QSST under § 1361(d), (ii) the trustee and current income beneficiary of the trust sign the QSST election containing all information required by § 1.1361-1(j)(6) and file such election with the service center where the S corporation files its income tax return, indicating that such election is being made to convert the trust from an ESBT to a QSST pursuant to § 1.1361-1(m), and (iii) the trust has not converted from a QSST to an ESBT within the 36-month period preceding the effective date of the new QSST election.

Section 1361(d)(4)(B) provides that if any QSST ceases to meet the income distribution requirement of § 1361(d)(3)(B) but continues to meet the requirements of § 1361(d)(3)(A) (regarding the terms of the trust), the provisions of § 1361(d) shall not apply to such trust as of the first day of the first taxable year beginning after the first taxable year for which it failed to meet the requirements of § 1361(d)(3)(B).

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 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 such 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 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 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 terminated on Date 5, the first day of the first taxable year beginning after the first taxable year for which Trust 1 failed to distribute all of its income pursuant to § 1361(d)(3)(B). We further conclude that X's S corporation election would have terminated on Date 6 and on the first date of each subsequent taxable year (if it had not already terminated on Date 5) due to Trust 1's repeated failure to distribute all of its income, and Trust 2's initial and subsequent failure to distribute all its income, in accordance with § 1361(d)(3)(B). We further conclude that the termination was inadvertent within the meaning of § 1362(f). Accordingly, X will be treated as continuing to be an S corporation from Date 5, and thereafter, provided that its S corporation election was otherwise valid and was not otherwise terminated under § 1362(d). We further hold that Trust 1 and Trust 2 will be treated as QSSTs from Date 5 and Date 6, respectively, and each year thereafter, provided each of the trusts meet the requirements of § 1361(d)(3)(A), and the beneficiary of each trust is treated, for purposes of § 678, as the owner of the above-referenced number of shares of X stock.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning the eligibility of X to be an S corporation or the eligibility of Trust 1 and Trust 2 to be QSSTs.

This ruling is directed only to the taxpayer requesting it. According to Section 6110(k)(3) of the Code, this ruling may not be used or cited as precedent.

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 request for rulings, it is subject to verification on examination.

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

Sincerely,

/s/

Joy Spies
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

PLR-111805-23

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Enclosure

Copy for § 6110 purposes

cc: