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Date:
May 2, 2024

Legend

I =

U =

V =

W =

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X =

Y =

Z =

A =

B =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

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Trust 9 =

Trust 10 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

Date 11 =

Date 12 =

Date 13 =

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Dear _____ :

This letter is in response to your letter dated October 11, 2023, and subsequent correspondence, submitted on behalf of State corporations, T, U, V, W, X, Y, and Z, (Taxpayers), by their authorized representatives, requesting rulings under § 1362(f) of the Internal Revenue Code (Code).

Facts

The information submitted states that each of T, U, X, Y, and Z elected to be an S corporation effective Date 1, W elected to be an S corporation effective Date 2, and V elected to be an S corporation effective Date 3.

Each of Trust 1, Trust 2, Trust 3, and Trust 4 owned shares of T and Y on Date 1 and shares of V on Date 3. Trust 1 and Trust 2 also owned shares of U on Date 1. T, V, and Y represent that Trust 1, Trust 2, Trust 3, and Trust 4 and U represents that Trust 1 and Trust 2 were eligible to be electing small business trusts (ESBTs) under § 1361(e)(1). However, the trustee(s) of Trust 1, Trust 2, Trust 3, and Trust 4 failed to make elections under § 1361(e)(3) treating Trust 1, Trust 2, Trust 3, and Trust 4 as ESBTs effective Date 1. Consequently, each of T's, U's, and Y's S corporation election was ineffective on Date 1 and V's S corporation election was ineffective on Date 3.

On Date 4, shares of U were transferred to Trust 5 and Trust 6. U represents that Trust 5 and Trust 6 were eligible to be ESBTs under § 1361(e)(1). However, the trustee(s) of Trust 5 and Trust 6 failed to make elections under § 1361(e)(3) treating Trust 5 and Trust 6 as ESBTs effective Date 4. Consequently, U's S corporation election would have terminated on Date 4, had it been effective.

On Date 5, shares of X were transferred to Trust 5 and Trust 6, on Date 6, shares of T, Y, and Z were transferred to Trust 5 and Trust 6, and on Date 11, shares of V and W were transferred to Trust 5 and Trust 6. At the time of the transfers, Trust 5 and Trust 6 were ineligible S corporation shareholders because the trustee(s) of Trust 5 and Trust 6 failed to make elections under § 1361(e)(3) treating Trust 5 and Trust 6 as ESBTs effective Date 4. Therefore, X's S corporation election terminated on Date 5, each of T's and Y's S corporation election would have terminated on Date 6 had it been effective, Z's S corporation election terminated on Date 6, and each of V's and W's S corporation election would have terminated on Date 11, had V's election been effective or had W's election not previously terminated.

A, an individual, owned shares of T, V, W, X, Y, and Z, and shares of U through Trust 7 and Trust 8. Each of Trust 7 and Trust 8 was treated under subpart E of part I

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of subchapter J of chapter 1 as entirely owned by A, and, thus, a permissible shareholder under § 1361(c)(2)(A)(i). On Date 7, A died.

On Date 8, pursuant to the terms of A's will, A's estate transferred shares of T, W, X, Y, and Z to Trust 9 for the benefit of B and shares of V to Trust 10 for the benefit of B. For a 2-year period beginning on Date 8, Trust 9 and Trust 10 were eligible S corporation shareholders under § 1361(c)(2)(A)(iii). T, W, X, Y, and Z represent that Trust 9 and V represents that Trust 10 were eligible to be qualified subchapter S trusts (QSSTs) under § 1361(d) effective Date 9. However, B, the income beneficiary of Trust 9 and Trust 10 failed to make an election under § 1361(d)(2) to treat Trust 9 as a QSST effective Date 9 with respect to each of T, W, X, Y, and Z and to treat Trust 10 as a QSST effective Date 9 with respect to V. Consequently, W's S corporation election terminated on Date 9, and each of T's, V's, X's, Y's, and Z's S corporation election would have terminated on Date 9, had it been effective or not previously terminated.

Following the death of A, Trust 7 and Trust 8 continued to be eligible S corporation shareholders for two years beginning on Date 7 under § 1361(c)(2)(A)(ii). U represents that Trust 7 and Trust 8 were eligible to be ESBTs under § 1361(e)(1) effective Date 10. However, the trustee(s) of Trust 7 and Trust 8 failed to make elections under § 1361(e)(3) treating Trust 7 and Trust 8 as ESBTs effective Date 10. Therefore, U's S corporation election would have terminated on Date 10, had it been effective or not previously terminated.

On Date 12, shares of X and Y were transferred to Trust 7 and Trust 8 and on Date 13, shares of T, W and Z were transferred to Trust 7 and Trust 8. At the time of the transfers, Trust 7 and Trust 8 were ineligible S corporation shareholders, because the trustee(s) of Trust 7 and Trust 8 failed to make elections under § 1361(e)(3) treating Trust 7 and Trust 8 as ESBTs effective Date 10. Consequently, each of X's and Y's S corporation election would have terminated on Date 12, had X's election not previously terminated and had Y's election been effective or not previously terminated, and each of T's, W's, and Z's S corporation election would have terminated on Date 13, had T's election been effective or not previously terminated and had each of W's and Z's election not previously terminated.

T, U, V, and Y represent that the circumstances resulting in their ineffective S corporation elections and W, X, and Z represent that the circumstances resulting in the termination of their S corporation elections were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, Taxpayers represent that (1) they have filed all of their federal tax returns consistent with being S corporations, (2) Trust 1 through Trust 4 have filed consistently as ESBTs effective Date 1, (3) Trust 5 and Trust 6 have filed consistently as ESBTs effective Date 4, (4) Trust 7 and Trust 8

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have filed consistently as ESBTs effective Date 10, and (5) Trust 9 and Trust 10 have filed consistently as QSSTs effective Date 9. Finally, Taxpayers and their shareholders agree to make any adjustments (consistent with the treatment of Taxpayers as S corporations) 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 1361(b)(1)(B) provides that the term “small business corporation” means a domestic corporation that is not an ineligible corporation and which does not, among other requirements, 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 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) 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 an S corporation shareholder, but only for the 2-year period beginning on the day on which such stock is transferred to it.

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(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

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(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) provides that, for purposes of § 1361, 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 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(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 made and subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(j)(6)(i) of the Income Tax Regulations provides, in part, that a QSST election must be made separately with respect to each corporation whose stock is held by the trust.

Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of a QSST must make the election by signing and filing with the service center for which the S corporation files its income tax return, the applicable form or a statement that includes the information listed in § 1.1361-1(j)(6)(ii).

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Section 1.361-1(j)(6)(iii) provides, in part, that a QSST election must be filed within the time requirements of § 1.361-1(j)(6)(iii)(A) through (D).

Section 1.361-1(m)(2)(i) 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 § 1.361-1(m)(2)(ii). Generally, only one ESBT election is made for the trust, regardless of the number of S corporations whose stock is held by the ESBT.

Section 1.361-1(m)(2)(iii) provides that the ESBT election must be filed within the time requirements prescribed in § 1.361-1(j)(6)(iii) for filing a QSST election.

Section 1.361-1(m)(2)(iv) provides that a trust that is a qualified S corporation shareholder under § 1361(c)(2)(A)(ii) or (iii) may elect ESBT treatment at any time during the 2-year period described in those sections or the 16-day and 2-month period beginning on the date after the end of the 2-year period.

Section 1362(a) 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 1362(d)(2)(A) provides that an election under § 1362(a) is 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 part, that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1361(b)(2)) by reason of failure to meet the requirements of § 1361(b), or (B) was terminated under § 1362(d)(2), (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 circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agree to make the 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

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in such ineffectiveness or 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 the representations made, we conclude that (1) each of T's, U's, and Y's S corporation election was ineffective on Date 1 and V's S corporation election was ineffective on Date 3 when the trustee(s) of Trust 1, Trust 2, Trust 3, and Trust 4 failed to make an ESBT election for each of Trust 1, Trust 2, Trust 3, and Trust 4 effective Date 1, (2) X's S corporation election terminated on Date 5 when shares of X were transferred to Trust 5 and Trust 6, ineligible S corporation shareholders, (3) Z's S corporation election terminated on Date 6 when shares of Z were transferred to Trust 5 and Trust 6, ineligible S corporation shareholders, and (4) W's S corporation election terminated on Date 9 when B, the income beneficiary of Trust 9, failed to make a QSST election effective Date 9 with respect to W. We also conclude that had each of T's, U's, V's, and Y's S corporation election been effective and had each of X's, Z's, and W's S corporation election not terminated on Date 5, Date 6, and Date 9, respectively, each election would have subsequently terminated as described in this letter. Further, we conclude that the circumstances resulting in the ineffectiveness of each of T's, U's, V's, and Y's S corporation election and in the termination of each of X's, Z's, and W's S corporation election were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), (1) each of T, U, and Y will be treated as an S corporation from Date 1 and thereafter, provided each of T's, U's, and Y's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d) for reasons not addressed in this letter, (2) V will be treated as an S corporation from Date 3 and thereafter, provided that V's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d) for reasons not addressed in this letter, and (3) each of X, Z, and W will continue to be treated as an S corporation from Date 5, Date 6, and Date 9, respectively, provided that each of X's, Z's, and W's S corporation election was valid and has not otherwise terminated under § 1362(d) for reasons not addressed in this letter.

These rulings are conditioned on: (1) the trustee(s) of Trust 1, Trust 2, Trust 3, and Trust 4 filing an ESBT election for each of Trust 1, Trust 2, Trust 3, and Trust 4 effective Date 1, (2) the trustee(s) of Trust 5 and Trust 6 filing an ESBT election for each of Trust 5 and Trust 6 effective Date 4, (3) the trustee(s) of Trust 7 and Trust 8 filing an ESBT election for each of Trust 7 and Trust 8 effective Date 10, (4) B filing a QSST election for Trust 9 effective Date 9 with respect to each of T, W, X, Y, and Z, and (5) B filing a QSST election for Trust 10 effective Date 9 with respect to V. The elections must be made with the appropriate service center within 120 days from the date of this letter and a copy of this letter should be attached to each ESBT and QSST election.

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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 (i) Taxpayers' eligibility to be S corporations, (ii) each of Trust 1's through Trust 8's eligibility to be an ESBT, or (iii) each of Trust 9's and Trust 10's eligibility to be a QSST.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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 requested rulings, it is subject to verification on examination.

These rulings are directed only to the taxpayers requesting them. Section 6110(k)(3) of the Code provides that they 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 Taxpayers' authorized representatives.

Sincerely,

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

Enclosure:

Copy of this letter for § 6110 purposes

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cc: