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Telephone Number:

Refer Reply To:
CC:PSI:B3
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Date:
November 18, 2025

Legend

X =

Y =

A =

B =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

m =

n =

Dear :

This letter is in response to your letter dated April 11, 2025, and subsequent correspondence, submitted on behalf of State corporations, X and Y (Taxpayers), by their authorized representative, requesting rulings under § 1362(f) of the Internal Revenue Code (Code).

Facts

The information submitted states that X was incorporated on Date 1 and elected to be an S corporation effective Date 2. Y was incorporated on Date 3 and elected to be an S corporation effective Date 2.

A, an individual, owned shares of X and Y. On Date 4, A died. On Date 4, pursuant to the terms of A's will, A's estate transferred shares of X and Y to Trust 1 and

Trust 2. For a 2-year period beginning on Date 4, Trust 1 and Trust 2 were eligible S corporation shareholders under § 1361(c)(2)(A)(iii).

On Date 5, Trust 2 distributed its shares in X and Y to B, an individual. Also on Date 5, B distributed the shares B received in X and Y to Trust 3, Trust 4, Trust 5, and Trust 6. X and Y represent that Trust 3, Trust 4, Trust 5, and Trust 6 were eligible to be qualified subchapter S trusts (QSSTs) under § 1361(d) effective Date 5. However, the income beneficiary of each of Trust 3, Trust 4, Trust 5, and Trust 6 failed to make an election under § 1361(d)(2) to treat Trust 3, Trust 4, Trust 5, and Trust 6 as a QSST effective Date 5 with respect to each of X and Y. Consequently, X and Y's S corporation elections terminated on Date 5.

Following the death of A, Trust 1 continued to be an eligible S corporation shareholder for two years beginning on Date 4 under § 1361(c)(2)(A)(iii). X and Y represent that Trust 1 was eligible to be an ESBT under § 1361(e)(1) effective Date 7. However, the trustee(s) of Trust 1 failed to make an election under § 1361(e)(3) treating Trust 1 as an ESBT effective Date 7. Therefore, X and Y's S corporation elections would have terminated on Date 7, had they not previously terminated.

X and Y 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. 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)(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 (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).

Section 1.1361-1(j)(6)(iii) provides, in part, that a QSST election must be filed within the time requirements of § 1.1361-1(j)(6)(iii)(A) through (D).

Section 1.1361-1(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 § 1.1361-1(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 1.1361-1(m)(2)(iii) provides that the ESBT election must be filed within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a QSST election.

Section 1.1361-1(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 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 X and Y's S corporation elections terminated on Date 5 when shares of X and Y were transferred to Trust 3, Trust 4, Trust 5, and Trust 6, ineligible S corporation shareholders. We also conclude that had X and Y's S corporation elections been effective not terminated on Date 5, each election would have subsequently terminated as described in this letter. Further, we conclude that the circumstances resulting in the termination of X and Y's S corporation elections were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X and Y will continue to be treated as S corporations from Date 5, provided that X and Y's S corporation elections were valid and have 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 filing an ESBT election for Trust 1 effective Date 7, with respect to X and Y, and (2) the income beneficiary of each of Trust 3, Trust 4, Trust 5, and Trust 6 filing a QSST election for Trust 3, Trust 4, Trust 5, and Trust 6, respectively, effective Date 5, with respect to each of X and Y. 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.

Furthermore, as an adjustment under § 1362(f)(4), X must send a payment of \$m, and Y must send a payment of \$n. Each payment must be accompanied by a copy of this letter, and must be sent within 45 days from the date of this letter to the following address:

Internal Revenue Service
Kansas City Service Center
333 W. Pershing Road
Kansas City, MO 64108
Stop 7777
Attn: Manual Deposit

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) Trust 1's eligibility to be an ESBT, or (iii) Trust 3, Trust 4, Trust 5, or Trust 6'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 representative.

Sincerely,

Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure:

Copy of this letter for § 6110 purposes

cc: