

Internal Revenue Service

Number: **202113001**

Release Date: 4/2/2021

Index Numbers: 1361.05-00, 1362.00-00,
1362.04-00

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:B03

PLR-112333-20

Date:

December 14, 2020

LEGEND

X =

Y =

Z =

A =

Trust1 =

Trust2 =

Trust3 =

Trust4 =

Trust5 =

Trust6 =

Trust7 =

Trust8 =

Trust9 =

Trust10 =

Trust11 =

Trust12 =

Trust13 =

Trust14 =

Trust15 =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

Date9 =

N1 =

N2 =

N3 =

N4 =

N5 =

N6 =

N7 =

Dear :

This letter responds to a letter dated May 18, 2020, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

The information submitted states that X was formed under the laws of State on Date1 and elected to be an S corporation effective Date1. Y and Z are wholly-owned subsidiaries of X. X made elections under § 1361(b)(3)(B)(ii) to treat Y and Z as Qualified Subchapter S Subsidiaries ("QSubs") effective Date1 and Date2, respectively. At the time of formation, A owned N1 shares of X. On Date3, A transferred N2 shares of X to Trust1 and N3 shares of X to Trust2. On Date4, A died. X represents that prior to A's death, Trust1 and Trust2 were properly treated as grantor trusts under §§ 671-678, and A was treated as owning the shares of X held by Trust1 and Trust2.

On Date4, pursuant to the terms of the trust agreement for Trust1, Trust1 was divided into four separate but equal shares for the benefit of certain grandchildren of A, namely Trust3, Trust4, Trust5 and Trust6, and N4 shares of X were transferred to each trust. Also on Date4, pursuant to the terms of the trust agreement for Trust2, Trust2 was divided into three separate but equal shares for the benefit of certain other grandchildren of A, namely Trust7, Trust8, and Trust9, and N4 shares of X were transferred to each trust. X represents that Trust3, Trust4, Trust5, Trust6, Trust7, Trust8, and Trust9 (collectively, the "Grandchildren's Trusts") qualify as Electing Small Business Trusts (ESBTs) under § 1361(e)(1)(A), but the trustees of the respective trusts failed to file elections under § 1361(e)(3) effective Date4.

Moreover, at the time of A's death, the remaining N5 shares of X owned by A were held in Trust10. X represents that prior to A's death, Trust10 was properly treated as a grantor trust under §§ 671-678, and A was treated as owning the shares of X held by Trust10. Effective on Date4, the trustees of Trust11 purchased N5 shares of X from Trust10. X represents that Trust11 qualified as an ESBT under § 1361(e)(1)(A), but the trustee of Trust11 failed to file an election under § 1361(e)(3) effective Date4. Consequently, X's S corporation election terminated on Date4. Because X's S corporation election terminated on Date4, its QSub election for Y also terminated on Date4 and its QSub election for Z was ineffective.

On Date5, pursuant to the terms of the trust agreement for Trust11, Trust11 was divided into two separate but equal shares for the benefit for A's surviving children, namely Trust12 and Trust13 (the "Children's Trusts"), and N6 shares of X were transferred to each trust. X represents that the Children's Trusts qualified as ESBTs under § 1361(e)(1)(A) and filed ESBT elections under § 1361(e)(3). However, these elections were filed late. Therefore, had X's S corporation election not terminated on Date4, it would have terminated on Date5. Nevertheless, X represents that Trust12 and Trust13 filed consistently as ESBTs during taxable years Date6 through Date7.

On Date8, the shares of X held by Trust12 and Trust13 were transferred to Trust14 and Trust15, respectively. X represents that Trust14 and Trust15 qualify as ESBTs under § 1361(e)(1)(A) and filed late ESBT elections under § 1361(e)(3) effective Date8 pursuant to Rev. Proc. 2013-30, 2013-36 I.R.B. 173.

X represents that X and all of its shareholders have always filed tax returns consistent with X being an S corporation. X further represents that the circumstances resulting in the termination of X's S corporation election and its QSub election for Y and the ineffectiveness of its QSub election for Z were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make adjustments consistent with the treatment of X as an S corporation, and the trusts as ESBTs, 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) 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(b)(3)(B) provides that a QSub means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a QSub.

Section 1361(b)(3)(C) provides that if any corporation which was a QSub ceases to meet the requirements of § 1361(b)(3)(B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.

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) provides that an ESBT 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), (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 trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(1)(B) provides that an ESBT does not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

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(m)(2)(i) of the Income Tax Regulations 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) provides that (A) an election under § 1362(a) shall 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; and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or termination occurred is a small business corporation or a QSub, as the case may be, or (B) to acquire the shareholder consents, and (4) the corporation for which the election was made or termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be

treated as an S corporation or a QSub, as the case may be 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 and its QSub election for Y terminated on Date4 when the trustees of the Grandchildren's Trusts and Trust11 failed to make elections under § 1361(e)(3) to treat the Grandchildren's Trusts and Trust11 as ESBTs effective Date4. In addition, had X's S corporation election and its QSub election for Y not terminated on Date4, they would have terminated on Date5 when the trustees of the Children's Trusts failed to make elections timely under § 1361(e)(3) to treat the Children's Trusts as ESBTs effective Date5. Moreover, because X's S corporation had terminated, its election to treat Z as a QSub effective Date2 was ineffective. We further conclude that the circumstances resulting in the termination of X's S corporation election and its QSub election for Y and its ineffective QSub election for Z were inadvertent within the meaning of § 1362(f). Therefore, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date4 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d) for reasons not addressed in this letter. Furthermore, Y will be treated as continuing to be a QSub from Date4 and thereafter, and Z will be treated as a QSub effective Date2 and thereafter, provided that the QSub elections for Y and Z were otherwise valid and not otherwise terminated under § 1361(b)(3)(C) for reasons not addressed in this letter.

This ruling is contingent on (1) the trustees of the Grandchildren's Trusts filing within 120 days from the date of this letter ESBT elections effective Date4 on behalf of their respective trusts with the appropriate service center and (2) the Grandchildren's Trusts filing within 120 days from the date of this letter amended returns for taxable years Date9 to properly reflect the treatment of the Grandchildren's Trusts as ESBTs. A copy of this letter should be attached to each ESBT election.

Furthermore, as an adjustment under § 1362(f)(4), a payment of \$N7 and a copy of this letter must be sent within 45 days from the date of this letter to the following address: Internal Revenue Service, Kansas City Submission Processing Campus, Attn: Manual Deposit, 333 W. Pershing Road, Stop 7777, Kansas City, MO 64108.

If the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the service center with which it filed its S corporation election that its election terminated on Date4.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation, and Y's and Z's eligibility to be QSubs. In addition, we express or imply

no opinion as to whether the Grandchildren's Trusts, the Children's Trusts (including Trust 11), and Trust 14 and Trust 15 are eligible to elect to be treated as ESBTs.

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 upon examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, we are sending copies 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)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: