

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:PSI:01

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Date:

March 29, 2023

LEGEND

X =

State =

A =

B =

C =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Trust 1 =

Trust 2 =

Dear :

This responds to a letter dated September 20, 2022, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

The information submitted states that X was incorporated under the laws of State on Date 1. X filed an election in accordance with provisions of § 1362(a) of the Code to be taxed as an S corporation effective Date 1.

A, an individual, transferred shares of X stock to Trust 1. Trust 1 was treated (under subpart E of part I of subchapter J of chapter 1 of the Code) as a grantor trust owned by A until Date 2 when A died and Trust 1 ceased to qualify as a shareholder under § 1361(c)(2)(A)(i). Trust 1 continued to qualify as an eligible S corporation shareholder for the two-year period beginning on the day of A's death and ending Date 3 under § 1361(c)(2)(A)(ii).

X represents that beginning on Date 3, Trust 1 met the requirements of an Electing Small Business Trust (ESBT) within the meaning of § 1361(e)(1)(A). However, the trustees of Trust 1 failed to file an election under § 1361(e)(3) for the trust to be an ESBT effective Date 3. Consequently, Trust 1 was an ineligible shareholder of X and X's S corporation status was terminated on Date 3. Subsequently, on Date 9, the trustees of Trust 1 distributed all the shares of X stock owned by Trust 1 to the individual beneficiaries of Trust 1.

B and C, a married couple, each owned shares of X stock. B died on Date 4 and C died a day later on Date 5. On Date 6, C's estate transferred shares of X stock to Trust 2 pursuant to the terms of C's will. Trust 2 qualified as an eligible S corporation shareholder for the two-year period beginning on the day the shares of X stock were transferred to it and ending Date 7 under § 1361(c)(2)(A)(iii).

X represents that beginning on Date 7, Trust 2 met the requirements of an ESBT within the meaning of § 1361(e)(1)(A). However, the trustees of Trust 2 failed to file an election under § 1361(e)(3) for the trust to be an ESBT effective Date 7. Consequently, Trust 2 was an ineligible shareholder of X and X's S corporation status would have

terminated on Date 7, had it not already terminated on Date 3. Subsequently, on or around Date 8, the trustees of Trust 2 distributed all the shares of X stock owned by Trust 2 to the individual beneficiaries of Trust 2.

X represents that the circumstances resulting in the termination of X's S corporation election were not motivated by tax avoidance or retroactive tax planning considerations. X further represents that for each taxable year since X elected to be an S corporation, X and its shareholders have filed their federal income tax returns consistent with having a valid S corporation election in effect for X. Further, X and its shareholders have agreed to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

LAW AND ANALYSIS

Section 1361(a)(1) of the Code 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 which is not an ineligible corporation and which does not 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 1 of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(A)(ii) provides that a trust that was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after the owner's death may be a shareholder, but only for the two-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 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 is a permitted shareholder of a small business corporation.

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)(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, in relevant part, 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 Qualified Subchapter S Trust 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) in general, 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, 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 § 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), (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 is a small business corporation or (B) to acquire the shareholder consents, and (4) the corporation 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) 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 during the period specified by the Secretary.

CONCLUSION

Based solely on the information submitted and the representations made, we conclude that X's S corporation election terminated on Date 3 when Trust 1 became an ineligible shareholder. We also conclude that X's S corporation election would have terminated on Date 7 when Trust 2 became an ineligible shareholder, had it not already terminated on Date 3.

We further conclude that the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 3 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.

We further conclude that: (1) Trust 1 will be treated as an ESBT for the period beginning on Date 3 and ending on Date 9; and (2) Trust 2 will each be treated as an ESBT for the period beginning on Date 7 and ending on or around Date 8.

This letter is subject to the following conditions that must occur within 120 days from the date of this letter: (1) the trustees of Trust 1 must file an election to treat Trust 1 as an ESBT effective Date 3 with the appropriate service center; (2) the trustees of Trust 2 must file an election to treat Trust 2 as an ESBT effective Date 7 with the appropriate service center.

A copy of this letter should be attached to each ESBT election. Furthermore, if these conditions are not met, X must notify the service center where X's S corporation election is filed that its S corporation election has terminated effective Date 3.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the transactions 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 or the eligibility of Trust 1 or Trust 2 to be an ESBT.

The ruling contained in this letter is based on 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 the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative

Sincerely,

Jennifer N. Keeney
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy of letter for § 6110 purposes

cc: