

Internal Revenue Service

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Date:

April 2, 2025

In Re: Private Letter Ruling Request

LEGEND

X =

Trust 1 =

Trust 2 =

Trust 3 =

H =

W =

State =

Date 1 =

Date 2 =

Date 3 =

Dear _____ :

This letter responds to a letter dated September 27, 2024, and subsequent correspondence, submitted on behalf of X by its authorized representatives, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X is a corporation that made an election to be treated as a subchapter S corporation. Prior to H's death on Date 1, all of the stock in X was community property held by Trust 1, a grantor trust described in § 1361(c)(2)(A)(i) (under subpart E of part I of subchapter J of chapter 1 of the Code) of which H and W were the deemed owners. Following H's death on Date 1, Trust 1 qualified under § 1361(c)(2)(A)(ii) as an eligible shareholder for two years from H's date of death. However, Trust 1 continued to hold the X stock after the two-year period. X represents that Trust 1 qualified to elect to be treated as an electing small business trust (ESBT) as of Date 2, the day after the two-year period following H's death. However, the trustee of Trust 1 failed to make a timely ESBT election under § 1361(e)(3) effective Date 2. Consequently, Trust 1 was an ineligible shareholder of X thereby causing X's S corporation status to terminate on Date 2.

On Date 3, the assets of Trust 1, including the X stock, were transferred to Trust 2 and Trust 3. Trust 2 is treated (under subpart E of part I of subchapter J of chapter 1 of the Code) as a grantor trust owned by W. X represents that Trust 3 meets the requirements of a qualified subchapter S trust (QSST) within the meaning of § 1361(d)(3). Further, W, the income beneficiary of Trust 3, timely made an election under § 1361(d)(2) to treat Trust 3 as a QSST effective Date 3.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make such adjustments, consistent with the treatment of X as an S corporation, as may be required by the Service.

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) 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 of an S corporation.

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 a shareholder of an S corporation, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT may be a shareholder.

Section 1361(d)(1) provides, in part, 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 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) of the Income Tax Regulations 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 S corporation files its income tax returns the applicable form or statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(6)(iii)(A) provides that the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1361(e) 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 paragraph (2), (3), (4), or (5) of § 170(c), 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) 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 qualified subchapter S trust election (within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2)(A) provides that 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. 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 relevant part, that if (1) an election under § 1362(a) by any corporation 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 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 or to acquire the required shareholder consents, and (4) the corporation for which the election was made or 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 ineffectiveness or 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 election to be treated as an S corporation terminated on Date 2, after the two-year period following H's death. We also conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). Accordingly, X will be treated as continuing to be an S corporation from Date 2, and thereafter, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d). In addition, Trust 1 will be treated as an ESBT from Date 2 until Date 3.

Except as specifically ruled 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 whether X is otherwise eligible to be an S corporation. In addition, we express or imply no opinion as to whether Trust 3 is eligible to elect to be treated as a QSST.

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,

Jennifer Keeney
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure

Copy of letter for § 6110 purposes

cc: