

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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PLR-103567-25

Date:

July 25, 2025

LEGEND

X =

State =

A =

B =

Trust =

Date 1 =

Date 2 =

Date 3 =

Dear :

This responds to a letter dated January 7, 2025, submitted on behalf of X by X's authorized representatives, requesting relief under section 1362(f) of the Internal Revenue Code.

FACTS

X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation effective for the tax year ending on Date 2. On Date 3, A, one of X's shareholders, established Trust and transferred shares of X to Trust. Trust is an irrevocable trust. Under Trust's terms, until the fifteenth anniversary of Date 3 or the death of B, if sooner, the net income of Trust is required to be distributed to B, A's spouse. After Trust's initial term, Trust's assets will be divided among multiple trusts for the benefit of A's children. Neither A nor B has any power over Trust principal, including capital gains. Pursuant to § 677, because only the net income of Trust is distributable to B, Trust is not 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.

X represents that Trust was eligible to be an Electing Small Business Trust (ESBT) under § 1361(e)(1) beginning on Date 3. However, the trustee of Trust failed to make a timely ESBT election for Trust under § 1361(e)(3); thus, X's S corporation election terminated on Date 3.

X represents that X and its shareholders have filed all income tax returns consistent with X being an S corporation and Trust being an ESBT since Date 3. X further represents that the failure to file an ESBT election was inadvertent and not motivated by tax avoidance or retroactive tax planning. Finally, X and its shareholders agree 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 in § 1362(f).

LAW AND ANALYSIS

Section 671 provides, in relevant part, that where it is specified in subpart E of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D of subchapter J.

Section 1.671-3(b)(1) of the Income Tax regulations provides that if a grantor or another person is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus. For example, only ordinary income is included by reason of an interest in or a power over ordinary income alone. Thus, if a grantor is treated under section 673 as an owner by reason of a reversionary interest in ordinary income only, items of income allocable to corpus will not be included in the portion he is treated as owning. Similarly, if a grantor or another person is treated under sections 674-678 as an owner of a portion by reason of a power

over ordinary income only, items of income allocable to corpus are not included in that portion.

Section 677(a) provides, in relevant part, that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse, or (2) held or accumulated for future distribution to the grantor or the grantor's spouse.

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 1 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)(v) provides that, for purposes of § 1361(b)(1)(B), an electing small business trust (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)(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)(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 an S corporation election will 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(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which 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 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 S corporation election terminated on Date 3 because the trustee of Trust failed to make a timely ESBT election for Trust under § 1361(e)(3). We further conclude that the circumstances resulting in the termination were inadvertent within the meaning of § 1362(f). Accordingly, X will be treated as an S corporation on and after Date 3, provided its S corporation election was valid and is not otherwise terminated under § 1362(d).

This ruling is contingent on the trustee of Trust filing an ESBT election for Trust, effective Date 3, with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the ESBT election.

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 and the regulations thereunder, including whether X is eligible to be an S corporation or whether Trust is eligible 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 a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Joy C. Spies
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure
Copy for § 6110 purposes

cc: