

Internal Revenue Service

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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:3
PLR-117332-22

Date:
March 08, 2023

Legend:

Company =

State =

Date =

Trust 1 =

Trust 2 =

Trust 3 =

A =

B =

Years =

Dear _____ :

This letter responds to a letter dated May 31, 2022, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, Company was incorporated under the laws of State on Date and elected to be an S corporation effective Date. On Date, Trust 1, Trust 2, and Trust 3 held shares of stock in Company.

Company represents that Trust 1 and Trust 2 are grantor trusts and eligible S corporation shareholders under § 1361(c)(2)(A)(i) and that Trust 3 qualifies as an electing small business trust (ESBT) within the meaning of § 1361(e). Company recently learned that the trustee of Trust 1 and Trust 2, and not the deemed owners of Trust 1 and Trust 2, A and B, respectively, consented to Company's S corporation election on its Form 2553, Election by a Small Business Corporation. Moreover, Company learned that the trustee of Trust 3 failed to make an ESBT election under § 1361(e)(3) to treat Trust 3 as an ESBT effective Date, and thus, Trust 3 was an ineligible S corporation shareholder on Date. Consequently, Company's S corporation election was ineffective.

Company represents that the ineffectiveness of its S corporation election was inadvertent and not motivated by tax avoidance or retroactive tax planning. Also, Company and its shareholders agree to make any adjustments required as a condition of obtaining relief under § 1362(f) that may be required by the Secretary. Lastly, Company and its shareholders represent that they have filed all returns consistent with Company being an S corporation since Date.

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 the 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(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.

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

Section 1361(e)(1)(A) defines an ESBT as 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 a 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 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(a)(2) provides that an S corporation election shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(b)(2)(iv) provides that in the case of a trust described in § 1361(c)(2)(A) (including a trust treated under § 1361(d)(1)(A) as a trust described in § 1361(c)(2)(A)(i) and excepting an ESBT described in § 1361(c)(2)(A)(v)), only the person treated as the shareholder for purposes of § 1361(b)(1) must consent to the election.

Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1362(f) provides, in 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, (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, steps were taken (A) so that the corporation for which the election was made is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made, 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 this period, then, notwithstanding the circumstances resulting in such ineffectiveness, 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 Company's S corporation election was ineffective because (1) A and B failed to consent to Company's S corporation election, and (2) the trustee of Trust 3 failed to file an ESBT election under § 1361(e)(3) and, thus, Trust 3 was an ineligible S corporation shareholder on Date. However, we also conclude that the circumstances resulting in the ineffectiveness of Company's S corporation election were inadvertent within the meaning of § 1362(f). Therefore, Company will be treated as an S corporation effective Date and thereafter, provided Company's S corporation election was otherwise valid and not otherwise terminated under § 1362(d).

This ruling is contingent on A and B signing a written statement as described in § 1.1362-6(b)(1) consenting to Company's S corporation election effective Date. The written statement(s) must be filed with the appropriate service center within 120 days from the date of this letter, indicating that the statement(s) are to be associated with Company's originally filed Form 2553.

In addition, this ruling is contingent on the following conditions that must occur within 120 days from the date of this letter: (1) the trustee of Trust 3 filing an election to treat Trust 3 as an ESBT, effective Date, with the appropriate service center, and (2) Trust 3 filing amended returns for Years to properly reflect the treatment of Trust 3 as an ESBT. A copy of this letter should be attached to the ESBT election and the amended returns.

If these conditions are not met, then this ruling is null and void. In addition, if these conditions are not met, Company must notify the service center with which it filed its S corporation election that its election was ineffective.

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 Company's eligibility to be an S corporation, or whether Trust 3 otherwise qualifies as a valid ESBT.

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 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.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:

Copy of letter for § 6110 purposes

cc: