

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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CC:PT&E:B03

PLR-119294-24

Date:

April 21, 2025

LEGEND

X =

Sub 1 =

Sub 2 =

Sub 3 =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

A =

B =

C =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Dear :

This letter responds to a letter dated October 17, 2024, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X was incorporated under the laws of State 1 on Date 2. X elected to be an S corporation effective Date 1, a date that preceded X's taxable year beginning on Date 2. Consequently, X's S corporation election was ineffective.

Also on Date 2, Sub1 and Sub2 were incorporated under the laws of State 2. X wholly owned Sub1 and Sub2. X elected to treat Sub1 and Sub2 as qualified subchapter S subsidiaries (QSubs) under § 1361(b)(3) effective Date 2 and Date 4,

respectively. Because X's S corporation election was ineffective, its elections treating Sub1 and Sub2 as QSubs were also ineffective.

X represents that prior to Date 3, Trust 1 was an eligible S corporation shareholder under § 1361(c)(2). As of Date 3, X represents that separate shares of Trust 1 were created for the benefit of A and B and that the separate shares of Trust 1 for the benefit of A and B satisfied the qualified subchapter S trust (QSST) requirements under § 1361(d)(3). However, A and B, the income beneficiaries of the separate shares of Trust 1, failed to make an election under § 1361(d)(2) to treat each of their separate shares of Trust 1 as a QSST effective Date 3. Therefore, had X's S corporation election been effective, it would have terminated on Date 3.

On Date 4, Trust 1 transferred its shares of X stock to Trust 2 for the benefit of A and to Trust 3 for the benefit of B. After the transfer, Trust 1 no longer held any shares of X stock. X represents that Trust 2 and Trust 3 satisfied the QSST requirements under § 1361(d)(3). However, A and B, the income beneficiaries of Trust 2 and Trust 3, respectively, failed to make QSST elections with respect to X for Trust 2 and Trust 3, respectively, effective Date 4. Therefore, X's S corporation election would have terminated on Date 4, had its election been effective or not previously terminated.

On Date 5, X and Sub2 merged with and into Sub1 with Sub1 surviving. X represents that the merger was intended to be a reorganization under § 368(a)(1)(F) and resulted in X's S corporation election continuing for Sub1 under Rev. Rul. 64-250, 1964-2 C.B. 333, and Rev. Rul. 2008-18, 2008-1 C.B. 674. On Date 6, Sub3, a State 1 corporation, became a wholly owned subsidiary of Sub1. Sub1 elected to treat Sub3 as a QSub under § 1361(b)(3) effective Date 6. Because X's S corporation election was ineffective, Sub1 was not a valid S corporation. Therefore, Sub1's election treating Sub3 as a QSub was ineffective.

Also on Date 6, Trust 4 became a shareholder of Sub1. It is represented that Trust 4 satisfied the QSST requirements under § 1361(d)(3). However, C, the income beneficiary of Trust 4, failed to make a QSST election with respect to Sub1 for Trust 4 effective Date 6. Therefore, Sub1's S corporation election would have terminated on Date 6, had Sub1 been a valid S corporation. As of Date 7, Trust 4 no longer owned any shares of Sub1 stock.

X represents that the circumstances resulting in its ineffective S corporation election and the resulting ineffective QSub elections and the subsequent termination of its S corporation election, including Sub1's S corporation election, were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X, Sub1, and their shareholders have filed tax returns consistent with X being an S corporation effective Date 2 and Sub1 being an S corporation following the reorganization on Date 5. X, Sub1, and their shareholders agree to make any adjustments consistent with the treatment of X and Sub1 as S corporations 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)(B) provides that the term “small business corporation” means a domestic corporation that is not an ineligible corporation and that does not, among other requirements, 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(b)(3)(A) provides that, except as provided in regulations prescribed by the Secretary, for purposes of the Code (i) a corporation which is a QSub shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that the term “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 1.1361-3(a)(1) of the Income Tax Regulations provides that the corporation for which a QSub election is made must meet all the requirements of § 1361(b)(3)(B) at the time the election is made and for all periods for which the election is to be effective.

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(d)(1) provides 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)(1) apply.

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust — (A) the terms of which require that — (i) during the life of the current income beneficiary, there shall only be one income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to

such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or a resident of the United States.

Section 1.1361-1(j)(6)(ii) 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 return, the applicable form including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

An S corporation election effective for a taxable year immediately preceding the corporation's first taxable year is not valid. See § 1.1362-6(a)(2)(iii), Example 1.

Section 1362(d)(2)(A) provides that an election under § 1362(a) is 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 that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation (i) 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 (ii) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C); (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 a QSub, as the case may be, 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 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 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 such ineffectiveness or termination, the corporation shall be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

Rev. Rul. 2008-18, situation 2, holds that consistent with Rev. Rul. 64-250, a reorganization under § 368(a)(1)(F) does not terminate an S corporation election under § 1362. In Rev. Rul. 2008-18, C, an individual owned all of the stock of Z, an S corporation. In Year 1, Z formed Newco, which in turn forms Mergeco. Pursuant to a plan of reorganization, Mergeco merges with and into Z, with Z surviving and C receiving solely Newco stock in exchange for Z stock. Newco meets the requirements for qualification as a small business corporation and timely elects to treat Z as a QSub, effective immediately following the transaction. The transaction met the requirements of a reorganization under § 368(a)(1)(F) and Z's original S corporation election continued for Newco. Newco must obtain a new employer identification number (EIN). Z must retain its EIN even though a QSub election is made for Z and must use its original EIN any time the QSub is otherwise treated as a separate entity for federal tax purposes (including for employment and certain excise taxes) or if the QSub election terminates.

Rev. Rul. 64-250 provides that when an S corporation merges into a newly formed corporation in a transaction qualifying as a reorganization under § 368(a)(1)(F) and the newly formed surviving corporation also meets the requirements of an S corporation, the reorganization does not terminate the S corporation election. Thus, the S corporation election remains in effect for the new corporation.

CONCLUSION

Based on the facts submitted and the representations made, we conclude that X's S corporation election was ineffective as of Date 1 and consequently the QSub elections for Sub1, Sub2, and Sub3 were also ineffective. We also conclude that had X's S corporation election been effective, its S corporation election would have terminated on Date 3 and Date 4 when it had ineligible S corporation shareholders and Sub1's S corporation election following the represented § 368(a)(1)(F) reorganization would have terminated on Date 6 when it had an ineligible S corporation shareholder. However, we conclude that the circumstances resulting in the ineffectiveness of X's S corporation election and the QSub elections for Sub1, Sub2, and Sub3 and in the termination of X's and Sub1's S corporation elections were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), (1) X will be treated as an S corporation from Date 2 and thereafter, provided that X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(d) for reasons not addressed in this letter, (2) Sub2 will continue to be treated as an S corporation from Date 6 and thereafter, provided that its S corporation election has not otherwise terminated under § 1362(d) for reasons not addressed in this letter, and (3) Sub1 will be treated as a QSub effective Date 2 and thereafter, Sub2 will be treated as a QSub effective Date 4 and thereafter, and Sub3 will be treated as a QSub effective Date 6 and thereafter, provided the QSub elections for Sub1, Sub2, and Sub3 were otherwise valid under § 1361(b)(3)(B) and have not otherwise terminated under § 1361(b)(3)(C).

This ruling is contingent on each of A and B, the income beneficiaries of Trust 2 and Trust 3, respectively, filing a QSST election for their respective trusts effective Date

4 with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to each QSST 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. Specifically, we express or imply no opinion regarding whether X and Sub1 were otherwise valid S corporations, whether Sub1, Sub2, and Sub3 were otherwise valid QSubs, whether the separate shares of Trust 1 were valid QSSTs, and whether Trust 2, Trust 3, and Trust 4 were valid QSSTs. Further, we express or imply no opinion on the validity of the reorganization under § 368(a)(1)(F) and its tax consequences.

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 representative.

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 requested ruling, it is subject to verification on examination.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure:

Copy of this letter for § 6110 purposes

cc: