

# 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. \_\_\_\_\_

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July 21, 2025

## LEGEND

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

A =

B =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Dear :

This letter responds to a letter dated June 23, 2025, and subsequent correspondence, submitted on behalf of X by its authorized representatives, 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 elected to be an S corporation effective on Date 2. A owned X stock. On Date 3, A died. On Date 4, A's estate transferred A's X stock to Trust 1 for the benefit of B during her life. Trust 1 made a qualified subchapter S trust (QSST) election effective Date 4.

On Date 5, B died. Trust 1 continued as a trust but ceased to be a QSST. X represents that, at all times since Date 6, Trust 1 has been qualified to be an electing small business trust (ESBT). The trustee of Trust 1, despite timely attempting to make an ESBT election effective Date 6, inadvertently omitted several potential current beneficiaries. Specifically, if Trust 1 were an ESBT on Date 6, Trust 2, Trust 3, Trust 4,

and Trust 5 would have been distributee trusts with respect to Trust 1 under § 1.1361-1(m)(1)(ii)(B) of the Income Tax Regulations. Trust 1's ESBT election correctly listed one potential current income beneficiary of Trust 2 and Trust 4 but failed to list that the children of that person, and correctly listed one potential current income beneficiary of Trust 3 and Trust 5 but failed to list that the children of that person.

Under § 1.1361-1(j)(7)(ii), Trust 1 remained an eligible shareholder through Date 7, two years after Trust 1 ceased to be a QSST on Date 5. X's S corporation election terminated on Date 7, because an ESBT election was not made for Trust 1.

On Date 8, Trust 1 transferred some of its X stock to Trust 2 and Trust 4. X represents that, at all times since Date 8, Trust 2 and Trust 4 have been qualified to be ESBTs. The trustees of Trust 2 and Trust 4, despite timely attempting to make ESBT elections effective Date 8, inadvertently omitted several potential current beneficiaries. Specifically, Trust 2's and Trust 4's ESBT elections correctly listed one potential current income beneficiary of Trust 2 and Trust 4, but failed to list that the children of that person.

On Date 9, Trust 1 transferred its remaining X stock to Trust 3 and Trust 5. X represents that, at all times since Date 9, Trust 3 and Trust 5 have been qualified to be ESBTs. The trustee of Trust 3 and Trust 5, despite timely attempting to make ESBT elections effective Date 9, inadvertently omitted several potential current beneficiaries. Specifically, Trust 3's and Trust 5's ESBT elections correctly listed one potential current income beneficiary of Trust 3 and Trust 5, but failed to list that the children of that person.

X represents that the failures to make valid ESBT elections for Trust 1, Trust 2, Trust 3, Trust 4, and Trust 5 were inadvertent and not motivated by tax avoidance or retroactive tax planning. X represents that it and its shareholders have filed all returns consistent with X's status as an S corporation, that Trust 1 has filed all returns consistent with its status as an ESBT effective Date 6, that Trust 2 and Trust 4 have filed all returns consistent with their status as ESBTs effective Date 8, and that that Trust 3 and Trust 5 have filed all returns consistent with their status as ESBTs effective Date 9. Further, X and its shareholders agree to make any adjustments required as a condition of obtaining relief for the termination of X's election as provided under § 1362(f) of the Code that may be required by the Secretary.

#### LAW AND ANALYSIS

Section 1362(a) of the Code 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.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1) provides that a small business corporation means a domestic corporation which is not an ineligible corporation for such year and which does not, among other limitations, 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 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, may be an S corporation 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), such trust shall be 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 the S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(3) defines a QSST as a trust 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 resident of the United States. In addition, the terms of the trust must require that (i) during the life of the current income beneficiary, there shall be only 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 the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary.

Section 1.1361-1(j)(7)(ii) of the Income Tax Regulations provides that if, upon the death of an income beneficiary of a QSST, the trust continues in existence, continues to hold S corporation stock but no longer satisfies the QSST requirements, is not a qualified subpart E trust, and does not qualify as an ESBT, then, solely for purposes of § 1361(b)(1), as of the date of the income beneficiary's death, the estate of that income beneficiary is treated as the shareholder of the S corporation with respect to which the income beneficiary made the QSST election. The estate ordinarily will cease to be treated as the shareholder for purposes of § 1361(b)(1) upon the earlier of the transfer of that stock by the trust or the expiration of the 2-year period beginning on the day of the income beneficiary's death. During the period that the estate is treated as the shareholder for purposes of § 1361(b)(1), the trust is treated as the shareholder for purposes of §§ 1366, 1367, and 1368. If, after the 2-year period, the trust continues to hold S corporation stock and does not otherwise qualify as a permitted shareholder, the corporation's S election terminates. If the termination is inadvertent, the corporation may request relief under § 1362(f).

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1362(b)(1)(B), an ESBT is a permitted shareholder of an S corporation.

Section 1361(e)(1)(A) provides that the term ESBT means any trust if (i) such trust does not have as a beneficiary any person other than an individual, an estate, or a qualifying charitable organization, (ii) no interest in the 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.

Section 1.1361-1(m)(2)(i) provides in 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)(ii) provides in part that the election statement must include the name, address, and taxpayer identification number of the potential current beneficiaries.

Section 1361(e)(2) and § 1.1361-1(m)(4)(i) provide in part that a potential current beneficiary generally is, with respect to any period, any person who at any time during such period is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust.

Section 1.1361-1(m)(4)(iv) contains the rules for determining who are the potential current beneficiaries of an ESBT if a distributee trust becomes entitled to, or at the discretion of any person, may receive a distribution from principal or income of an ESBT. Section 1.1361-1(m)(1)(ii)(B) provides that in part that a distributee trust is a trust that receives or may receive a distribution from an ESBT, whether the rights to receive the distribution are fixed or contingent, or immediate or deferred.

Section 1.1361-1(m)(4)(iv)(B) provides that, if the distributee trust is not a trust described in § 1361(c)(2)(A), then the distributee trust is the potential current beneficiary of the ESBT and the corporation's S corporation election terminates.

Section 1.1361-1(m)(4)(iv)(C) provides that, if the distributee trust is a trust described in § 1361(c)(2)(A), the persons who would be its potential current beneficiaries if the distributee trust were an ESBT are treated as the potential current beneficiaries of the ESBT. Section 1.1361-1(m)(4)(iv)(D) provides that, for the purposes of § 1.1361-1(m)(4)(iv)(C), a trust will be deemed to be described in § 1361(c)(2)(A) if such trust would qualify for a QSST election under § 1361(d) or an ESBT election under § 1361(e) if it owned S corporation stock.

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 a corporation is an S corporation) such corporation ceases to be a small business

corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in pertinent 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 terminated under § 1362(d)(2) or (3), (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 event resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation, 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 such ineffectiveness or termination, the 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 7, because the trustee of Trust 1 failed to make a valid election under § 1361(e)(3) to treat Trust 1 as an ESBT effective Date 6. Further, if X's S corporation election had not already terminated on Date 7, the election would have terminated on Date 8, because the trustees of Trust 2 and Trust 4 failed to make valid elections under § 1361(e)(3) to treat Trust 2 and Trust 4 as ESBTs effective Date 8. Additionally, if X's S corporation election had not already terminated on Date 7, and did not terminate on Date 8, the election would have terminated on Date 9, because the trustee of Trust 3 and Trust 5 failed to make valid elections under § 1361(e)(3) to treat Trust 3 and Trust 5 as ESBTs effective Date 9. We further conclude that the circumstances resulting in the terminations of X's S corporation election were inadvertent within the meaning of § 1362(f). Therefore, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 7 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.

This ruling is contingent on the trustees of Trust 1 filing within 120 days of the date of this letter an ESBT election effective Date 6 with the appropriate service center, the trustees of Trust 2 and Trust 4 filing within 120 days of the date of this letter ESBT elections effective Date 8 with the appropriate service center, and the trustees of Trust 3 and Trust 5 filing ESBT elections effective Date 9 with the appropriate service center. A copy of this letter should be attached to all required ESBT elections. If these conditions are not met, then this ruling is null and void.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X was otherwise eligible to be an S corporation or whether Trust 1, Trust 2, Trust 3, Trust 4, or Trust 5 are otherwise eligible to be shareholders or ESBTs.

This ruling is directed only to the taxpayer that requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

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.

Pursuant to a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

/S/

Christiaan T. Cleary  
Senior Technician Reviewer, Branch 1  
Office of the Associate Chief Counsel  
(Passsthroughs, Trusts, and Estates)

Enclosure

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CC: