

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

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, ID No.

Telephone Number:

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CC:PSI:B03  
PLR-138721-16

Date:  
March 22, 2017

### LEGEND

X =

Trust =

State =

Date 1 =

Date 2 =

Date 3 =

H =

\$d =

Dear

This letter responds to a letter dated December 8, 2016, that was submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated in State and elected to be an S corporation effective Date 1. Shares of stock in X were held by Trust. Trust was

a grantor trust described in § 1361(c)(2)(A)(i) of which H was the deemed owner. H died on Date 2. Trust qualified under § 1361(c)(2)(A)(ii) as an eligible shareholder for the next two years until Date 3. However, Trust continued to hold the X stock after the two-year period. According to X, Trust qualifies as an electing small business trust (“ESBT”), but its trustees made no ESBT election. As a result, X’s S corporation election terminated on Date 3.

X represents that the failure to file the ESBT election for Trust was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X further represents that X and its shareholders have agreed to make such adjustments consistent with the treatment of X as an S corporation as required by the Secretary.

Section 1362(a) provides that a small business corporation may elect to be an S corporation.

Section 1361(b)(1)(B) 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 a tax year.

Section 1361(b)(1)(B) provides that for purposes of subchapter S, a “small business corporation” cannot 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)(ii) provides that for purposes of § 1361(b)(1)(B), a trust which is 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, 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(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(2)(B), 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)(i) of the Income Tax Regulations provides, in part, that the trustee of the trust 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 1362(d)(2) 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(f) provides 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 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 termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

Based solely upon the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 3 due to the trustees' failure to make an ESBT election for Trust. We also conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S

corporation from Date 3 provided X's S corporation election was valid and was not otherwise terminated under § 1362(d).

This ruling is contingent on the following: (1) the trustees of Trust must file, within the sooner of 120 days following the date of this letter or the date any year will close under § 6501(a), an ESBT election effective Date 3; and (2) trustees must file within that same period all required returns, including amended returns, for all open years consistent with the requested relief. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Furthermore, as an adjustment under § 1362(f)(4), a payment of \$d and a copy of this letter must be sent to the following address: Internal Revenue Service, Cincinnati Service Center, 201 West Rivercenter Blvd., Covington, KY 41011, Stop 31, Manual Deposit. This payment must be sent no later than 45 days from the date of this letter; and if these conditions are not met, then this ruling is null and void. In addition, if these conditions are not met, X must send notification that its S election has terminated to the service center with which X's S election was filed.

Except as specifically ruled upon above, no opinion is expressed concerning the Federal tax consequences of any facts discussed or referenced in this letter, including whether X was or is an S corporation for Federal tax purposes.

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 the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Bradford Poston  
Senior Counsel, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy of this letter for section 6110 purposes