

Number: **201745008**
Release Date: 11/9/2017
Index Number: 1362.04-00

Date:
August 03, 2017

The information submitted states that X was incorporated under the laws of State on Date 1. X filed a timely election under § 1362(a) to be treated as an S corporation effective Date 1. On Date 2, A and B, individual shareholders of X, established Trust 1,

Trust 2, and Trust 3, nongrantor trusts whose beneficiaries were all U.S. citizens. On Date 3, A and B transferred shares of X stock to each of Trust 1, Trust 2, and Trust 3.

X represents that Trust 1, Trust 2, and Trust 3 each qualified to elect to be treated as electing small business trusts (ESBTs) under § 1361(e), however, the trustees for each of the trusts failed to make timely ESBT elections within the meaning of § 1361(e)(1)(A)(v) thereby causing X's S corporation election to terminate on Date 3.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and not motivated by tax avoidance. X further represents that X filed returns consistent with X's status as an S corporation. X also represents that, on Date 3, Trust 1, Trust 2, and Trust 3 each qualified to be an ESBT and continue to qualify as an ESBT. X further represents that Trust 1, Trust 2, and Trust 3 each filed returns consistent with rules applicable to ESBTs. X and its shareholders agree to make such adjustments (consistent with the treatment of X as an S corporation) 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, for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not 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)(v) provides that for the purposes of § 1362(b)(1)(B), an ESBT may be a shareholder.

Section 1361(e)(1)(A) provides that for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term "electing small business trust" 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 1st day of the 1st 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 in such corporation at any time during the period specified pursuant to 1362(f), agrees to make such 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.

Section 1.1362-4(b) provides, in relevant part, 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, in part, 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 on the facts submitted and representations made, we conclude that X's S corporation election terminated beginning on Date 3 because the trustees of Trust 1, Trust 2, and Trust 3 failed to timely file the required ESBT elections under § 1361(e)(1)(A)(v). We further conclude that the termination was inadvertent within the meaning of § 1362(f) and X will continue to be treated as an S corporation for the period

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

This ruling is conditioned upon the trustees of Trust 1, Trust 2, and Trust 3 filing a ESBT elections effective upon Date 3. The elections must be filed with the appropriate service center within 120 days of the date of this ruling. A copy of this letter should be attached to the ESBT elections.

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 whether X is otherwise eligible to be treated as an S corporation or whether Trust 1, Trust 2, or Trust 3 is eligible to be treated as an ESBT. 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. Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Laura C. Fields

Laura C. Fields
Senior Technician Reviewer, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this Letter
Copy for 6110 purposes

cc: