

## Internal Revenue Service

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Department of the Treasury  
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Person To Contact:  
 , ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:01  
PLR-133625-17

Date:  
April 16, 2018

### Legend

X =

State 1 =

Date 1 =

Date 2 =

Y =

State 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

A =

Trust 1 =

Trust 2 =

Years =

N =

Dear \_\_\_\_\_ :

This responds to a letter dated October 30, 2017, and subsequent correspondence submitted on behalf of X and Y by their authorized representative, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code

### FACTS

The information submitted states that X was incorporated under the laws of State 1 on Date 1 and elected to be an S corporation effective Date 2. The information further states that Y was incorporated under the laws of State 2 on Date 3 and elected to be an S corporation effective Date 4.

Pursuant to an agreement originally dated Date 5 and which was last amended and completely restated on Date 6, A established Trust 1, a revocable trust treated as a wholly-owned grantor trust under §§ 671 and 676. A transferred shares of X and Y stock to Trust 1.

On Date 7, A died and Trust 1 ceased to be a grantor trust with respect to A's interests, but continued to qualify as an eligible S corporation shareholder under § 1361(c)(2)(A)(ii) for the two year period beginning on the day of the deemed owner's death. X and Y each represent that Trust 1 qualified to elect to be treated as an electing small business trust (ESBT), however, the trustee failed to make timely ESBT elections within the meaning of § 1361(e)(1)(A)(v) thereby causing X and Y's respective S corporation elections to terminate on Date 8.

On Date 9, Trust 1 distributed the stock in X and Y to Trust 2, a residuary created pursuant to the terms of Trust 1. X and Y represent that Trust 2 qualified to elect to be treated as an ESBT and the trustee made timely ESBT elections within the meaning of § 1361(e)(1)(A)(v). However, because each of X and Y's S corporation elections terminated on Date 8, the ESBT elections were never valid.

X and Y represent that the circumstances resulting in the termination of their respective S corporation elections were inadvertent and not motivated by tax avoidance. X and Y further represent that they each filed returns consistent with their status as S corporations. X, Y, and their shareholders agree to make such adjustments (consistent with the treatment of X and Y 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, 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)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part 1 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(c)(2)(A)(ii) and § 1.1361-1(b)(1)(ii) provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted S corporation shareholder, but only for the two-year period beginning on the day of the deemed owner’s death. Section 1.1361-1(h)(3)(i)(B) provides that if stock is held by a trust described in § 1.1361-1(h)(1)(ii), the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner’s death.

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.

### CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X and Y's respective S corporation elections terminated beginning on Date 8 because the trustee of Trust 1 failed to timely file the required ESBT elections under § 1361(e)(1)(A)(v). We further conclude that the circumstances resulting in such terminations were inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X and Y each will be treated as S corporations on and after Date 8, unless X and Y's S corporation elections are otherwise terminated under § 1362(d). Moreover, had X and Y's respective S corporation elections been effective, their respective elections would have terminated on Date 9 upon the failure of the trustee to file ESBT elections for Trust 2. Similarly, this terminating event would have been an inadvertent termination within the meaning of § 1362(f).

This ruling is conditioned on (1) the trustee of Trust 1 filing ESBT elections effective Date 8 with the appropriate service center within 120 days of the date of this

letter, and 2) the trustee of Trust 2 filing ESBT elections for Trust 2 effective Date 9 within 120 days from the date of this letter. A copy of this letter should be attached the ESBT elections.

In addition, this ruling is conditioned on Trust 1 and Trust 2 filing any amended returns and making adjustments that are necessary to properly reflect the treatment of Trust 1 and Trust 2 as ESBTs for Years taxable years.

Furthermore, as an adjustment under § 1362(f)(4), this ruling is conditioned on the payment of \$n and a copy of this letter ruing must be sent to the address: Internal Revenue Service, Cincinnati Service Center, 201 West Rivercenter Blvd., Covington, KY 41011, Stop 31, Terri Lackey, Manual Deposit. The payment and copy of this letter must be sent no later than Date 10.

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 and Y are otherwise eligible to be treated as S corporations or whether Trust 1 or Trust 2 are eligible to be treated as ESBTs. This ruling is directed only to the taxpayers 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 and Y's authorized representative.

Sincerely,

*Laura C. Fields*

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

Enclosures (2)  
Copy of Letter  
Copy for 6110 purposes