

**Internal Revenue Service**

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Date of Communication: Month DD, YYYY]

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B01  
PLR-126644-18

Date:  
April 08, 2019

LEGEND:

X =

State =

A =

B =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Year 1 =

Year 2 =

n =

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

This responds to a letter dated August 30, 2018, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

### Facts

The information submitted states that X was incorporated under the laws of State on Date 1, and elected to be treated as an S corporation effective Date 2.

On Date 3, and on subsequent dates thereafter, A, a shareholder of X, transferred shares of X's outstanding stock to each of Trust 1, Trust 2, Trust 3, and Trust 4. In addition, A transferred shares of X's outstanding stock to Trust 5 on Date 4, and on subsequent dates thereafter. X represents that each of Trust 1, Trust 2, Trust 3, and Trust 4 was eligible to make an Electing Small Business Trust (ESBT) election as of Date 3 and thereafter, and Trust 5 was eligible to make an ESBT election as of Date 4 and thereafter. However, the trustee of each trust failed to file an ESBT election.

Therefore, X's S corporation election terminated on Date 3, and if it had not already terminated, it would have terminated on Date 4.

On Date 5, B, a shareholder of X, established Trust 6, a trust treated as a wholly-owned grantor trust under §§ 671 and 676. B transferred shares of X stock to Trust 6 on Date 6. On Date 7, B died and Trust 6 ceased to be a grantor trust with respect to B'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 represents that Trust 6 qualified to elect to be treated as an ESBT, however, the trustee failed to make a timely ESBT election. Therefore, X's S corporation election would have terminated on Date 9 if it had not already terminated on Date 3.

X represents that it has filed all tax returns since Date 2 consistent with its status as an S corporation. Trust 6 has filed its tax returns consistent with treatment as an ESBT since Date 8. However, each of Trust 1, Trust 2, Trust 3, Trust 4 and Trust 5 has been filing tax returns and paying taxes as a complex trust rather than as an ESBT.

X represents that the failure to file ESBT elections for Trust 1, Trust 2, Trust 3, Trust 4, Trust 5 and Trust 6 was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Further, X represents that X and its shareholders agree to make any adjustments (consistent with the treatment of X as an S corporation and each of the trusts as an ESBT) that 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) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not: (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

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 an S corporation shareholder.

Section 1361(c)(2)(A)(ii) and § 1.1361-1(h)(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 purposes of § 1362(b)(1)(B), an ESBT may be an S corporation shareholder.

Section 1361(e)(1)(A) provides that 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) provides 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)(iii) provides that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a qualified subchapter S trust election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2)(A) 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) the 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 of § 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 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 any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in such

termination, such corporation will 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 required 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 representation made, we conclude X's S corporation election terminated on Date 3 when Trust 1, Trust 2, Trust 3, and Trust 4 became shareholders because the trustee of such trusts failed to timely file the required ESBT elections. We further conclude that the termination of X's S corporation election was inadvertent within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided that X's S corporation election is not otherwise terminated under § 1362(d). Moreover, had X's S corporation election been effective, the election would have terminated on Date 4 upon the failure of the trustee of Trust 5 to file an ESBT election for such trust, and on Date 9 upon the failure of the trustee of Trust 6 to file ESBT election for such trust. Similarly, these terminating events would have been inadvertent terminations within the meaning of § 1362(f).

This ruling is contingent on (1) the trustee of each of Trust 1, Trust 2, Trust 3, and Trust 4 filing ESBT elections effective Date 3 with the appropriate service center within the 120 days; (2) the trustee of Trust 5 filing an ESBT election effective Date 4 with the appropriate service center within the 120 days; and (3) the trustee of Trust 6 filing an ESBT election effective Date 9 with the appropriate service center within the 120 days. X and each trust must also file within that same period amended returns for Year 1 and Year 2 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 \$n and a copy of this letter must be sent to the following address: Internal Revenue Service, Kansas City Service Center, 333 W. Pershing Road, Kansas City, MO 64108, Stop 7777, Manual Deposit. This payment must be sent no later than 120 days from the date of this letter. 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 corporation election has terminated to the service center with which X's S corporation election was filed.

Except as expressly provided herein, no opinion is expressed or implied 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 an S corporation or whether any of Trust 1, Trust 2, Trust 3, Trust 4, Trust 5 or Trust 6 is otherwise eligible to be 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

*Faith P. Colson*

Faith P. Colson  
Senior Counsel, Branch 1  
(Passthroughs & Special Industries)

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

cc: