

Dear _____ :

This letter responds to a letter dated November 12, 2019, submitted on behalf of X from X's authorized representatives, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted and the representations made, X was incorporated on Date 1 under the laws of State and elected to be an S corporation effective Date 2. On Date 2, shares of stock in X were held by Trust 1. Trust 1 was a grantor trust described in § 1361(c)(2)(A)(i) of which A was a deemed owner.

On Date 3, Trust 1 transferred shares of X to Trust 2. X represents that Trust 2 was a grantor trust described in § 1361(c)(2)(A)(i) of which A was a deemed owner.

A died on Date 4. Trust 1 and Trust 2 each qualified under § 1361(c)(2)(A)(ii) as eligible shareholders for two years from A's date of death (Date 5). However, Trust 1 and Trust 2 each continued to hold the X stock after the two-year period. X represents that Trust 1 and Trust 2 each satisfied the electing small business trust (ESBT) requirements under § 1361(e). However, the trustees of each of Trust 1 and Trust 2 failed to make an election under § 1361(e) to treat each of Trust 1 and Trust 2 as ESBTs effective Date 5. Accordingly, Trust 1 and Trust 2 became ineligible shareholders of X and X's S corporation election terminated on Date 5.

X further represents that X has filed its income tax returns consistent with having a valid S election in effect for all taxable years since X elected to be an S corporation. X represents that Trust 1 and Trust 2's failure to each file an ESBT election and resulting termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Further, X and its shareholders agree to make any adjustments required as a condition of obtaining relief under § 1382(f) 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 1 of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), a trust which was 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 § 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 section 170(c)(2), (3), (4) or (b) 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)(1)(B) provides that the term ESBT does not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

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 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 QSST 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 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, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (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 the termination, steps were taken so that the corporation is once more 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 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 the termination, the corporation will be treated as continuing to be 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 5 when Trust 1 and Trust 2 became ineligible shareholders. We further conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 5 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d).

This ruling is contingent on the trustees filing an ESBT election for each of Trust 1 and Trust 2 effective Date 5, with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to each ESBT election.

Except as specifically ruled upon 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 X's eligibility to be an S corporation or Trust 1 and Trust 2's eligibility to be an ESBTs, respectively.

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.

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.

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

Sincerely,

Adrienne M. Mikolashek
Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: