



## FACTS

According to the information submitted, X was incorporated on Date 1 under the laws of State and elected to be treated as a subchapter S corporation effective Date 1. A died on Date 2. A's shares of stock in X were transferred to Trust 1 on Date 2. Trust 1 qualified under § 1362(c)(2)(A)(iii) as an eligible shareholder for two years from Date 2. However, Trust 1 continued to hold X stock after the two-year period. X represents that Trust 1 satisfied the electing small business trust (ESBT) requirements under § 1361(e). However, the trustee of Trust 1 failed to make an election under § 1361(e) to treat Trust 1 as an ESBT effective Date 3. Accordingly, Trust 1 became an ineligible shareholder of X and X's S corporation election terminated on Date 3.

On Date 4, upon the death of Trust 1's beneficiary, shares of X were transferred from Trust 1 to Trust 2. X represents that Trust 2 satisfied the electing small business trust (ESBT) requirements under § 1361(e). However, the trustee of Trust 2 failed to make a timely ESBT election. Accordingly, Trust 2 was an ineligible shareholder of X. Had X's S corporation election not terminated on Date 3, it would have terminated on Date 4.

X further represents that X and its shareholders have filed their income tax returns consistent with X having a valid S election for all taxable years since X elected to be an S corporation, and Trust 1 and Trust 2 have filed consistently as ESBTs since receiving shares in X. X represents that Trust 1 and Trust 2's failure to file timely ESBT elections and the 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)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an eligible 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)(v) provides that for the purposes of § 1362(b)(1)(B), an electing small business trust 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 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)(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 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 discover 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(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's S corporation election terminated beginning on Date 3 when the trustee of Trust 1 failed to file an ESBT election under § 1361(e)(3). We further conclude that the termination of X's S corporation election was inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as continuing to be an S corporation on and after Date 3, provided X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d).

This ruling is contingent on the following conditions: (1) the trustee of Trust 1 must file with the appropriate service center within 120 days from the date of this letter an ESBT election effective Date 3; (2) the trustee of Trust 2 must file with the appropriate service center within 120 days from the date of this letter an ESBT election effective Date 4; and (3) X and its shareholders must file any original and amended returns for all open taxable years consistent with the relief granted in this letter. A copy of this letter should be attached to the ESBT elections. If these conditions are not met, then this ruling is null and void.

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.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

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.

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

Sincerely,

By: /s/ \_\_\_\_\_  
Laura C. Fields  
Branch Chief, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure (1):

Copy of this letter for § 6110 purposes

cc: