



## **FACTS**

According to the information submitted and representations made, Company, organized under the laws of State, made an election to be treated as an S corporation on Date 1, effective as of Date 2. On Date 3, membership interests in Company were transferred to Trust. However, the trustees of Trust did not make a timely election for Trust to be treated as an electing small business trust (ESBT) under § 1361(e)(3), thus causing Company's S election to terminate effective Date 3.

Company represents that Trust has at all times met the requirements of an ESBT within the meaning of § 1361(e), except that the trustees of Trust did not make a timely ESBT election under § 1361(e)(3). Company represents that Trust will file to elect to be treated as an ESBT under § 1361(e)(3) if a ruling request is granted. Company further represents that it has filed income tax returns consistent with having a valid S election in effect for all taxable years since its election on Date 1. Company and Company's shareholders from Date 3 and thereafter consent to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Commissioner.

## **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) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and 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 1 class of stock.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(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)(1)(B) provides that an 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) of the Income Tax Regulations 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 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) 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. A termination of an S corporation election under § 1362(d)(2) shall be effective on and after the date of cessation.

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 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 is 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 the adjustments (consistent with the treatment of the corporation as an S corporation) as might be required by the Secretary regarding this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

### **CONCLUSION**

Based solely on the facts submitted and the representations made, we conclude that Company's S corporation election terminated on Date 3 when the trustees of Trust failed to make elections under section § 1362(e)(3) to treat Trust as an ESBT effective Date 3. We further conclude that the termination of Company's S election was inadvertent within the meaning of § 1362(f). Therefore, pursuant to the provisions of § 1362(f), Company will be treated as an S corporation effective Date 3 and thereafter,

provided Company's S corporation election is otherwise valid and not otherwise terminated under § 1362(d).

This letter is contingent on the following: within 120 days of this letter (1) the trustees of Trust filing an election to treat Trust as an ESBT, effective Date 3, with the appropriate service center, and (2) Trust filing any amended returns and making adjustments to properly reflect the treatment of the trusts as ESBTs for all taxable years. A copy of this letter should be attached to any elections or returns.

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  
Attn: Manual Deposit

This payment and a copy of this letter must be sent no later than Date 4.

If the conditions are not met, this ruling is null and void. In addition, if these conditions are not met, Company must notify the service center with which it filed its S corporation election that its election terminated on Date 3.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's eligibility to be an S corporation or Trust's eligibility to elect to be treated as an ESBT.

The ruling contained in this letter are 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 request for rulings, it is subject to verification on examination.

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, we are sending a copy of this letter to Company's authorized representatives.

Sincerely,

/S/

Richard T. Probst  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure:

Copy of this letter for § 6110 purposes

cc: