

FACTS

The information submitted states that X was incorporated on Date 1 under the laws of State and elected to be an S corporation effective Date 1. A owned shares of X stock.

On Date 2, A died. Pursuant to the terms of A's will, shares of X stock were transferred to Trust on Date 3. For a 2-year period beginning on Date 3, Trust was an eligible shareholder of X under § 1361(c)(2)(A)(iii). X represents that Trust was eligible to be an electing small business trust ("ESBT") under § 1361(e)(1), however, the trustees of Trust failed to file an ESBT election for Trust. As a result, X's S corporation election terminated on Date 4 when the 2-year period under § 1361(c)(2)(A)(iii) ended.

X represents that there was no tax avoidance or retroactive tax planning involved in the failure of the trustees to file an ESBT election for Trust and the resulting termination of X's S corporation election. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation 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 the year.

Section 1361(b)(1)(B) 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, (2) 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, (3) have a nonresident alien as a shareholder, and (4) have more than one class of stock.

Section 1361(c)(2)(A)(iii) provides that for purposes of § 1361(b)(1)(B), a trust with respect to stock transferred to it pursuant to the terms of a will is a permitted S corporation shareholder, but only for the 2-year period beginning on the day on which such stock is transferred to it.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible 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)-(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 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 an ESBT must make the ESBT election by signing and filing, with the service center for which 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 ESBT election must be filed within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a qualified subchapter S trust election.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

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(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or (B) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary ("QSub"), as the case may be, and (4) the corporation for which the election was made or 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 such adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation or a

QSub, as the case may be, during the period specified by the Secretary.

CONCLUSION

Based on the representations made and information submitted, we conclude that X's S corporation election terminated on Date 4 when the trustees of Trust failed to file an ESBT election for Trust. We further conclude that the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as continuing to be an S corporation from Date 4 and thereafter, provided X's S corporation election was valid and not otherwise terminated under § 1362(d).

This ruling is contingent on (1) Trust filing returns, including amended returns, for all open years consistent with the requested relief within 120 days from the date of the letter, and (2) the trustees of Trust filing an ESBT election for Trust effective Date 4 with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the ESBT election.

Except as specifically ruled upon 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 on whether X was eligible to be an S corporation or Trust was eligible to be an ESBT.

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. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

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

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:

Copy of this letter for § 6110 purposes

cc: