



The information submitted states that X was incorporated on D1. Trust, a revocable trust created by A, acquired stock of X on D2. X elected to be an S corporation effective D3. X died on D4. It is represented that Trust is eligible to be an electing small business trust (ESBT) under § 1361(e) and was intended to elect ESBT treatment effective D5, which is two years after D4, but no ESBT election was timely filed by the trustee of Trust and X's S corporation election terminated on D5. On D6, Trust distributed the X stock to B, an individual.

X represents that the failure to file the ESBT election for Trust was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) of the Code 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 the term "small business corporation" means a domestic corporation which is not an ineligible 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 a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States is an eligible shareholder. Section 1361(c)(2)(A)(ii) provides that 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 is an eligible 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 an ESBT is an eligible shareholder.

Section 1361(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1362(e)(2)(B), 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 the 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 1362(f) provides that if (1) an election under § 1362(a) 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 to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (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 (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents; 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 such adjustments (consistent with the treatment of the corporation as an S corporation) 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 during the period specified by the Secretary.

Based solely on the facts and representations submitted, we conclude that X's S corporation election was terminated on D5 because of the failure of Trust to file an ESBT election, and that this termination was inadvertent within the meaning of § 1362(f).

We hold that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from D5 to D6, and thereafter, provided X was otherwise eligible to make an S corporation election and provided that any such election would not have otherwise been terminated under § 1361(d). Trust will be treated as an ESBT from D5 until D6. The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

This ruling is conditioned upon the trustee of Trust filing an appropriately completed ESBT election for Trust effective D5, and upon Trust and its beneficiaries filing timely amended federal income tax returns consistent with the treatment of Trust as an ESBT from D5 to D6. The election must be made and the amended returns must be timely filed within 60 days following the date of this letter and a copy of this letter should be attached to the election and the returns.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the

Code. In particular, we express no opinion on any other federal tax consequences of the distribution of the X stock to B.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

J. THOMAS HINES  
Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures: 2  
Copy of this letter  
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