



This responds to a letter dated July 1, 2008, submitted on behalf of X by X's authorized representative, requesting inadvertent S corporation election termination relief under § 1362(f) of the Internal Revenue Code. In addition, your letter seeks relief allowing Trust A, Trust B, and Trust C to file late elections to be treated as electing small business trusts (ESBTs).

### FACTS

The information submitted states that X was incorporated in State on Date 1 and made an election to be treated as an S corporation effective Date 2. On Date 3, shares of X stock were transferred to Trust 1, Trust 2, and Trust 3. Each of Trust 1, Trust 2, and Trust 3 is represented as being eligible to be an ESBT as of Date 3. However, the trustees of Trust 1, Trust 2, and Trust 3 failed to make ESBT elections for the trusts. Therefore, X's S corporation election terminated on Date 3, when Trust 1, Trust 2, and Trust 3 became shareholders. This was not discovered until Date 4.

X represents that the failure to file the ESBT elections for Trust 1, Trust 2, and Trust 3, and the consequent termination of X's election to be an S corporation, was inadvertent, unintended, and not the result of tax avoidance or retroactive tax planning. X and each person who is or was a shareholder of X agree to make any adjustments consistent with the treatment of X as an S corporation, and consistent with the treatment of Trust 1, Trust 2, and Trust 3 as ESBTs, as may be required by the Secretary with respect to the period specified by § 1362(f).

### LAW AND ANALYSIS

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 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, a "small business corporation" cannot 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)(v) provides that, for the purposes of § 1362(b)(1)(B), an ESBT is a permitted shareholder of a small business corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever (at any time on or after the 1st day of the 1st taxable year for which a

corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1361(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1362(e)(2)(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 paragraph (2), (3), (4) or (5) of § 170(c), 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) 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. The termination is effective on and after the day of the termination.

Section 1362(f) provides, in part, 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 (B) was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or 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 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 such ineffectiveness

or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based solely on the representations made and the information submitted, we conclude that X's S election terminated on Date 3, when shares of the stock of X were transferred to Trust 1, Trust 2, and Trust 3. We further conclude, however, that the termination was an inadvertent termination within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation as of Date 3, and thereafter, provided that the trustees of Trust 1, Trust 2, and Trust 3 file ESBT elections for the trusts, and provided that X's S election is not otherwise terminated under § 1362(d). The trustees of Trust 1, Trust 2, and Trust 3 must file ESBT elections pursuant to the procedures set forth in § 1.1361-1 (m)(2), with the appropriate service center within 60 days of the date of this letter. A copy of this letter should be attached to the ESBT elections.

This ruling is contingent on X and all of its shareholders treating X as having been an S corporation for the period beginning Date 3, and thereafter. Accordingly, in determining their respective income tax, all the shareholders of X must include their pro-rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and nonseparately computed items of income and loss of X as provided in § 1366, make adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. This ruling is also contingent on Trust 1, Trust 2, and Trust 3 filing amended returns consistent with the treatment of these trusts as ESBTs. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Except as specifically ruled upon above, we express or imply no opinion as to the federal tax consequences of the facts of the facts described above under any other provision of the Code. In particular, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation, or whether Trust 1, Trust 2, and/or Trust 3 are eligible ESBTs under § 1361 (e).

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

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

Sincerely,

*David R. Haglund*

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Enclosures (2)

Copy of this letter

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