



Trust7 =

Trust8 =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Date8 =

Date9 =

Date10 =

N1 =

N2 =

N3 =

N4 =

N5 =

Dear \_\_\_\_\_ :

This letter responds to a letter dated May 18, 2020, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (the Code).

### FACTS

The information submitted states that X, a State corporation, elected to be an S corporation effective Date1. At the time of formation, A owned N1 shares of X. On Date2, A transferred N1 shares of X to Trust1. On Date3, A transferred N2 shares of X from Trust1 to Trust2. X represents that Trust1 and Trust2 were properly treated as grantor trusts under §§ 671-678, and A was treated as owning the shares of X held by Trust1 and Trust2, respectively.

On Date4, A died. Under § 1361(c)(2)(A)(ii), Trust2 continued to be an eligible S corporation shareholder for two years beginning on Date4. On Date5, pursuant to the terms of the trust agreement for Trust2, Trust2 was divided into two separate but equal shares for the benefit of A's surviving children, namely Trust3 and Trust4, and N3 shares of X were transferred to each trust. X represents that Trust3 and Trust4 qualified as Electing Small Business Trusts (ESBTs) under § 1361(e)(1)(A), but the trustees of Trust3 and Trust4 failed to file elections under § 1361(e)(3) effective Date5. Consequently, X's S corporation election terminated on Date5. Nevertheless, X represents that Trust3 and Trust4 filed consistently as ESBTs during taxable years Date6 through Date7.

On Date8, the shares of X held by Trust3 and Trust4 were transferred to Trust7 and Trust8, respectively. X represents that Trust7 and Trust8 qualify as ESBTs under § 1361(e)(1)(A) and filed late ESBT elections under § 1361(e)(3) effective Date8 pursuant to Rev. Proc. 2013-30, 2013-36 I.R.B. 173.

As part of the administration of A's estate, an election under § 645 was made to treat Trust1 as part of A's estate for federal tax purposes. Because Trust1 was treated as part of A's estate, Trust1 remained an eligible shareholder of X until Date9 under § 1361(b)(1)(B). On Date9, pursuant to the terms of the trust agreement for Trust1, Trust1 was divided into two separate but equal shares for the benefit of A's surviving children, namely Trust5 and Trust6, and N4 shares of X were transferred to each trust. X represents that Trust5 and Trust6 qualify as ESBTs under § 1361(e)(1)(A), but the trustees of Trust5 and Trust6 failed to file ESBT elections under § 1361(e)(3) effective Date9. Therefore, had X's S corporation election not terminated on Date5, it would have terminated on Date9.

X represents that X and all of its shareholders have always filed tax returns consistent with X being an S corporation. X further represents that the circumstances

resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make adjustments consistent with the treatment of X as an S corporation, and the trusts as ESBTs, 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 such year.

Section 1361(b)(1) 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, (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 one 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 (A) 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; and (B) any termination 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 a 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 for which the election was made or termination occurred is a small business corporation or (B) to acquire the shareholder consents, and (4) the corporation for which the election was made or 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) 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.

### CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date5 when the trustees of Trust3 and Trust4 failed to make elections under § 1361(e)(3) to treat Trust3 and Trust4 as ESBTs effective Date5. In addition, had X's S corporation not terminated on Date5, it would have terminated on Date9 when the trustees of Trust5 and Trust6 failed to make elections under § 1361(e)(3) to treat Trust5 and Trust6 as ESBTs effective Date9. 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, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date5 and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d) for reasons not addressed in this letter.

This ruling is contingent on (1) the trustees of Trust5 and Trust6 filing within 120 days from the date of this letter ESBT elections effective Date9 on behalf of their respective trusts with the appropriate service center and (2) Trust5 and Trust6 filing

within 120 days from the date of this letter amended returns for taxable years Date10 to properly reflect the treatment of Trust5 and Trust6 as ESBTs. A copy of this letter should be attached to each ESBT election.

Furthermore, as an adjustment under § 1362(f)(4), a payment of \$N5 and a copy of this letter must be sent within 45 days from the date of this letter to the following address: Internal Revenue Service, Kansas City Submission Processing Campus, Attn: Manual Deposit, 333 W. Pershing Road, Stop 7777, Kansas City, MO 64108.

If the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the service center with which it filed its S corporation election that its election terminated on Date5.

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 X's eligibility to be an S corporation. In addition, we express or imply no opinion as to whether Trust3, Trust4, Trust5, Trust6, Trust7 and Trust8 are eligible to elect to be treated as ESBTs.

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 upon examination.

This ruling is directed only to the taxpayer who requested 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 copies of this letter to X's authorized representatives.

Sincerely,

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

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes

cc: