

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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1362.04-00

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:01  
PLR-118737-20  
Date: November 17, 2021

Legend:

X =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

State =

\$n =

Dear :

This responds to a letter dated August 24, 2020, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

#### Facts

According to the information submitted and representations within, X was incorporated on Date 1, under the laws of State. Effective Date 2, X elected to be taxed as an S corporation.

On Date 2, Trust 1 became a shareholder of X. Taxpayer represents that it believes that its accountants believed that Trust 1 was a grantor trust because the trust agreement required that the trustee segregate any S corporation stock from the remainder of the trust and hold it for the benefit of each primary beneficiary. When X made its S election, the trustees of Trust 1 did not follow the provisions of the trust agreement.

X represents that gifts made to Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, and Trust 9 on Date 3, Date 4, Date 5, or Date 6 may have caused them to become ineligible S corporation shareholders and that timely elections to treat each of them as an Electing Small Business Trust (ESBT) were not made, causing X's S corporation election to terminate.

X represents that Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, and Trust 9 have at all times, met the requirements of an ESBT within the meaning of section 1361(e), except that the trustees did not make a timely ESBT election under section 1361(e)(3).

X represents that upon discovering that its S election was invalid or had terminated, X took corrective action by filing this request for relief. X represents that the circumstances resulting in the invalid election or inadvertent termination and the failure to make timely ESBT elections was inadvertent and not motivated by tax avoidance or retroactive tax planning. X further represents that X has filed its income tax returns consistent with having a valid S election in effect for all taxable years since X elected to be an S corporation. X represents that, other than the failure to administer Trust 1 according to its trust agreement, or make a valid ESBT elections, X has qualified as a small business corporation at all times since its election on Date 2. Lastly, X and its shareholders agree to make any adjustments required as a condition of obtaining relief under § 1362(f) that may be required by the Secretary.

X requests three rulings. First, the ineffectiveness of the X's S election caused by failing to execute the terms of the trust agreement of Trust 1 was inadvertent, as was the potential termination of X due to failure to make ESBT elections for Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, and Trust 9, within the meaning of § 1362(f), and X will be treated as an S corporation from Date 2 and thereafter.

#### Law and Analysis

Section 1361(a) provides that an S corporation is a small business corporation for which an election under § 1362(a) is in effect.

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) provides that the terms "small business corporation" means 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 1 class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of section 1361(b)(1) a trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(c)(2)(A)(iii) provides that a trust with respect to stock transferred to it, pursuant to the terms of a will, is a permissible shareholder for the two year period beginning on the day on which the 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) 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)(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 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(a) provides that a small business corporation may elect 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 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the

circumstances resulting in such termination, such 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 the failure to administer Trust 1 in accordance with its trust agreement, and the failure of Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, and Trust 9 to make ESBT elections, caused X's S corporation to be ineffective or to inadvertently terminate within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning on and after Date 2, unless X's S corporation election is otherwise terminated under § 1362(d).

This letter ruling is subject to the condition that within 120 days from the date of this letter, elections to treat each of Trust 3, Trust 4, Trust 5, and Trust 6 as an ESBT effective Date 5, an election to treat Trust 2 as an ESBT effective Date 6, and elections to treat each of Trust 7, Trust 8, and Trust 9 as an ESBT effective Date 4 must be made with the appropriate service center. As an adjustment under § 1362(f)(4), a payment of \$n attached with a copy of this letter and sent to the following address within 45 days from the date of this letter: Internal Revenue Service, Kansas City Submission Processing Campus, 333 W. Pershing Road, Kansas City, MO 64108, Stop 7777, Attn: Manual Deposit. A copy of this letter should also be attached to the ESBT elections. If these conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must send notification that its S election has terminated to the service center with which X's S election was filed.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation, or whether Trust 1 was or is otherwise eligible to be a grantor trust, or whether any of Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, and Trust 9 was or is otherwise 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 who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

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

Sincerely,

Laura Fields

Laura Fields

Chief, Branch 1

Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:

Copy for § 6110 purposes

cc: