

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

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Date:
May 09, 2024

LEGEND

X =

A =

B =

C =

D =

E =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

Trust 11 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

State =

n =

Dear _____ :

This responds to a letter dated October 3, 2023, submitted on behalf of X by X's authorized representative, requesting relief under section 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that X is incorporated under the laws of State and elected to be treated as an S corporation as of Date 1. Subsequently, the stock of X was held by A, C, D, E, and Trust 1. Trust 1 was a grantor trust under § 671 of A and A's spouse B. On Date 2, Trust 1 was divided into Trust 2, Trust 3, and Trust 4; each a grantor trust of spouses A and B.

On Date 3, A died and the following occurred: (i) A's X stock was transferred to Trust 5; (ii) Trust 2, Trust 3, and Trust 4 became non-grantor trusts, and; (iii) Trust 2, Trust 3, and Trust 4 partially distributed X stock to Trust 6, Trust 7, and Trust 8, each a grantor trust of B. On Date 4, Trust 5 transferred its X stock to Trust 9, Trust 10, and Trust 11.

X represents that Trust 2, Trust 3, Trust 4, Trust 9, Trust 10, and Trust 11 were eligible to make Electing Small Business Trust (ESBT) elections under § 1361(e)(3), effective Date 3 and Date 4, respectively. However, the trustees failed to make ESBT elections for the trusts to be eligible S corporation shareholders. Thus, Trust 2, Trust 3, and Trust 4 became ineligible shareholders of X on Date 3 and Trust 9, Trust 10, and Trust 11 became ineligible shareholders of X on Date 4. Accordingly, the failure to make ESBT elections caused X's S election to terminate on Date 3 and if it had not already terminated it would have terminated on Date 4.

X represents it filed income tax returns consistent with having an election to be treated as an S corporation for all taxable years since its formation. X represents that Trust 2, Trust 3, Trust 4, Trust 9, Trust 10, and Trust 11 have always met the requirements of an ESBT within the meaning of § 1361(e), except that the trustees of did not make a timely ESBT election under § 1361(e)(3). It is represented that failure to file ESBT elections were inadvertent and not motivated by tax avoidance or retroactive tax planning. X and each of its shareholders agree to make any adjustments required by the Secretary as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f).

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 1 class of stock.

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

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), an electing

small business trust (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)(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)(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) provides that an S corporation election will 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(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation 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 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 for which the election was made or termination occurred is a small business corporation; and (4) the corporation for which the election was made or 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 ineffectiveness or 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 representations made, we conclude that X's S corporation election terminated on Date 3 because the trustees of Trust 2, Trust 3, and Trust 4 failed to timely make ESBT elections under § 1361(e)(3). Further, X's S corporation election would have terminated on Date 4 because the trustees of Trust 9, Trust 10, and Trust 11 failed to timely make ESBT elections under § 1361(e)(3). However, the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f). Accordingly, X shall be treated as an S corporation from Date 3 and thereafter, provided its S corporation election is not otherwise terminated under § 1362(d).

This letter ruling is subject to the conditions that within 120 days from the date of this letter (1) the trustees of Trust 2, Trust 3, Trust 4, Trust 9, Trust 10, and Trust 11 must file ESBT elections with respect to Trust 2, Trust 3, Trust 4, Trust 9, Trust 10, and Trust 11, effective Date 3 or Date 4, as appropriate, with the appropriate service center and (2) X and its shareholders file any necessary original or amended returns consistent with the relief granted in this letter. A copy of this letter should be attached to the ESBT election and any original or amended returns.

Furthermore, as an adjustment under § 1362(f)(4), a payment of \$n with a copy of this letter within 45 days from the date of this letter to the following address:

Internal Revenue Service
Kansas City Service Center
333 W. Pershing Road
Kansas City, MO 64108
Stop 7777
Attn: Manual Deposit.

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 Date 3.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code and the regulations thereunder, including whether X was otherwise a valid S corporation or whether Trust 2, Trust 3, Trust 4, Trust 9, Trust 10, and Trust 11 are valid ESBTs within the meaning of § 1361(e)(3).

The ruling contained in this letter is based on 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 requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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

Sincerely,

Robert D. Alinsky
Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures
Copy for § 6110 purposes

Cc: