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The information submitted states that X is a State corporation that elected to be treated as an S corporation effective as of Date 1. On Date 2, Trust acquired shares of X. X represents that Trust has at all times since Date 2 satisfied the requirements of an electing small business trust (ESBT) except that the trustees of Trust did not make a

timely ESBT election under §1361(e)(3). Accordingly, Trust was not an eligible S corporation shareholder as of Date 2, thereby causing X's S corporation election to terminate on Date 2.

X represents that X and its shareholders have treated X as an S corporation at all relevant times, and that Trust has received a K-1 from X for Years but that Trust did not file its returns consistent with being an ESBT.

X represents that the termination of its S corporation election was inadvertent and 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.

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)(B) provides that, for purposes of subchapter S, 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)(v) provides that, for purposes of § 1362(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) provides, in part, 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)(A) provides that an election under § 1362(a) will 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 part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (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 the 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 of such 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 termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides, in relevant part, that for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides, in part, that the Commissioner may require any adjustments that are appropriate. In general, the adjustments should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 2 due to the trustees' failure to make an ESBT election for Trust. We also conclude that the termination was inadvertent within the meaning of § 1362(f). We further hold that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 2, provided X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d).

This letter ruling is subject to the following conditions. No later than 120 days from the date of this letter: (1) an election to treat Trust as an ESBT, effective Date 2, must be made with the appropriate service center; and (2) X and each of its shareholders must file any original and amended returns for all open taxable years consistent with the relief granted in this letter. A copy of this letter should be attached to the ESBT election. If these conditions are not met, then this ruling is null and void.

Furthermore, as an adjustment under § 1362(f), no later than 45 days from the date of this letter a payment of \$n and a copy of this letter ruling must be sent to the following address:

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

If X or its shareholders fail to treat themselves as described above or if these conditions are not met, 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 above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation.

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, copies of this letter are being sent to X's authorized representative.

Sincerely,

Caroline E. Hay
Assistant to the Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes

cc: