

X was incorporated under the laws of State in Year 1 and elected to be an S corporation effective D1. On D2, shares of X were transferred to Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6 and Trust 7 (collectively, the “Trusts”). X represents that Trusts qualified to be Electing Small Business Trusts (ESBTs) within the meaning of

§ 1361(e). However, no election was made under § 1361(e)(3) to treat Trusts as ESBTs. Trusts, consequently, were ineligible shareholders and, as a result, X's S corporation election terminated on D2. X represents that the termination was 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.

Section 1361(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), 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) no 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 the 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 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 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 is a small business corporation or (B) to acquire the shareholder consents, 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 the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we conclude that the termination of X's S corporation election on D2 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 D2 and thereafter, provided X's

S corporation election was valid and provided that the election was not otherwise terminated under § 1361(d).

The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. This ruling is further contingent upon (1) the respective trustees of each of the Trusts filing an ESBT election effective D2 with the appropriate service center and (2) each of the Trusts filing amended returns for taxable years beginning D2 and thereafter consistent with the treatment of the Trusts as ESBTs. The ESBT elections and the amended returns must be filed within 60 days following the date of this letter and a copy of this letter should be attached to any such elections or returns. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on whether X was or is otherwise eligible to be treated as an S corporation or whether Trusts are eligible to be ESBTs.

This ruling is directed only to the taxpayer that requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent. Pursuant to a power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Melissa C. Liquerman
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
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cc: