

Internal Revenue Service

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Person To Contact:

Telephone Number:

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Date:
April 27, 2015

LEGEND:

X =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

Trust 11 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear

This responds to a letter dated November 25, 2014, and supplemental information, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

Facts

The information submitted states that X was incorporated under the laws of State on Date 1. X elected to be treated as an S corporation effective Date 2. On Date 3, shares of X were transferred to Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9, Trust 10, and Trust 11 (the "Grandchild Trusts"). Also, on Date 4, additional shares of X were transferred to the Grandchild Trusts. Timely elections to treat the Grandchild Trusts as Electing Small Business Trusts (ESBTs) were not made causing an inadvertent termination of X's S corporation status on Date 3. Furthermore, X's S corporation election would have terminated on Date 4 (if it had not already terminated on Date 3) due to the additional transfers of X shares to the Grandchild Trusts.

X represents that the Grandchild Trusts have at all times met requirements to be treated as ESBTs within the meaning of § 1361(e), except that the respective trustees of the Grandchild Trusts did not make a timely ESBT election under § 1361(e)(3). In addition, X represents that X and its shareholders have treated X as an S corporation at all relevant times, and that the Grandchild Trusts have been treated as ESBTs since Date 3.

X represents that the failure to file ESBT elections for the Grandchild Trusts was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Further, X and its shareholders have agreed to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 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)(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(f) provides 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 is a small business corporation; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representation made, we conclude X's S election terminated on Date 3 upon the failure to timely file ESBT elections for the Grandchild Trusts. We further conclude that the termination was inadvertent within the meaning of § 1362(f). Moreover, had X's S corporation not already terminated, it would have terminated on Date 4 when the additional shares of X were transferred to the Grandchild Trusts. Similarly, this terminating event would have been an inadvertent termination within the meaning of § 1362(f).

Accordingly, under § 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided that X's S election is valid and not otherwise terminated under § 1362(d).

This ruling is contingent on the trustees of the Grandchild Trusts filing with the appropriate service center, within 120 days from the date of this letter, elections to treat each of the Grandchild Trusts as an ESBT effective Date 3. A copy of this letter should be attached to the ESBT election.

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.

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 representatives.

Sincerely,

David R. Haglund

David R. Haglund
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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