

Internal Revenue Service

Department of the Treasury
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Date: February 27, 2007

LEGEND

X =

Trust =

D1 =

D2 =

Dear :

This responds to the letter dated August 14, 2006, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that Trust was formed on D1. On D2 and D3, shares of X, an S corporation, were transferred to Trust, an ineligible shareholder. X represents that, although Trust was eligible to elect to be an electing small business trust (ESBT) under § 1361(e), an invalid qualified subchapter S trust (QSST) election was inadvertently filed instead. Therefore, X's S election terminated on D2.

X represents that the circumstances resulting in the termination of X's election to be an S corporation were inadvertent. X represents that X and its shareholders have treated X consistent with X being an S corporation and Trust being an ESBT. X and each person who was a shareholder of X at any time since D2 agree to make such

adjustments, consistent with the treatment of X as an S corporation, as the Secretary may require.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a small business corporation cannot 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 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S corporation.

Section 1361(e)(1) provides that the term 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 paragraph (2), (3), (4), or (5) of § 170(c), 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 to be an ESBT shall be made by the trustee. Any such election shall be applied 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 1362(f) provides 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 consent, or (B) 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 the termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required 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 this subsection, 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, such

corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely upon the representations made and the information submitted, we conclude that X's S election terminated as of D2, when shares of the stock of X were transferred to Trust. We further conclude, however, that the termination was an inadvertent termination within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation as of D2, and thereafter, provided that the trustee of Trust files an ESBT election and provided that X's S election is not otherwise terminated under § 1362(d). Trust must file an ESBT election pursuant to the procedures set forth in § 1.1361-1(m)(2) effective D2, with the appropriate service center within 60 days of the date of this letter. Trust will be treated as an ESBT under § 1361(e) effective D2. A copy of this letter should be attached to the ESBT election.

X's shareholders must include their pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X to its shareholders as provided in § 1368.

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the facts described above under any other provision of the code. Specifically, no opinion is expressed concerning whether X was or is a small business corporation or whether Trust is otherwise eligible to be an ESBT.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter ruling will be sent to your authorized representatives.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

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