

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200921022**
Release Date: 5/22/2009

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:

Index Number: 1362.04-00

, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-144516-08
Date:
February 17, 2009

LEGEND

X =

Trust
1 =

Trust
2 =

Trust
3 =

State
A =

State
B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear _____ :

This letter responds to a letter from your authorized representative dated October 14, 2008, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

X was incorporated under the laws of State A on Date 1. On Date 2, Trust 1 was created under the laws of State B and was funded with stock of X. X elected to be an S corporation effective Date 3. Trust 1 made an election to be a qualified subchapter S trust (QSST) effective Date 3. X acknowledges, however, that as of Date 3, Trust 1 did not meet the qualifications of a valid QSST for purposes of being an S corporation shareholder. X represents that Trust 1 was eligible to be an electing small business trust (ESBT) within the meaning of § 1361(e), but failed to make the required election under § 1361(e)(3). Therefore, Trust 1 was an ineligible shareholder which caused X's S corporation election to be invalid.

Thereafter, on Date 4, Trust 1 was split into two trusts for the benefit of two separate beneficiaries. At this time, X's stock was transferred to Trust 2 and Trust 3. Neither Trust 2 nor Trust 3 made any elections to be treated as either QSSTs or ESBTs. X represents that at all times Trusts 2 and 3 were eligible to be ESBTs, within the meaning of § 1361(e), except for the failure to make an election under § 1361(e)(3).

X and its shareholders represent that the circumstances surrounding X's ineffective S corporation election and the trustees' failure to timely file ESBT elections for Trusts 1, 2, and 3 were inadvertent and not motivated by tax avoidance or retroactive tax planning. For all taxable years, X reported income consistently with X qualifying as an S corporation. In addition, X and its shareholders agree 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

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 shareholder 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 one class of stock.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term “electing small business trust” 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)-(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 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 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 (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 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 (A) so that the corporation for which the election was made or the termination occurred is a small business corporation, or (B) to acquire the required shareholder consents; and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 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 with respect to this period, then, notwithstanding the circumstances resulting in such ineffectiveness or 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 representations made, we conclude that X's S corporation election was ineffective beginning Date 3 because Trust 1 was an ineligible shareholder. We also conclude that the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f). In addition, to the extent X's S corporation election would have terminated on Date 4 when Trust 1 transferred X's

stock to Trusts 2 and 3, such termination was inadvertent within the meaning of § 1362(f).

Under § 1362(f), X will be treated as continuing to be an S corporation on and after Date 3, unless X's S corporation election is otherwise terminated under § 1362(d), provided that the trustee of Trust 1 and the trustee of Trusts 2 and 3 file ESBT elections with the appropriate service center within 60 days of the date of this letter to be effective Date 3 and Date 4, respectively. A copy of this letter should be attached to the ESBT elections.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

The rulings contained in this letter are based upon 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 request for rulings, it is subject to verification on examination.

Sincerely,

/s/

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for §6110 purposes

cc: