

Internal Revenue Service

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Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B1

PLR-147744-04

Date:

September 24, 2004

Legend

X =

Y =

Trust 1 =

Income Beneficiary =

Trust 2 =

Trustee =

D1 =

D2 =

D3 =

D4 =

State =

Dear _____ :

This letter responds to your letter dated December 5, 2003, requesting relief for X to be treated as continuing to be an S corporation under § 1362(f).

FACTS

X was incorporated on D1 under the laws of State. X filed an S corporation election, effective on D2. On D3, one of X's shareholders transferred X shares to Trust 1 and another of X's shareholders transferred shares to Trust 2. Because Income Beneficiary inadvertently failed to make a timely election for Trust 1 to be a Qualified Subchapter S Trust (QSST) and because Trustee inadvertently failed to make a timely election for Trust 2 to be an Electing Small Business Trust (ESBT), neither Trust 1 nor Trust 2 was an eligible S corporation shareholder when it received the X shares. Therefore, when Trust 1 and Trust 2 received the X shares on D3, X's S corporation election terminated.

On D4 Y acquired one hundred percent of X. X does not wish to be an S corporation on or after D4.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) defines an S corporation as a small business corporation for which an election under § 1362(a) is in effect. Section 1361(b)(1) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in (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)(i) provides that a trust, all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States, may be a subchapter S corporation shareholder.

Under § 1362(d)(2), an election to be an S corporation will be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides that a corporation will be treated as continuing to be an S corporation during the period specified by the Secretary if (1) an election under § 1362(a) by the corporation was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the termination was inadvertent, (3) no later than a reasonable period of time after discovery of the terminating event, steps were taken so that the corporation is once more 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 pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to that period.

CONCLUSION

Based solely on the facts submitted and the representations set forth above, we conclude that (1) X's S corporation election was terminated on D3; and (2) the termination was inadvertent within the meaning of § 1362(f). Pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D3 to D4 unless X's S corporation election otherwise terminates under § 1362(d). X must file a new Form 2553 effective D3 with the appropriate service center within sixty (60) days of this letter. A copy of this letter should be attached to the Form 2553.

In addition, we conclude that Income Beneficiary has until sixty (60) days from the date of this letter to elect to treat Trust 1 as a QSST, effective D3, and that Trustee has until sixty (60) days from the date of this letter to elect to treat Trust 2 as an ESBT, effective D3. The elections should be made with the appropriate service center. Copies of this letter should be attached to the elections.

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 regarding whether X's original election to be an S corporation was a valid election under § 1362.

These rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) provides that this letter may not be used or cited as precedent. Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

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

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

CC: