

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3-PLR-118052-01

Date:

April 2, 2002

LEGEND

Company =

Individuals =

A Trusts =

B Trusts =

PLR-118052-01

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to your letter, dated March 14, 2001, and subsequent correspondence, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that Company was incorporated on Date 1. Company's shareholders are Individuals, A Trusts, and B Trusts. Company elected to be an S corporation effective on Date 2. The trustees of A Trusts made timely Electing Small Business Trust (ESBT) elections. The trustees of B Trusts failed to make ESBT elections. In Date 3, Company learned that, due to a misunderstanding between its accountants and attorneys, its S election was invalid because the trustees of B Trusts failed to make the ESBT elections.

Company and its shareholders consent to make adjustments consistent with the treatment of Company as an S corporation and of all the trusts as ESBTs from Date 2 to the present.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code 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 1362(a)(2) provides that an election under § 1362(a) is valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1361(b)(1)(B) provides that an S 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 1361(c)(2)(A)(v) provides that an "electing small business trust" may be a shareholder in an S corporation.

Section 1361(e)(1)(A) provides that 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 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 this subsection applies to such trust.

Section 1361(e)(1)(B) provides that the term "electing small business trust" shall 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 ESBT 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.

Notice 97-12, 1997-1 C.B. 385, provides that the trustee of the ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing qualified subchapter S trust elections (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 (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 paragraph (2) or (3) of § 1362(d), (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 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 § 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 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 the representations made, we conclude that Company's S corporation election under § 1362(a) was ineffective on Date 2. We also conclude that Company's invalid election was inadvertent within the meaning of § 1362(f). Pursuant to § 1362(f), Company will be treated as an S corporation from Date 2 and thereafter, provided that Company's S election is not otherwise terminated under § 1362(d), and provided that within 60 days from the date of this letter the trustees of B Trusts file ESBT elections with an effective date of Date 2 with the appropriate service center for each of the B Trusts. A copy of this letter should be attached to the ESBT elections. Company and its shareholders must file all amended returns necessary to properly reflect the ESBT status for the B Trusts from Date 2 to the present. Moreover, Company and its shareholders must make any other adjustments necessary for the consistent treatment of Company as an S corporation.

Except as specifically set forth above, no opinion is expressed concerning the

PLR-118052-01

federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether Company qualifies as an S corporation under § 1361(a) or whether A Trusts and B Trusts qualify as ESBTs under § 1361(e).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Company and Company's second authorized representative.

Sincerely,
Jeanne M. Sullivan
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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