

# Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B02 – PLR-132348-03

Date:

March 24, 2004

## Legend

X = EIN:

A =

B = SSN:

C = SSN:

D = SSN:

E = SSN:

F = SSN:

G = SSN

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H =

SSN:

Trust 1 =

EIN:

Trust 2 =

EIN:

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Dear :

This letter responds to your letter dated January 23, 2003, together with subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on Date 1. X elected to be treated as an S corporation effective Date 2. A, B, C, D, and D and C as custodians for their children G and H signed the original Form 2553, Election by a Small Business Corporation, thereby consenting to X's S election. However, because the accountant did not know of Trust 1 and Trust 2's creation, the Form 2553 did not have the required consents from Trust 1 and Trust 2. Furthermore, Trust 1 and Trust 2 were ineligible shareholders. Therefore, X's S election was ineffective.

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X's accountant was unaware of the existence of Trust 1 and Trust 2, and consequently, income, losses, and deductions were passed through to and reported by G and H, the respective beneficiaries of Trust 1 and Trust 2.

In Year 3, A died. However, prior to A's death, A had transferred his shares to B. On Date 4, Trust 1 terminated. Currently, the shareholders of X are B, C, D, E, F, H, and Trust 2.

D, as president of X, represents that X and its shareholders since Date 2 have filed tax returns under the assumption that the S election was filed properly and effective. D, as president of X, also represents that the circumstances resulting in the ineffectiveness of X's election to be an S corporation were inadvertent and that X and X's shareholders did not intend to engage in tax avoidance or retroactive tax planning. X and X's shareholders have agreed to make any adjustments that the Secretary may require, consistent with the treatment of X as an S corporation.

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 the term "small business corporation" is a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2) or an organization described in § 1361(c)(6)) who is not an individual.

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.

Based solely on the facts and representations submitted, we conclude that X's S corporation election was ineffective because X had ineligible shareholders and failed to acquire the necessary consents at the time of the election. We also conclude that the

ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f). Accordingly, we hold that under the provisions of § 1362(f), X will be treated

as an S corporation effective Date 2, and thereafter, provided that X's S election was not otherwise invalid or terminated under § 1362(d). In addition, Trust 1 and Trust 2 will be treated as ESBT's under 1361(e), effective Date 3, and thereafter; Trust 1 and Trust 2 and their respective beneficiaries must amend and/or file returns, as appropriate, consistent with Trust 1 and Trust 2 being ESBTs for Year 2, Year 3, Year 4, and thereafter.

This ruling is contingent on X and all of its shareholders treating X as having been an S corporation for the period beginning Date 2, and thereafter. Accordingly, all of the shareholders of X, in determining their respective income tax liabilities for the period beginning Date 2, and thereafter, must include their pro rata share of the separately stated and non-separately computed items of X as provided in §1366, make any adjustments to basis provided in §1367, and take into account any distributions made by X as provided in §1368. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

This ruling is contingent on Trust 1 and Trust 2 filing ESBT elections pursuant to the procedures set forth in § 1.1361-1(m)(2), effective Date 3, with the appropriate Service Center within 60 days of this letter. Also, Trust 1 and Trust 2 must file consents with the appropriate Service Center within 60 days of this letter, indicating that the consents are to be associated with the originally filed Form 2553. A copy of this letter should be attached to Trust 1 and Trust 2's consents and the ESBT elections. Copies of the letter have been provided for this purpose.

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation or whether Trust 1 or Trust 2 are eligible to elect to be treated as an ESBTs.

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.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X.

Sincerely,

J. Thomas Hines  
Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: (3)  
2 Copies of this letter  
Copy for § 6110 purposes