

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

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Date:

February 2, 2004

X =

A =

Trust =

D1 =

Dear :

This letter responds to a letter dated October 20, 2003, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was formed D1. Effective D1, X elected to be an S corporation. On D1, Trust was the sole shareholder of X. However, Trust was an ineligible shareholder and therefore, X's election to be an S corporation was invalid. A, the president of X, represents that Trust was qualified to be an electing small business trust ("ESBT") effective D1. However, the trustee of Trust inadvertently failed to make an ESBT election effective D1. A represents that X filed Form 1120S, U.S. Income Tax Return for an S corporation, for all the years involved in this request.

A represents that the circumstances resulting in X's invalid election to be an S corporation were inadvertent. A represents also that X and its shareholder did not intend to engage in tax avoidance or retroactive tax planning. X and its shareholder agree to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

PLR-161493-03

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

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)(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 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, or (III) an organization described in paragraph (2), (3), (4), (5) of § 170(c), (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) 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 section 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 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.

In Notice 97-12, 1997-1 C.B. 385, the Service provided guidance regarding ESBT elections. In particular, the notice provided that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in regulation § 1.1361-1(j)(6)(iii) for filing QSST 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), in relevant part, 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 section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of section 1362(d); (2) the Secretary determines

PLR-161493-03

that the circumstances resulting in such ineffectiveness or termination was inadvertent, (3) no later than a reasonable period of time after discovery of the event 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 section 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 the period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Based solely on the information submitted, and the representations made, we conclude that X's S corporation election was an inadvertent invalid election within the meaning of § 1362(f). Pursuant to the provisions of 1362(f), X will be treated as an S corporation effective D1 and thereafter, provided that X's election to be an S corporation was not otherwise invalid and not terminated under § 1362(d). Trust will be treated as the shareholder of X effective D1. Trust will be treated as an ESBT under § 1361(e), effective D1.

X's shareholder must include its 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 shareholder as provided in 1368. If X or X's shareholder fail to treat X as described above, this ruling will be null and void.

These rulings are conditioned on X, within 60 days of the date of this letter, filing a new Form 2553 with the appropriate Service Center with an effective date of D1. An ESBT election for Trust pursuant to the procedures set forth in Notice 97-12 must be filed, effective D1, with the appropriate Service Center within 60 days of the date of this letter. A copy of this letter should be attached to the new Form 2553 and the ESBT election.

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, including whether X was otherwise eligible to be an S corporation, and whether Trust was a valid ESBT.

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

PLR-161493-03

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

Carolyn Hinchman Gray  
Senior Counsel, Branch 2  
Office of Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes