

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

ID No.

Telephone Number:

Refer Reply To:

CC:PSI:2 – PLR-135653-07

Date:

July 01, 2008

X =

Trust 1 =

Trust 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Dear :

This responds to a letter dated June 13, 2007, and subsequent correspondence, written on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated and made an election to be treated as an S corporation effective Date 1. On Date 2, shares of X stock were transferred to Trust 1 and Trust 2. Each of Trust 1 and Trust 2 is represented as being eligible to be an electing small business trust (ESBT) as of Date 2. However, the trustees of Trust 1 and Trust 2 failed to make ESBT elections for the trusts. Therefore, X's S corporation election terminated on Date 2, when Trust 1 and Trust 2 became shareholders. This was not discovered until Date 3.

X represents that the failure to file the ESBT elections for Trust 1 and Trust 2, and the consequent termination of X's election to be an S corporation, was inadvertent, unintended, and not the result of tax avoidance or retroactive tax planning. X further

represents that, since Date 2, X and each person who is or was a shareholder of X have filed their income tax returns consistent with the treatment of X as an S corporation and consistent with the treatment of Trust 1 and Trust 2 as ESBTs.

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 for purposes of subchapter S, 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 ESBT is a permitted shareholder of a small business corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever (at any time on or after the 1<sup>st</sup> day of the 1<sup>st</sup> taxable year for which a corporation is an S corporation) such corporation ceases to be a small business 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 paragraphs (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 § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1351(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(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 (B) was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken so that the corporation is 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 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 the ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides that the trustee of the trust must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1361-1(m)(2)(ii).

Based solely on the representations made and the information submitted, we conclude that X's S election terminated on Date 2, when shares of the stock of X were transferred to Trust 1 and Trust 2. We further conclude, however, that the termination was an inadvertent termination within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation as of Date 2, and thereafter, provided that the trustees of Trust 1 and Trust 2 file ESBT elections for the trusts and provided that X's S election is not otherwise terminated under § 1362(d). The trustees of Trust 1 and Trust 2 must file ESBT elections pursuant to the procedures set forth in § 1.1361-1(m)(2), with the appropriate service center within 60 days of the date of this letter. A copy of this letter should be attached to the ESBT elections.

Except as specifically ruled upon above, no opinion is expressed as to the federal tax consequences of the facts of the facts described above under any other provision of the Code. In particular, no opinion is expressed or implied concerning whether X was or is a small business corporation, or whether Trust 1 and/or Trust 2 are eligible ESBTs under § 1361(e).

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 forwarded to X's authorized representative.

Sincerely,

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