

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

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Refer Reply To:

CC:PSI:2 - PLR-100015-01

Date:

April 24, 2001

X =

A =

D1 =

D2 =

D3 =

Year 1 =

x =

Trust =

Dear :

This letter responds to a letter dated December 15, 2000, and subsequent correspondence, submitted by X's authorized representative on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1. A, the president of X, represents that X became an S corporation for federal income tax purposes effective for its taxable year beginning D2.

Prior to D3 of Year 1, all of the stock of X was owned by individuals. On D3 of Year 1, X issued x shares of stock to Trust. A represents that Trust met the requirements to be treated as an electing small business trust (ESBT), other than the requirement that a proper election to be treated as an ESBT be timely filed.

The trustees of Trust failed to timely file an election for Trust to be treated as an ESBT with X's Internal Revenue service

center. The trustees of Trust were apparently unaware of the need to file an election for Trust to be treated as an ESBT. Subsequently, while reviewing X's tax return, X's legal advisers discovered that the trustees of Trust had failed to file an election for Trust to be treated as an ESBT and that X's S corporation election had terminated on D3 of Year 1.

A represents that the termination of its election to be taxed as an S corporation was inadvertent and was not motivated by tax avoidance intent.

X and its shareholders consent to adjustments consistent with the treatment of X as an S corporation. A represents that X and its shareholders have treated X as an S corporation and the Trust as an ESBT, and have reported all of X's income consistent with this treatment.

Section 1362(a) of the Code 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 the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not 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, for purposes of § 1361(b)(1)(B), an electing small business trust may be a shareholder.

Section 1361(e)(1) provides, in general, 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 § 1361(e)(1) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e)(1) 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 in part that the trustee of the ESBT must make the ESBT election pursuant to § 1361(e)(3) by signing and filing a statement with the service center with which the corporation files its income tax return. The trustee of the ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) of the Income Tax Regulations for filing qualified subchapter S trust (QSST) elections (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1.1361-1(j)(6)(iii)(A) provides, in part, that if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) shall be effective on and after the date of cessation.

Section 1362(f) of the Code 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 submitted, and the representations made, we conclude that the termination of X's S corporation election occurred on D3 of Year 1. We further conclude that the termination was an "inadvertent termination" within the meaning of § 1362(f).

We further hold that under the provisions of § 1362(f) of the Code, X will be treated as continuing to be an S corporation from D2 of Year 1, and thereafter, provided that X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d). During the period beginning D3 of Year 1, Trust will be treated as a trust described in § 1361(e). The shareholders of X must, in determining their federal income tax liabilities, report their 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 as provided in § 1368. This ruling is further conditioned on Trust making an election described in § 1361(e)(3) that is effective within 60 days following the date of this letter. A copy of this letter should be attached to the election. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

Except as ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express no opinion as to whether X is otherwise qualified to be an S corporation or whether Trust meets the requirements to elect to be treated as an ESBT.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) 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 representatives.

Sincerely yours,

JEANNE M. SULLIVAN
Acting Senior Technician
Reviewer, Branch 2
Office of the Associate
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of a letter
Copy for § 6110 purposes