

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

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Date:
June 8, 2001

X =
A =
Trusts =

D1 =
D2 =
D3 =
D4 =
D5 =

Dear :

This letter responds to a letter, dated March 21, 2001, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1 and elected to be an S corporation effective on D2. On D3, A created the Trusts and transferred nine shares of X stock to each of the Trusts. On D4, A transferred an additional nine shares of X stock to each of the Trusts. The trustees of Trusts failed to make Electing Small Business Trust (ESBT) elections within two and one-half months of the transfers to qualify as shareholders of X. A was unaware that the failure to file ESBT elections terminated X's S election. On D5, it was discovered that transfers of X stock to the Trusts terminated X's S election.

A represents that for the period from D3 and thereafter, X treated the Trusts as shareholders of X. A further represents that neither X nor any of its shareholders engaged in tax avoidance or retroactive tax planning and that X intended to maintain its status as an S corporation at all times. X and its shareholders consent to make adjustments consistent with the treatment of X as an S corporation.

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 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 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 (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(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) 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 X's S corporation election under § 1362(a) was terminated on D3 when the Trusts acquired X stock. We also conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). Pursuant to § 1362(f), X will be treated as continuing to be an S corporation from D3, until the effective date of the ESBT elections for the Trusts, provided that X's S election is not otherwise terminated under § 1362(d), and, provided further, that the trustees file ESBT elections for the Trusts that are effective within 60 days of the date of this letter. A copy of this letter should be attached to the elections.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X qualifies as an S corporation § 1361(a) or whether the Trusts qualify as 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.

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

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