

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:1-PLR-109829-03

Date:

Aug 15 2003

Legend:

X =

A =

B =

C =

D =

Trust1 =

Trust2 =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

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D6 =
D7 =
Y1 =
Y2 =
Y3 =
a =
b =
c =
d =
e =
f = 12,796

Dear

This responds to your letter dated February 6, 2003, requesting relief under § 1362(f) of the Internal Revenue Code on behalf of X and an extension of time under § 301.9100-03 of the Procedure and Administration Regulations to make an Electing Small Business Trust (ESBT) election for Trust1.

Facts

According to the information submitted, X was incorporated in State on D1. X made an S election effective D2. On D4, A and B, two of the shareholders of X, created Trust1 for the benefit of their daughter C, C's issue, and the settlers' issue and Trust2 for the benefit of their son D, D's issue, and the settlers' issue.

Prior to the creation of Trust1 and Trust2, A and B each owned a shares of X stock. On D4, A and B each contributed b shares of X stock to each trust and, consequently, each trust owned c shares. On D5, D died. Pursuant to the terms of Trust2, Trust2 was liquidated and the c shares of X stock owned by Trust2 were contributed to Trust1. A and B each contributed to Trust1 d shares on D6 and an additional e shares on D7. Trust1 currently holds f shares of X stock.

For the taxable years from Y1 to Y2, Trust2 was incorrectly treated as a grantor trust with D as grantor and, consequently, D reported the income of Trust2 on his personal tax returns for the relevant years. For the taxable years from Y1 to Y3, Trust1 was incorrectly treated as a grantor trust with C as grantor and, consequently, C

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reported the income of Trust1 on her personal tax returns for the relevant years.

X recently discovered that Trust1 and Trust2 both did not qualify as grantor trusts and that ESBT elections had not been made for the trusts. Within a reasonable time after the discovery of its mistakes, X submitted this ruling request to correct the mistakes.

It is represented that at all relevant times, X and its shareholders treated X as an S corporation and filed all tax returns consistent with the treatment of X as an S corporation.

X and its shareholders have agreed to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

Law and Analysis

Section 1361(a)(1) defines an “S corporation” as a small business corporation for which an election under § 1362(a) is in effect.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible corporation which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate and other than a trust described in subsection (c)(2)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), trusts that may be shareholders include an electing small business trust.

Section 1361(e)(1)(A) provides that an “electing small business trust” means any trust if (i) such trust does not have as a beneficiary any person other than an (I) individual, (II) an estate, or (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 1.1361-1(m)(2)(i) of the Income Tax Regulations provides in part 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 paragraph (m)(2)(ii) of this section.

Under § 1.1361-1(m)(2)(iii), if S corporation stock is transferred to a trust, the ESBT election must be made within the 16-day-and-2-month period beginning on the

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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 the corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the 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 of inadvertent termination of the S election, 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 termination, the corporation is treated as an S corporation during the period specified by the Secretary.

The committee reports accompanying the Subchapter S Revision Act of 1982 explains § 1362(f) as follows:

If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and the shareholders agree to be treated as if the election had been in effect for such period.

The Committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers. ... It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24; H.R. Rep. No. 826, 97th Cong. 2d Sess. 12 (1982), 1982-2 C.B. 730, 735.

Under § 301.9100-1(c), the Commissioner may grant a reasonable extension of time to make a regulatory election, or a statutory election (but no more than six months except in the case of a taxpayer who is abroad), under all subtitles of the Code, except subtitles E, G, H, and I. Section 301.9100-1(b) defines the term "regulatory election" as

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including an election whose deadline is prescribed by a regulation published in the Internal Revenue Bulletin.

Sections 301.9100-1 through 301.9100-3 provide the standards that the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-1(a).

Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government. Section 301.9100-3(a).

Conclusion

Based solely on the facts submitted and the representation made, we conclude that the requirements of §§ 301.9100-1 and 301.9100-3 have been satisfied. Therefore, the trustee of Trust1 is granted an extension of time of 60 days from the date of this letter to file an ESBT election for Trust1, effective as of D3, with the appropriate service center. A copy of this letter should be attached to the election.

We also conclude that X's election to be treated as an S corporation terminated on D4. We further conclude that the termination constituted an "inadvertent termination" within the meaning of § 1362(f). Under the provisions of § 1362(f) and contingent on the filing of the ESBT election for Trust1, X will be treated as continuing to be an S corporation from D4, and thereafter, provided that X's S election is not otherwise terminated under §1362(d).

Except as provided herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is an S corporation for federal tax purposes, or whether Trust1 is an ESBT under § 1361(e)(1)(A).

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

Sincerely,

Heather C. Maloy
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures:

Copy of this letter, Copy for § 6110 purposes