

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-122396-05

Date:

November 1, 2005

Legend

X:

A:

Trust 1:

Trust 2:

Trust 3:

Trust 4:

Trust 5:

Trust 6:

Date 1:

Dear _____ :

This responds to a letter dated March 25, 2005, and subsequent correspondence submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was formed on Date 1. Effective Date 1, X elected to be an S corporation. On Date 1, Trust 1, Trust 2, Trust 3, Trust 4, Trust 5 and Trust 6 (collectively the Trusts) were shareholders of X. However, the Trusts were ineligible shareholders and therefore, X's election to be an S corporation was ineffective. A, the president of X, represents that the Trusts were qualified to be electing small business trusts ("ESBTs") effective Date 1. However, the trustees of the Trusts failed to make ESBT elections effective Date 1.

X represents that X and its shareholders did not intend to engage in tax avoidance or retroactive tax planning. X represents that the circumstances resulting in the ineffectiveness of X's election to be an S corporation were inadvertent. X represents that since Date 1, X and its shareholders have filed federal income tax returns consistent with X's S corporation election. X and each person who was or is a shareholder of X at anytime since Date 1, agree to make such adjustments, consistent with the treatment of X as an S corporation that the Secretary may require.

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 an S 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, (III) an organization described in paragraph (2), (3), (4), (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)(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.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation 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, (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, 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 in such 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, such corporation shall be treated as 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 ineffective on Date 1, because X had ineligible shareholders. We also conclude that the election was inadvertently invalid under § 1362(f). Therefore, under § 1362(f), X will be treated as being an S corporation from Date 1, and thereafter, provided that the Trustee of the Trusts files ESBT elections, pursuant to the procedures set forth in § 1.1361-1(m)(2) effective Date 1, with the appropriate service center within 60 days of the date of this letter. The Trusts must also amend their federal income tax returns consistent with being ESBTs and partial § 678(a) trusts. The Trusts will be treated as ESBTs under § 1361(e) and as shareholders of X effective Date 1. A copy of this letter should be attached to the ESBT elections.

X's shareholders must include 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 to its shareholders as provided in § 1368.

These rulings are conditioned upon the Trusts filing ESBT elections effective Date 1 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. If X or X's shareholders fail to treat X as described above, this ruling will be null and void.

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 was or is a small business corporation or whether the Trusts are otherwise eligible to be ESBTs.

This ruling is directed only to the taxpayer requesting 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 sent to X's authorized representative.

Sincerely,

Audrey W. Ellis
Senior Counsel, Branch 1
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: