

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:3-PLR-157649-01

Date:

April 4, 2002

Legend

P =

Q =

Individuals =

Trusts =

State =

Date 1 =

Dear :

This letter responds to a letter dated October 16, 2001, and subsequent correspondence, requesting rulings under § 301.9100 of the Procedure and Administration Regulations and under § 1362(f) for an inadvertently invalid S election.

### Facts

On Date 1, Individuals and Trusts transferred all of the stock in Q, an S corporation, to P, a business trust under the laws of State. No entity election was made for P, nor was a QSub election made for Q. The S election filed for P and QSST elections filed for Trusts were ineffective. It is represented that failure to file effective elections was inadvertent.

### Law

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) may elect its classification for federal tax purposes as provided in this section. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership.

Section 301.7701-3(b)(1)(i) provides in general that, unless it elects otherwise, a domestic eligible entity with two or more members is a partnership.

Section 301.7701-3(c)(1)(i) provides in general that an eligible entity may elect to be classified other than as provided under § 301.7701-3(b) by filing Form 8832, Entity Classification Election, with the applicable service center.

Section 301.7701-3(c)(1)(iii) provides that an election made under § 301.7701-3(c)(1)(i) will be effective on the date specified by the entity on Form 8832 or on the date filed if no such date is specified on the election form. The effective date specified on Form 8832 cannot be more than 75 days prior to the date on which the election is filed and cannot be more than 12 months after the date on which the election is filed.

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 Internal Revenue Code, except subtitles E, G, H, and I.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make a regulatory 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.

Section 301.9100-3(a) provides that 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 1362(a) 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), as in effect for taxable years beginning on or before December 31, 1997, provided that a "small business corporation" cannot have as a shareholder a person (other than an estate, and other than a trust described in § 1361(c)(2)) who is not an individual.

Section 1361(b)(3)(B) provides that a qualified subchapter S subsidiary (QSub) means any domestic corporation which is not an ineligible corporation if 100 percent of the stock of such corporation is held by the S corporation and the S corporation elects to treat such corporation as a QSub. If a valid QSub election is made, the subsidiary is not treated as a separate corporation, and all assets, liabilities, and items of income, deduction, and credit of the QSub are treated as assets, liabilities, and items of income, deduction, and credit of the parent S corporation. Section 1361(b)(3)(A).

A taxpayer makes a QSub election with respect to a subsidiary by filing a Form 8869, Qualified Subchapter S Subsidiary Election, with the appropriate service center. Section 1.1361-3(a)(4) of the Income Tax Regulations provides that the election will be effective on the date specified on the election form or on the date the election is filed if no date is specified. The effective date specified on the election cannot be more than two months and 15 days prior to the date of filing and cannot be more than 12 months after the filing date.

Section 1361(b)(3)(A) provides that, except as provided in regulations, (i) a corporation which is a QSub shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1.1361-4(a) states that the separate existence of a QSub is ignored for federal tax purposes. Thus, a corporation which is a QSub shall not be treated as a separate corporation and all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and items of income, deduction, and credit of the S corporation.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that in the case of a qualified subchapter S trust (QSST) with respect to which a beneficiary makes an election under § 1361(d)(2), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation is 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 was terminated under § 1362(d)(2) or (3)), (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 so that the corporation is a small business corporation, or to acquire the required shareholder consents, (4) and the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

### Conclusion

Based on the facts submitted and representations made, we conclude that P's S election was invalid and that the circumstances which caused the election to be invalid were inadvertent. Thus, under the provisions of § 1362(f), P will be treated as an S corporation from Date 1 and thereafter provided the requirements specified in this letter are satisfied. First, the beneficiaries of Trusts must file QSST elections effective within 60 days of the date of this letter, and the other requirements specified in

this paragraph are satisfied. Second, we conclude that the requirements of §§ 301.9100-1 and 301.9100-3 have been satisfied and P is granted an extension of time of 90 days from the date of this letter to file a Form 8832, Entity Classification Election, to elect corporate status for P and a Form 8869, Qualified Subchapter S Subsidiary Election, for Q with effective dates of Date 1. Copies of this letter should be appended to the elections.

During the period from Date 1 until the elections are effective as specified above, P will be treated as an S corporation and Q will be treated as a QSub, Trusts will be treated as if they were QSSTs described in § 1361(c)(2)(A)(i), and the respective beneficiaries of the Trusts will be treated, for purposes of § 678, as the owners of that portion of the respective trusts that consists of P's stock. Accordingly, the shareholders of P must include their pro rata share of the separately and nonseparately computed items of P under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by P to shareholders under § 1368. If P, the Trusts, and other shareholders of P fail to treat P as described above, this ruling will be null and void.

Except for the conclusions above, no opinion is expressed or implied concerning the federal income tax consequences under any other provision of the Internal Revenue Code. In particular, no opinion is expressed as to whether P is otherwise qualified to be an S corporation, Q is otherwise qualified to be a QSub, or Trusts are otherwise qualified to be QSSTs.

Pursuant to your request, we are sending a copy of this letter by facsimile transmission.

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.

Sincerely,  
Paul F. Kugler  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (3):  
Copy for § 6110 purposes  
Copies of this letter (2)