

**Internal Revenue Service**

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

In Re:

Refer Reply To:

CC:PSI:BR01

PLR-162753-04

Date:

March 23, 2005

Legend:

X =

Y =

Z =

Trust 1 =

Trust 2 =

Trust 3 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This letter is in response to your letter, dated November 22, 2004, on behalf of X, seeking relief from an inadvertent invalid under §1362(f) of the Internal Revenue Code to file an election, on behalf of X, to be treated as an S corporation and to treat Y and Z as qualified subchapter S corporations (QSubs). In addition, your letter also is seeking relief allowing Trust 1, Trust 2, and Trust 3 to file late elections to be treated as small business trusts (ESBTs).

### Facts

Based on the information submitted and representations made therein, we understand the relevant facts to be as follows. X was incorporated on Date 1 in accordance with the laws of State. On Date 2, X filed a Form 2553 to be treated as an S corporation, effective Date 3. Among the various shareholders of X, were Trust 1, Trust 2, and Trust 3. Each trust inadvertently failed to file a complete and valid election to be treated as an ESBT by Date 4, in order to be effective Date 3. Thus, on Date 3, Trust 1, Trust 2, and Trust 3 were ineligible shareholders and therefore, X's S corporation election was ineffective. Also on Date 3, Y was a wholly-owned subsidiary of X and Z was a wholly-owned subsidiary of Y. On Date 4, elections were filed to treat both Y and Z as qualified subchapter S subsidiaries (QSubs), effective Date 3, under the belief that X had a valid S corporation election in place.

X represents that it and its individual shareholders have reported their income consistent with X's S corporation status beginning on Date 3. In addition, Trust 1, Trust 2, and Trust 3 represent that they have reported income received from X consistent with each trust being an ESBT. X, Trust 1, Trust 2, and Trust 3 represent that the failure to file a complete ESBT election for each trust was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X, Y and Z represent that the granting of relief to file a late election will not prejudice the interests of the government and is not based on hindsight. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

### Law and Analysis

Section 1362(a) provides that, except as provided in section 1362(g), a small business corporation may elect, in accordance with the provisions of section 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 section 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 shareholders (other than an estate, a trust described in section 1361(c)(2), or a organization described in section 1361(c)(6)) who is not an individual.

Section 1361(b)(3)(B) provides that the term “qualified subchapter S subsidiary” means any domestic corporation which is not an ineligible corporation, if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

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 section 170(c), or (IV) an organization described in section 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 section 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 section 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 section 664(d)).

Section 1361(e)(3) provides that an election under section 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.

In Notice 97-12, 1997-1 C.B. 385, the Service provided guidance regarding ESBT elections. In particular, the Notice provided that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in regulation section 1.1361-1(j)(6)(iii) for filing 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(f) provides that if (1) an election under section 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of

section 1361(b) or to obtain shareholder consents, or (B) was terminated under section 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 (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 the corporation at any time during the period specified pursuant to section 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

### Conclusion

Based solely on the representations made and the information submitted, we conclude that X's S corporation election was inadvertently invalid on Date X, under section 1362(f), because the trustees of Trust 1, Trust 2, and Trust 3 failed to timely file the complete required ESBT elections under section 1361(e)(3). Therefore, X should be treated as an S corporation from Date 3 and thereafter, provided that, apart from the inadvertent invalid election ruling, X's S election was otherwise valid and has not otherwise terminated under §1362(d)(2). This ruling is contingent on all of X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, including their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and non-separately stated computed items of income and loss of X as provided in section 1366, making any adjustments to basis provided in section 1367, and taking into account any distributions made by X as provided in section 1368.

Additionally, from Date 3 and thereafter, Trust 1, Trust 2, and Trust 3 will be treated as the shareholders of X, and Trust 1, Trust 2, and Trust 3 will be treated as ESBTs under section 1361(e), effective Date 3 and thereafter, provided that the trustee filed an ESBT election effective Date 3 for each of Trust 1, Trust 2, and Trust 3 with the appropriate service center within 60 days following the date of this letter. If Trust 1, Trust 2, Trust 3, X, or X's shareholders fail to treat X as described above, the ruling shall be null and void. A copy of this letter should be attached to each ESBT election.

Finally, we conclude that X's inadvertent invalid S election does not affect the status of Y and Z as Qualified subchapter S subsidiaries (QSubs). Thus, Y and Z should be treated as QSubs effective Date 3.

Except as specifically ruled above, we express no opinion concerning the Federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed on: (1) Whether X is otherwise eligible to be treated as an S corporation; (2) Whether Trust 1, Trust 2, or

Trust 3 are eligible ESBTs under section 1361(e); (3) Whether the reorganization qualified as a tax-free split-off under § 355; and (4) Whether Y and Z qualify as a qualified subchapter S subsidiary under § 1361(b)(3) .

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

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

/s/ David R. Haglund

David R. Haglund  
Senior Technician Reviewer, Branch 1  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for section 6110 purposes

cc: