

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:1
PLR-121676-05

Date:
June 21, 2005

Legend

X =

State =

D1 =

D2 =

Trust =

A =

Dear :

This responds to a letter dated April 15, 2005, together with subsequent correspondence, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated on D1 under the laws of State. X elected to be an S corporation effective D2. Among X's shareholders is Trust. Due to an administrative oversight, Trust failed to timely make an Electing Small Business Trust (ESBT) election. Accordingly, Trust was not a permissible S corporation shareholder, and therefore X's S corporation election was invalid.

The trustees of X and its shareholders represent that they filed Form 1120S consistent with S corporation status for all years involved. However, X and A, the beneficiary of Trust, erroneously filed their returns as if A were a direct shareholder in X. Finally, X, all of its shareholders, and A consent to make adjustments consistent with the treatment of X as an S corporation and Trust as an ESBT from D2 to present.

LAW AND ANALYSIS

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 1362(a)(2) provides that an election under section 1362(a) is valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

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 section 1361(c)(2), or an organization described in section 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), or (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 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 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 ESBT 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.

Section 1362(f) provides in relevant part that if (1) an election under section 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to subsection (b)(2)) by reason of a failure to meet the requirements of section 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 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, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely upon the facts submitted and the representations made, we conclude that X's subchapter S corporation election on D2 was an inadvertent invalid election within the meaning of section 1362(f). Pursuant to section 1362(f), X will be treated as continuing to be an S corporation from D2 and thereafter, provided that the beneficiary of Trust files an ESBT election with the appropriate service center, effective D2, within 60 days of the date of this ruling. A copy of this letter must be attached to the ESBT election.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed on whether X qualifies to be an S corporation or whether Trust is an ESBT within the meaning of section 1361(c)(2)(A)(v).

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

/s/ Dianna K. Miosi

Dianna K. Miosi
Branch Chief, Branch 1
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes