

## 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:B01  
PLR-166090-04

Date:  
February 10, 2005

### Legend

X =

State =

Trust =

D1 =

D2 =

D3 =

Dear :

This responds to a letter dated December 17, 2004, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

### FACTS

According to the information submitted, X was incorporated on D1 pursuant to the laws of State. X elected to be an S corporation effective on D2. Among X's shareholders is Trust. The trustees of 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. In D3, X learned that its S election was invalid because the trustees of Trust failed to timely make the ESBT election.

The trustees of Trust and X represent that Trust is qualified to make an ESBT election, and will make the election if X is granted relief for the inadvertent invalid election. X and its shareholders also represent that they filed Form 1120S, consistent with S corporation status, for all years involved in this request. Finally, X and all of its shareholders 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 § 1362(a) is in effect for such year. Section 1362(a)(2) provides that an election under § 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 § 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), 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 1361(e)(1)(B) provides that the term “electing small business trust” shall not include (i) any qualified subchapter S trust (as defined in § 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 ESBT 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 in relevant part 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 subsection (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 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 set forth above, we conclude that X's subchapter S corporation election on D2 was an inadvertent invalid election within the meaning of § 1362(f). Pursuant to § 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, with a D2 effective date, within 60 days of the date of this ruling. A copy of this letter must be attached to the ESBT election.

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 on whether X qualifies to be an S corporation or whether Trust is an ESBT within the meaning of § 1361(c)(2)(A)(v).

This ruling is directed only to the taxpayer that requested 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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Dianna K. Miosi  
Chief, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

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