

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200734011**

Release Date: 8/24/2007

Index Number: 1362.00-00, 1362.02-00,
1362.02-02, 1362.04-00,
1361.03-03

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-132720-06

Date:
May 22, 2007

X =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

A =

B =

C =

D =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Year =

a =

b =

c =

d =

e =

Dear :

We received the letter dated June 20, 2006, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code. This letter responds to that request.

FACTS

X was incorporated under the laws of State on Date 1. X elected to be treated as an S corporation effective Date 2. On Date 2, X had three shareholders: Trust 1, Trust 2, and Trust 3. X represents that Trust 2 and Trust 3 each made timely elections to be treated as an Electing Small Business Trust (ESBT) under § 1361(c)(2)(A)(v). X further represents that Trust 1 was a revocable trust during the life of A, and therefore qualified to be an S corporation shareholder under § 1361(c)(2)(i).

A and B were husband and wife, and died on Date 3 and Date 4, respectively. B died before the estate of A closed.

On Date 5, Trust 1 transferred a shares of X stock to Trust 4. Trust 4 failed to make a timely election to be treated as an ESBT. On Date 6, Trust 1 made the following

transfers of X stock: b shares to C, c shares to D, d shares to Trust 5, and an additional e shares to Trust 4.

During the preparation of Trust 5's Year income tax return, Trust 5's accountant discovered that Trust 5 had failed to make a timely election to be treated as an ESBT. Further investigation by Trust 5's accountant revealed that Trust 4 had also failed to make a timely election to be treated as an ESBT. Trust 5's accountant is currently seeking § 1362(f) relief for X and Trust 5 under Revenue Procedure 2003-43.

X represents that X issued Forms K-1 to Trust 4 for the taxable years beginning Date 5, and for all subsequent years. X further represents that Trust 4 reported and paid any tax attributable to X stock that it held. X also represents that each potential current beneficiary of Trust 4 is an eligible shareholder under § 1361(b).

X represents that X and its shareholders have at all times intended X to be an S corporation since its election on Date 2, and that X and its shareholders have treated themselves consistent with S corporation status. X further represents that the failure of the trusts to file timely ESBT elections was not motivated by tax avoidance or retroactive tax planning. In addition, X represents that, other than the failure to file ESBT elections for Trust 4 and Trust 5, X has met the definition of an S corporation under § 1361(a)(1). X and all of its shareholders consent and agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary under § 1362(f).

LAW

Section 1361(a) 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) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

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 this chapter) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), an electing small business trust may be a shareholder of an S corporation.

Section 1361(c)(2)(B)(v) provides that, for purposes of § 1361(b)(1), in the case of an electing small business trust, each potential current beneficiary of such trust shall be treated as a shareholder; except that, if for any period there is no potential current beneficiary of such trust, such trust shall be treated as the shareholder during such period.

Section 1361(e)(1)(A) provides that except as provided in § 1361(e)(1)(B), 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 1362(a)(1) provides, in general, 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 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a), 1361(b)(3)(B)(ii), or § 1361(c)(1)(A)(ii) by any corporation (A) 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, or (B) was terminated under § 1362(d)(2) or § 1362(d)(3), § 1361(b)(3)(C), or § 1361(c)(1)(D)(iii), (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 for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) 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 or a qualified subchapter S subsidiary, as the case may be during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that, for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's S corporation election terminated on Date 5 when Trust 1 transferred shares in X to Trust 4, and Trust 4 failed to make a timely ESBT election. We also conclude that Trust 1 transferred shares in X to an ineligible S corporation shareholder on Date 6 when it transferred shares to Trust 5, and Trust 5 failed to make a timely ESBT election. Finally, we conclude that the terminations were inadvertent within the meaning of § 1362(f). Consequently, we conclude that X will continue to be treated as an S corporation from Date 5 and thereafter, provided that X's S corporation election was valid and was not, except for the event described on Date 6, otherwise terminated.

This ruling is contingent on Trust 4 and Trust 5 filing the appropriate ESBT elections within 60 days of the date of this letter, and X's S corporation election not being otherwise terminated under § 1362(d). A copy of this letter should be attached to the elections.

Except for the specific rulings above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied as to whether X otherwise qualifies as a subchapter S corporation under § 1361. In addition, no opinion is expressed as to whether Trust 4 and Trust 5 qualify as ESBTs.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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.

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,

/s/

Leslie H. Finlow
Senior Technician Reviewer,
Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes