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Department of the Treasury

Washington, DC 20224

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Date: December 3, 2008

Legend

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

State =

A =

B =

C =

Dear :

This letter responds to the letter dated May 30, 2008, and subsequent correspondence, requesting a ruling that X be given an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to elect to be treated as an association taxable as a corporation for federal tax purposes and to be granted relief under § 1362(f) of the Internal Revenue Code.

Facts

According to the information submitted and representations therein, X elected to be taxed as an S corporation for federal tax purposes, effective Date 1. On Date 2 and Date 3, X entered into a series of restructurings, one of which included the formation of a State limited partnership, that were intended to qualify as reorganizations under § 368(a)(1)(F). However, due to inadvertence, no Form 8832, Entity Classification Election, was timely filed for X.

On Date 4, A transferred interests in X to Trust 1 and Trust 2, which are represented as having been wholly-owned grantor trusts under § 671 with respect to A. A died on Date 5. Nevertheless, Trust 1 and Trust 2 continued to qualify as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) for the 2-year period beginning on the day of the deemed owner's death and ending on Date 6. Because no election was made to treat Trust 1 and Trust 2 as an Electing Small Business Trust (ESBT), X's S corporation election would have terminated on Date 6.

Effective Date 7, B, a shareholder of X, intended to transfer interests in X to Trust 1 and Trust 3. However, B inadvertently transferred the interests intended for Trust 3 to Trust 4. On Date 8, documents were executed to treat the transfer on Date 7 as a transfer from B to Trust 3, rather than Trust 4.

On Date 9, Trust 6 acquired shares in X. Because no election was timely made to treat Trust 6 as an ESBT, X's S corporation election would have terminated on Date 9.

Also on Date 7, Trust 5 acquired shares in X from C.

The trust agreements for Trust 1, Trust 2, Trust 3, and Trust 5 provided that the grantor of the respective trust had the power to reacquire assets of the trust by substituting property of equivalent value. Pursuant to § 675(4), this power would cause each trust to be a grantor trust until the death of the grantor of the trust. However, the trust agreements for Trust 1, Trust 2, Trust 3, and Trust 5 also provided that the respective trust beneficiary had the power to demand immediate possession and enjoyment of corpus or income.

X represents that there was no intent to terminate X's S corporation election. X also represents that the failure to file timely the ESBT elections for Trust 1 and Trust 2, the failure to file a timely entity classification, the inadvertent transfer to Trust 4, and the conversion to a limited partnership were not motivated by tax avoidance or retroactive tax planning. X represents that Trust 1 and Trust 2 each comply with the requirements under section 1361(e), which defines an ESBT. X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

Law and Analysis

Section 301.7701-3(a) of the Income Tax Regulations provides that a business entity that is not classified as a corporation under section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an "eligible entity") can elect its classification for federal tax purposes. A "business entity" is an entity recognized for federal tax purposes that is not properly classified as a trust under section 301.7701-4 or otherwise subject to special treatment

under the Code. Section 301.7701-2(a). An eligible entity with a single owner can elect either to be classified either as an association (and thus a corporation under section 301.7701-2(b)(2)) or as an entity separate from its owner.

Section 301.7701-3(b)(1)(ii) provides that unless a domestic eligible entity elects otherwise, the entity is disregarded as an entity separate from its owner if it has a single owner.

To elect to be classified other than as provided in section 301.7701-3(b), an eligible entity must file Form 8832, *Entity Classification Election*, with the designated service center. Section 301.7701-3(c)(1)(i). An election can be effective on the date specified on the Form 8832 or on the date filed if no such date is specified. The effective date specified on the Form 8832 cannot be more than 75 days prior to the date the election is filed. Section 301.7701-3(c)(2)(iii).

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 an 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 for time for making elections that do not meet the requirements of section 301.9100-2. Requests for relief under section 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 301.9100-3(a).

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 section 1362(a) is in effect for the year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(d)(2)(A) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business 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(c)(2)(A)(ii) provides that, for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death may be a shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under section 1362(d)(2) will be treated as a trust described in section 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of section 678(a)) of that portion of the QSST's S Corporation stock to which the election under section 1361(d)(2) applies. Under section 1361(d)(2)(A), a beneficiary of a QSST may elect to have section 1361(d) apply. Under section 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of section 643(b) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1361(c)(2)(A)(iii) provides that for purposes of section 1361(b)(1)(B), a trust, with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it, may be an S corporation shareholder.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S corporation.

Section 1361(e)(1) defines an ESBT, in part, as a 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)(3) provides that an election to be an ESBT shall be made by the trustee. Any such election shall be applied 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 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 673 through 678 specify the circumstances under which the grantor or a person other than the grantor is treated as the owner of any portion of a trust.

Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 678(a) provides that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which: (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of §§ 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

Section 678(b) provides that § 678(a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom § 679 applies) is otherwise treated as the owner under the provisions of subpart E other than § 678.

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 section 1362(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 termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to

section 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Section 1361(b)(1)(D) provides that S corporations may not have more than one class of stock. Section 1.1361-1(l)(1) provides that, except as provided in section 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions).

Based on Rev. Proc. 99-51, 1999-2 C.B. 760, Rev. Proc. 2006-3, 2006-1 I.R.B. 122, Sec. 5.06, provides that the Service will not rule on the following issue because it is being studied: whether a state law limited partnership electing under § 301.7701-3 to be classified as an association taxable as a corporation has more than one class of stock for purposes of § 1361(b)(1)(D). Rev. Proc. 2006-3 also provides that the Service will treat any request for a ruling whether a state law limited partnership is eligible to elect S corporation status as a request for a ruling on whether the partnership complies with § 1361(b)(1)(D).

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 section 1362(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 termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to section 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude that the requirements of §§ 301.9100-1 and 301.9100-3 have been satisfied. Consequently, X is granted an extension of time of 60 days from the date of this letter to make an election under § 301.7701-3 to be treated as an association taxable as a corporation effective Date 3. X must file Form 8832 within the extension period with the appropriate service center, with a copy of this letter attached. A copy is enclosed for that purpose.

Further, we conclude that if X's conversion from a State corporation to a State limited partnership created a second class of stock and thereby terminated X's S corporation election, then the termination was inadvertent within the meaning of § 1362(f). We also conclude that X's S election terminated on Date 6 because the trustees of Trust 1 and Trust 2 failed to timely file and complete the required ESBT elections under § 1361(e)(3). We conclude that this termination also was an inadvertent termination within the meaning of § 1362(f). We also conclude that if the transfer of the interests in X to Trust 4 terminated X's S corporation election, then this termination was inadvertent within the meaning of § 1362(f).

Finally, we conclude that X's S corporation election did not terminate as a result of the acquisition of X stock by Trust 1, Trust 2, Trust 3, and Trust 5. The power granted to the beneficiaries to withdraw amounts contributed to Trust 1, Trust 2, Trust 3, and Trust 5 will result in the beneficiaries being treated as the owners of their respective portions of each trust subject to their withdrawal power, unless as provided in § 678(b), the grantor is treated as the owner. Under the terms of Trust 1, Trust 2, Trust 3, and Trust 5, the power to reacquire assets of the trust by substituting property of equivalent value affects beneficial enjoyment. Accordingly, the grantors are treated as the owners of Trust 1, Trust 2, Trust 3, and Trust 5 under § 674(a). Because Trust 1, Trust 2, Trust 3, and Trust 5 are grantor trusts under § 674, each is a grantor trusts in its entirety, notwithstanding the powers of withdrawal held by the beneficiaries that would otherwise make them the owners under § 678. Accordingly, Trust 1, Trust 2, Trust 3, and Trust 5 each qualify as a permitted shareholder of X under § 1361(c)(2)(A)(i).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4, and thereafter, provided that X's S election is not otherwise terminated under § 1362(d) and that X and its shareholders treat X as an S corporation during this period.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code.

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.

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

Sincerely,

Curt G. Wilson

Curt G. Wilson
Associate Chief Counsel
(Passthroughs & Special Industries)