

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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PLR-112199-11

Date:
June 23, 2011

Company =

Trust =

State =

a =

b =

c =

Dear :

We received a letter dated March 22, 2011, submitted on behalf of Company requesting a ruling under § 1362(f) of the Internal Revenue Code. This letter responds to that request.

FACTS

Company was formed on a, under the laws of State and elected to be as S corporation effective b. On c, one of Company's shareholders sold Company stock to Trust, which Company represents qualifies as an electing small business trust ("ESBT") within the meaning of § 1361(e). However, no ESBT election was properly filed for

Trust with respect to the Company stock. As a result, Company's S corporation election terminated on c.

Company represents that the circumstances resulting in the termination of Company's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Company and its shareholders have agreed to make such adjustments, consistent with the treatment of Company as an S corporation, as may be required by the Service.

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 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 one class of stock.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT may be a shareholder.

Section 1361(e)(1)(A) provides that for purposes of § 1361, 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 § 170(c)(2), (3), (4), or (5), 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 § 1361(e) applies to such trust. Section 1361(e)(3) provides that an 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 1.1361-1(m)(2)(i) of the Income Tax Regulations provides, in part, that the trustee of the trust must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1362(d)(2) provides that (A) in general, an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small

business corporation, and (B) any termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (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 such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make 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 termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides, in pertinent part, 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 terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination of the election was inadvertent.

Section 1.1362-4(d) provides, in pertinent part, 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. In the case of stock held by an ineligible shareholder that causes an inadvertent termination for an S corporation under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of the S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent the loss of any revenue due to the holding of stock by an ineligible shareholder (for example, a nonresident alien).

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that Company's election to be treated as an S corporation terminated on c, upon the failure to properly file an ESBT election for Trust. We also conclude that the termination constituted an inadvertent termination within the meaning of § 1362(f). Accordingly,

Company will be treated as continuing to be an S corporation from c, and thereafter, provided that Company's S corporation election is not otherwise terminated under § 1362(d). Moreover, Trust will be treated as an ESBT from c, and thereafter, provided Trust files income tax returns for this period consistent with the trustee of Trust having made an ESBT election for Trust.

This ruling is contingent on Company and all its shareholders treating Company as having been an S corporation for the period beginning on c, and thereafter. The shareholders of Company must include their pro rata share of the separately stated and nonseparately computed items of income, loss, deduction, or credit as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by Company as provided in § 1368. This ruling is also contingent on the trustee of Trust filing an ESBT election effective c, with the appropriate service center. The ESBT election and any amended returns must be filed within 120 days following the date of this letter, and a copy of this letter should be attached to such election and returns. If Company or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether Company is otherwise eligible to be treated as an S corporation or whether Trust is eligible to be treated as an ESBT.

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, we are sending a copy of this letter to Company's authorized representative.

Sincerely,

/s/

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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