

The information submitted states that X was incorporated under the laws of State on D1. On D2, X converted to a limited liability company for State law purposes, and on D3 filed Form 8832, Entity Classification Election, to elect to be classified as an association taxable as a corporation effective D3. X also filed Form 2553, Election by a Small Business Corporation, to elect to be an S corporation, also effective D3. On this Form 2553, the income beneficiaries of Trust 1 and Trust 2 elected for their respective trusts to be treated as qualified subchapter S trusts (QSSTs), also effective D3. However, X has since learned that neither Trust 1 nor Trust 2 are eligible to be QSSTs, though they have been eligible to be electing small business trusts (ESBTs) at all times from D3 and thereafter. As a result, X's S corporation election was not effective on D3.

X represents that it and its shareholders, including Trust 1 and Trust 2, have filed consistently with the treatment of X as an S corporation since D3. X represents that the ineffective election was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

LAW

Section 1361(a)(1) of the Code 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)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not 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)(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 an S corporation shareholder.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1362(b)(1)(B), an ESBT is a permitted shareholder of a small business corporation.

Section 1361(d)(1) provides that in the case of a QSST for which a beneficiary makes an election under § 1361(d)(2), the trust is treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust shall be treated as the owner of that portion of the trust that consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(e) provides that an ESBT 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)(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) provides that the trustee of an ESBT 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 1.1361-1(m)(2)(iii) provides that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a QSST election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1361(d)(2)(A) provides that a beneficiary of a QSST may elect to have § 1361(d) apply. Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of a QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax returns the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(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 under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) 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 (3), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or (B) to acquire the shareholder consents, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), 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 the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that X's S corporation election was ineffective as of D3 because Trust 1 and Trust 2 were ineligible shareholders. We conclude that the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f).

Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D3 and thereafter, provided X's S corporation election was valid and not otherwise terminated under § 1362(d).

This ruling is contingent on X and its shareholders treating X as having been an S corporation for the period beginning D3 and thereafter. The trustees of Trust 1 and Trust 2 must file appropriate ESBT elections effective D3 with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to each ESBT election.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation or the eligibility of Trust 1 or Trust 2 to be ESBTs.

The ruling contained in this letter is 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 ruling request, it is subject to verification on examination.

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, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

/s/

Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
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cc: