

Internal Revenue Service

Department of the Treasury

Number: **200115022**
Release Date: 4/13/2001
Index Number: 1362.01-01, 1362.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B01-PLR-118278-00
Date:
January 11, 2001

X =

State =

a =

b =

c =

Trust 1=

Trust 2=

Date 1=

Date 2=

This letter responds to a letter, dated August 21, 2000, written on behalf of X, requesting rulings, under 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted X was incorporated, in State, on Date 1. X filed a Form 2553, Election by a Small Business Corporation, to elect to be classified as an S corporation under section 1361, effective Date 2. At the time the election was made the shareholders of X were a, b, c, Trust 1 and Trust 2. While the appropriate consents on the Form 2553 were submitted by a and b, c consented only in a spousal capacity and there were no consents by the trustee of Trust 1 and Trust 2.

In addition Trust 1 and Trust 2 intended to qualify as Electing Small Business

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Trusts (ESBTs) as defined in section 1361(e). However, the trustee of Trust 1 and Trust 2 did not make ESBT elections pursuant to section 1361(e)(3).

X represents that there was no intent to knowingly make an invalid S election. In addition X represents that the events that resulted in the invalid election were not motivated by tax avoidance or retroactive tax planning. Further, X represents that, from Date 2 and thereafter, X and all of the shareholders of X have or will file consistently with the treatment of X as an S corporation and agree to make any adjustments as required by the Secretary consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

Section 1361(a)(1) defines an S corporation as a small business corporation for which an election under section 1362(a) is in effect. Section 1362(a)(2) provides that an election under section 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. For a trust described in section 1361(c)(2)(A), including ESBTs, section 1.1362-6(b)(2)(iv) of the Income Tax Regulations provides that only the person treated as the shareholder under section 1361(b)(1) must consent to the election. Under section 1.1362-6(b)(2)(ii), the consent of a minor must be made by the minor or by the legal representative of the minor (or by a natural or adoptive parent of the minor if no legal representative has been appointed).

For tax years beginning after December 31, 1996, section 1361(c)(2)(A)(v) provides that an ESBT is a permissible shareholder under section 1361(b)(1)(B). Section 1361(e)(1)(A) provides that an ESBT means, except as provided in section 1361(e)(1)(B), any trust if (i) the trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, or (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), which holds a contingent interest and is not a potential current beneficiary, (ii) no interest in the trust was acquired by purchase, and (iii) an election under section 1361(e) applies. For tax years beginning after December 31, 1997, the clause "which holds a contingent interest and is not a potential current beneficiary" in section 1361(e)(1)(A)(i)(III) is deleted.

Section 1362(d)(2)(A) of the Code provides that an election to be treated as an S corporation terminates whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the date the S corporation ceases to meet the requirements of a small business corporation. Section 1362(d)(2)(B).

For the relevant tax years, section 1362(f) provides that if (1) an election under section 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to satisfy

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the requirements of section 1361(b) or to obtain shareholder consents or (B) was terminated under section 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 under 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 for 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.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24, in discussing section 1362(f) of the Code, provides, in part, as follows:

If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and the shareholders agree to be treated as if the election had been in effect for such period.

The committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers . . . It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

CONCLUSIONS

The failure of c and of the Trustee of Trust 1 and Trust 2 to sign the consents on the Form 2553 caused X's S election to be invalid. Further, the failure to file the ESBT elections for Trust 1 and Trust 2 also caused X's S election to be invalid. Based upon the information submitted and the representations set forth above, we conclude that X's invalid election was inadvertent within the meaning of section 1362(f). Therefore, under the provisions of section 1362(f), X will be treated as an S corporation from Date 2 and thereafter provided that within 60 days from the date of this letter: Trust 1 and Trust 2 file correct ESBT elections with the appropriate service center pursuant to section 1361(e) and Notice 97-12 with an effective date of Date 2; and all of the shareholders

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of X must have filed shareholder consents to X's S corporation election with the service center within 60 days of the date of this letter. A copy of this letter should be attached to the ESBT elections and shareholder consents filed with the service center. This ruling shall be null and void if the requirements of this paragraph are not met.

Except as specifically set forth above, we express no opinion concerning the federal income tax consequences of the facts described above under any other provision of the Code. Specifically, we express no opinion as to whether or not X would qualify as a small business corporation as defined in § 1361(d).

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office a copy of this letter is being sent to the taxpayer and the second listed authorized representative.

Sincerely yours,
David R. Haglund
Senior Technician Reviewer, Branch 1
Associate Chief Counsel
(Passthroughs and Special Industries)

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