

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B1-PLR-135515-02
Date:
March 5 2003

Legend

X =

Y =

Shareholders =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This responds to the letter dated June 25, 2002, together with subsequent correspondence, submitted on behalf of X requesting that X be given an extension of time to elect to treat Y as a Qualified Subchapter S Subsidiary (QSub) for its taxable year beginning Date 4 under section 301.9100 of the Procedure and Administration Regulations, as well as relief under section 1362(f) of the Internal Revenue Code for inadvertent termination relief.

Facts

The following facts have been represented. On Date 1, X filed a timely election under section 1362(a) to be treated as an S corporation effective Date 2. On Date 1, X also contributed its operating business to Y, a wholly-owned subsidiary of X. X retained certain assets, which were then leased to Y. X failed to make an election to treat Y as a QSub.

At the close of three consecutive taxable years, X had subchapter C earnings and profits and the rental income from Y exceeded 25 percent of X's gross receipts. As a result, X's S election terminated on Date 3.

X represents that the termination of X's election to be an S corporation was inadvertent and not the result of tax avoidance or retroactive tax planning.

X and Shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required.

Law and Analysis

Section 1361(a)(1) provides that, for purposes of the Code, the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under section 1362(a) is in effect for the year.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

Section 1362(d)(3)(A)(i) provides that an election under section 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of three consecutive taxable years, and has gross receipts for each of such years more than 25 percent of which are passive investment income. Section 1362(d)(3)(A)(ii) provides that any termination under section 1362(d)(3) shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to in section 1362(d)(3)(A)(i).

Section 1362(f) provides that if (1) an election under section 1362(a) by any corporation was not effective for the tax year for which made 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 the ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness, steps were taken so that the corporation is a small business corporation or to acquire the required 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 section 1362(f) agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be

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required by the Secretary with respect to that period, then, notwithstanding the circumstances resulting in the ineffectiveness, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1361(b)(3)(B) defines the term "qualified subchapter S subsidiary" as a domestic corporation that is not an ineligible corporation, if 100 percent of the stock of the corporation is owned by the S corporation, and the S corporation elects to treat the corporation as a QSub.

A taxpayer makes a QSub election with respect to a subsidiary by filing a Form 8869, Qualified Subchapter S Subsidiary Election, with the appropriate service center.

Section 1.1361-3(a)(4) of the Income Tax Regulations provides that the election will be effective on the date specified on the election form or on the date the election is filed if no date is specified. The effective date specified on the election form cannot be more than two months and 15 days prior to the date of filing and cannot be more than 12 months after the date of filing.

Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in section 301.9100-3 to make a regulatory election. Section 301.9100-1(b) defines a regulatory election as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

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 of 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).

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Conclusion

Based solely on the representations made and the information submitted, we conclude that X has satisfied the requirements of sections 301.9100-1 and 301.9100-3. Accordingly, Y will be treated as a QSub, effective Date 4 and thereafter, unless Y fails to meet the requirements of a QSub under section 1361(b)(3)(B).

We also conclude that X's S corporation election terminated on Date 3 under section 1362(d)(3)(A), because X had subchapter C earnings and profits at the close of each of three consecutive taxable years, and had gross receipts for each of those taxable years more than 25 percent of which were passive investment income.

We further conclude that the termination of X's S corporation election was an inadvertent termination within the meaning of section 1362(f). Accordingly, pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation beginning Date 3, and thereafter, provided that X's S corporation election was valid and is not otherwise terminated under section 1362(d).

This ruling is contingent on X and Shareholders treating X as an S corporation for the period beginning Date 1 and thereafter and on X treating Y as a QSub for the period beginning Date 4 and thereafter. X and its Shareholders must make any adjustments that are necessary to comply with this ruling.

Except for the specific ruling above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code, including whether X or Y is otherwise eligible to be an S corporation or a QSub, respectively.

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.

Sincerely,

Heather C. Maloy
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

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