

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:B1-PLR-123930-02  
Date:  
Aug 16 2002

Legend:

X =  
Y =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =

Dear :

This responds to the letter dated April 16, 2002, together with subsequent correspondence, submitted on behalf of X requesting relief under section 1362(f) of the Internal Revenue Code.

FACTS:

You have represented that the facts are as follows: On Date 1, X filed a timely election under section 1362(a) to be treated as an S corporation effective Date 2. On Date 3, pursuant to a Merger Agreement, X acquired all of the issued and outstanding shares of a related corporation, Y. On Date 3, X filed an election to treat Y as a Qualified Subchapter S Subsidiary (QSub), effective Date 2.

The Merger Agreement provided that the shareholders of Y were entitled to receive common shares of X in exchange for their shares in Y. X and its representatives represent that the Merger Agreement in conjunction with its Articles of Incorporation caused X's election to be an S corporation to be inadvertently invalid. On Date 4, X amended its Articles of Incorporation in order to satisfy the terms of the Merger Agreement.

X and its Shareholders agree to make any adjustments, consistent with the treatment of X as an S corporation, as might be required by the Secretary.

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## 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)(D) 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 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.

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 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.

The committee reports accompanying the Subchapter S Revision Act of 1982 explain 1362(f) 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

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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.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24; H.R. Rep. No. 826, 97th Cong., 2d Sess. 12 (1982), 1982-2 C.B. 730, 735.

## CONCLUSION

Based solely on the facts submitted and the representations made by X, we conclude that X's election to be treated as an S corporation was inadvertently invalid within the meaning of section 1362(f). Consequently, we conclude that X will be treated as an S corporation beginning Date 2 and thereafter, unless X's S election otherwise terminates under section 1362(d). Moreover, we conclude that because X's S corporation election is effective as of Date 2, Subsidiary will be treated as a QSub beginning Date 2 and thereafter, unless X's S corporation election otherwise terminates under section 1362(d) or Subsidiary fails to meet the requirements of a QSub under section 1361(b)(3)(B).

This ruling is contingent on X and its Shareholders treating X as an S corporation for the period beginning Date 2 and thereafter and on X treating Subsidiary as a QSub for the period beginning Date 2 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 Subsidiary is otherwise eligible to be an S corporation or a QSub, respectively.

Under power of attorney on file with this office, we are sending a copy of this letter to X and X's second authorized representative.

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

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

Enclosures (2)

Copy of this letter  
Copy for § 6110 purposes