

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2-PLR-118269-02
Date:
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Legend

X =

Y =

Z =

Partnership 1 =

Partnership 2 =

State 1 =

State 2 =

Year 1 =

x =

Dear :

This responds to a letter dated March 15, 2002, together with subsequent correspondence, requesting rulings on the transactions described below.

Facts

The information submitted states that X is a State 1 corporation that elected to be treated as an S corporation in Year 1. For business reasons, X plans to restructure its operations by undertaking the following transactions.

First, all of X's shareholders will contribute all of their X stock to Y, a newly formed State 1 corporation, in exchange for all of the issued and outstanding stock of Y. Y will file an election to be treated as an S corporation effective on the date of the

contribution (the “Transaction Date”), and will file a qualified subchapter S subsidiary (“QSub”) election for X, also effective on the Transaction Date. The Transaction Date will be the first day on which Y has shareholders, acquires assets, or begins doing business. Also on the Transaction Date, but after the contribution of X stock to Y, X will contribute to Z, a newly formed State 2 corporation, X’s entire interest in Partnership 1 and Partnership 2, cash, and certain short term investments. Z will assume the obligations of X that are related to Partnership 1 and Partnership 2. Simultaneously, Z will issue x shares of Z common stock to X, which will constitute all of the issued and outstanding stock of Z. Immediately following X’s contribution to Z, and on the Transaction Date, X will distribute to Y all of the issued and outstanding stock of Z. Y will file a QSub election for Z effective on the Transaction Date. X represents that the series of transactions through which Y will become the parent corporation of X and Z will qualify as a reorganization under § 368(a)(1)(F).

Law and Analysis

Section 1361(a)(1) of the Internal Revenue Code defines an “S corporation” as a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(3)(A) provides that generally a QSub shall not be treated as a separate corporation, and that all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items of the S corporation.

Section 1361(b)(3)(B) provides that a QSub is any domestic corporation which is not an ineligible corporation if 100 percent of the stock of the corporation is owned by an S corporation, and the S corporation elects to treat the corporation as a QSub.

Section 1.1361-4(a)(2) of the Income Tax Regulations provides that if an S corporation makes a valid QSub election with respect to a subsidiary, the subsidiary is deemed to have liquidated into the S corporation.

Section 1.1361-4(a)(2)(i) provides that if an S corporation makes a valid QSub election, the tax treatment of the liquidation or of a larger transaction that includes the liquidation will be determined under the Internal Revenue Code and the general principals of law, including the step transaction doctrine. Thus, for example, if an S corporation forms a subsidiary and makes a valid QSub election effective on the date of the subsidiary’s formation, the transfer of assets to the subsidiary and the deemed liquidation are disregarded, and the corporation will be deemed to be a QSub from its inception.

Section 1.1364-4(a)(4) provides that, except for purposes of §§ 1361(b)(3)(B)(i) and 1.1361-2(a)(1), the stock of a QSub shall be disregarded for all federal tax purposes.

Section 1.1361-4(b)(2) provides that when QSub elections for a tiered group of subsidiaries are effective on the same date, the S corporation may elect the order of the liquidations. If no order is specified, the liquidations that are deemed to occur as a result of the QSub election will be treated as occurring first for the lowest tier entity and proceed successively upward until all the liquidations have occurred.

Section 1.1361-4(b)(3)(i) provides that if an S corporation does not own 100% of the stock of the subsidiary on the day before the QSub election is effective, the liquidation into the S corporation occurs immediately after the time at which the S corporation first owns 100% of the stock.

Section 1.1361-4(b)(3)(ii) provides that, except as otherwise provided in § 1.1361-4(b)(4) (relating to S corporations making elections under §338), if a corporation for which an election under § 1362(a) was in effect is acquired, and a QSub election is made effective on the day the corporation is acquired, the acquired corporation is deemed to liquidate into the S corporation at the beginning of the day the termination of its S election is effective. As a result, if corporation X acquires Y, an S corporation, and makes an S election for itself and a QSub election for Y effective on the day of acquisition, Y liquidates into X at the beginning of the day when X's S election is effective, and there is no period between the termination of Y's S election and the deemed liquidation of Y during which Y is a C corporation.

Conclusions

Based on the facts provided, there will be no period between the termination of X's S election and the deemed liquidation of X during which X will be a C corporation. Under step transaction principles, the formation of Z, X's distribution to Y of all of its stock in Z, and the immediate liquidation of X and Z on the Transaction Date will be disregarded.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed or implied as to whether the described transactions constitute a reorganization under § 368(a)(1)(F), and no opinion is expressed or implied as to whether X is a valid S corporation.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X and X's second authorized representative.

Sincerely,

Matthew Lay
Senior Technician Reviewer, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter

Copy for §6110 purposes