

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200817005**
Release Date: 4/25/2008
Index Number: 1362.04-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-115482-07
Date:
January 16, 2008

Legend:

X =

Y =

S1 =

S2 =

S3 =

d1 =

d2 =

d3 =

d4 =

d5 =

State =

A =

B =

C =

D =

Dear _____ :

This letter responds to a letter dated March 28, 2007, and subsequent correspondence, written on behalf of X, requesting rulings under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on d1. X later elected under § 1362(a) to be an S corporation by filing Form 2553, Election by a Small Business Corporation, with an effective date of d2. X also elected under § 1361(b)(3) to treat S1, S2, and S3 as qualified subchapter S subsidiaries (QSubs) by filing Form 8869, Qualified Subchapter S Subsidiary Election, effective d2.

As of d2, one of X's shareholders was Y, an S corporation. The shareholders of Y were individuals A, B, C, and D. As an S corporation, Y was an ineligible S corporation shareholder under § 1361(b)(1)(B). In addition, one of X's shareholders from a community property state failed to obtain the required consents to X's S corporation election.

On d3, X was informed by its tax advisor that Y was an ineligible shareholder of an S corporation, and that X's S corporation election was ineffective. On d4, Y distributed its shares of X stock to individuals A, B, C, and D in accordance with their ownership percentages in Y. On d5, X also learned that its S corporation election was not valid because it failed to obtain the consents from all shareholders of X as required under § 1362(a)(2). X filed for a private letter ruling soon afterward.

X and its shareholders represent that X's ineffective S corporation election and QSub elections were inadvertent, unintended, and were not motivated by tax avoidance or retroactive tax planning. From d2 onward, X and its shareholders have consistently treated X as an S corporation, and S1, S2, and S3 as QSubs. This includes allocating

X's items of income, loss, deduction, and credit to all of its shareholders, including Y. Y in turn, allocated those items to its shareholders, A, B, C and D. In addition, X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation and with the treatment of S1, S2 and S3 as QSubs that the Secretary may require.

Law and Analysis

Section 1361(a) 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) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) 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, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(b)(3)(A) provides that except as provided in regulations prescribed by the Secretary, for purposes of title 26 (i) a corporation which is a QSub shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), if 100 percent of the stock of the corporation is held by the S corporation, and the S corporation elects to treat the corporation as a QSub.

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(a)(2) provides that an election under § 1362(a) shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

Section 1.1362-6(b)(2)(i) of the Income Tax Regulations provides that when stock of the corporation is owned by husband and wife as community property (or the income from the stock is community property), or is owned by tenants in common, joint tenants, or tenants by the entirety, each person having a community interest in the stock or income therefrom and each tenant in common, joint tenant and tenant by the entirety must consent to the election.

Section 1362(f) provides that if (1) an election under §§ 1362(a), 1361(b)(3)(B)(ii), or 1361(c)(1)(A)(ii) 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), 1361(b)(3)(C), or 1361(c)(1)(D)(iii), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or a QSub, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election and QSub election were ineffective for the taxable year beginning d2. We also conclude that the ineffectiveness of X's S corporation election and QSub election were inadvertent within the meaning of § 1362(f).

Under the provisions of § 1362(f), X will be treated as an S corporation from d2 and thereafter, provided X's S corporation election is otherwise valid and is not otherwise terminated under § 1362(d). In addition, S1, S2, and S3 will be treated as QSubs of X from d2 and thereafter, provided the QSub elections are otherwise valid and are not otherwise terminated. Furthermore, during the period from d2 to d4, A, B, C, and D will be treated as the owners of the shares of X stock held by Y.

Accordingly, from d2 and thereafter, the shareholders of X, including A, B, C, and D, must include their pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368.

As a condition to this ruling, X must, within 60 days of the date of this letter, file a new Form 2553 that contains the proper consents, with an effective date of d2, with the appropriate service center. A copy of this letter should be attached to the Form 2553.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be an S corporation, or whether S1, S2, or S3 are otherwise eligible to be QSubs.

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.

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

Sincerely,

/s/

Mary Beth Collins
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes

cc: