Internal Revenue Service

Number: **201041001**
Release Date: 10/15/2010

Index Number: 1361.03-02, 1362.01-03

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-101178-10

Date:
July 08, 2010

Legend

Company =

State =

D1 =

D2 =

D3 =

N =

Parent =

A =

Shareholders =

Dear :

This letter responds to a letter dated December 31, 2009, submitted on behalf of Company by its authorized representatives, requesting rulings under §§ 1362(b)(5) and 1362(f) of the Internal Revenue Code (Code).

Facts

Company was incorporated under State law on D1. Parent, an S corporation, owned 100% of the stock of Company. An election to treat Company as a qualified subchapter S subsidiary (QSub) was made effective on D1.

On D2, A purchased N% of the outstanding Company stock from Parent. It was intended for Company to continue to be treated as a pass-through entity, however, a Form 2553, Election by a Small Business Corporation, was not timely filed. When Company became aware of the failure to file Form 2553 and the ineligible shareholder, Parent distributed all of its remaining Company shares to Shareholders in accordance with their percentage holdings in Parent on D3.

Company represents that the presence of an ineligible shareholder was inadvertent. Company and Shareholders agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary.

Law

Section 1361(a)(1) 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 the Code — (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, for purposes of § 1361(b)(3), the term “qualified subchapter S subsidiary” means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), if — (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a QSub.

Section 1361(b)(3)(D) provides, in part, that if a corporation’s status as a QSub terminates, such corporation (and any successor corporation) shall not be eligible to make an election under § 1362(a) to be treated as an S corporation before its 5th taxable year which begins after the 1st taxable year for which such termination was effective, unless the Secretary consents to such election.

Section 1.1361-5(a)(1)(iii) of the Income Tax Regulations provides that a QSub election will terminate at the close of the day on which an event occurs that renders the subsidiary ineligible for QSub status under § 1361(b)(3)(B).

Section 1.1361-5(c)(2) provides that in the case of S and QSub elections effective after December 31, 1996, if a corporation’s QSub election terminates, the corporation may, without requesting the Commissioner’s consent, make an S election before the expiration of the five-year period described in § 1361(b)(3)(D) if immediately following the termination, the corporation (or its successor corporation) is otherwise eligible to make an S election and the relevant election is made effective immediately following the termination of the QSub election.

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(b)(1) provides that an election under § 1362(a) may be made by a small business corporation for any taxable year - (A) at any time during the preceding taxable

year, or (B) at any time during the taxable year and on or before the 15th day of the third month of the taxable year.

Section 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)), after the date prescribed by § 1362(b) for making such election for such taxable year or no such election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make the election, the Secretary may treat such an election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

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

Conclusions

Based on the facts submitted and representations made, we conclude that Company has established reasonable cause for failing to make a timely S corporation election. Thus, we conclude that Company is eligible for relief under § 1362(b)(5). Accordingly, if Company makes an election to be an S corporation by filing with the appropriate service center a completed Form 2553 effective D2, within 120 days following the date of this letter, the election shall be treated as timely made. A copy of this letter should be attached to the Form 2553 filed with the service center. A copy is enclosed for that purpose.

Company failed to timely file an election to be treated as an S corporation effective D2. Had Company timely filed the election, it would have been ineffective because Company had an ineligible shareholder on D2. Based solely on the facts submitted and representations made, we conclude that Company's election to be treated as an S corporation effective D2, would have been ineffective and also conclude that the ineffectiveness would have been inadvertent within the meaning of § 1362(f).

Under the provisions of § 1362(f), Company will be treated as an S corporation effective D2, and thereafter, provided that Company's S corporation election is not otherwise

terminated under § 1362(d). From D2 through D3, Shareholders will be treated as if they held the shares in Company directly. Company and Shareholders must file federal income tax returns consistent with Company being an S corporation. Accordingly, Shareholders, in determining their respective income tax liabilities, must include their pro rata shares of separately and nonseparately computed items of Company under § 1366, make any adjustments to stock basis under § 1367, and take into account any distributions made by Company under § 1368. If Company or Shareholders fail to treat Company as described above, this letter ruling will be null and void.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether Company is otherwise eligible to be an S corporation or whether Company was a valid QSub.

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.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to Company's authorized representatives.

Sincerely,

/s/

Tara P. Volungis
Acting Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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