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Telephone Number:

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Date:
October 03, 2008

Legend

X =

Y =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

State 1 =

State 2 =

Year 1 =

Year 2 =

Year 3 =

Dear :

This letter responds to a request, dated April 1, 2008, written on behalf of X, requesting an extension of time under section 301.9100-3 of the Procedure and Administration Regulations to make a late Qualified Subchapter S Subsidiary (QSub) election under § 1.1361-3, and for relief under § 1362(f) for inadvertent S corporation and QSub terminations.

FACTS

Based on the information submitted and representations made within, the relevant facts are as follows. On Date 1, X was organized as a State 1 corporation and made a timely election to be an S corporation for federal tax purposes. On Date 2, X acquired the stock of Y, a State 2 corporation. At the time of the acquisition, X intended to make the election provided for under section 338(h)(10) of the Internal Revenue Code to treat the acquisition of Y stock as an acquisition of Y's assets and, in addition, to treat Y as an entity disregarded from X for federal tax purposes. X timely filed the election provided for under section 338(h)(10). That election was effective on Date 3. However, X was mistakenly advised by a qualified tax professional that no QSub election was required for Y to be treated as disregarded from X for federal tax purposes. Therefore, no such QSub election was made. From Year 1 through Year 2, X filed returns consistent with its belief that Y was disregarded from X for federal tax purposes.

On Date 4, the owners of X sold all of their stock in X to various individuals and S corporations. Later in Year 3, X for the first time realized that Y was not, in fact, disregarded from X for federal tax purposes because it had failed to timely file a QSub election for Y, effective on Date 3, and that in addition, the sale of X stock on Date 4 had the effect of terminating X's S corporation election. X represents that it did not know at the time that the transfer of X stock to the S corporations on Date 4 would have the effect of terminating X's status as an S corporation, and had it known so, it would have structured the transaction to avoid terminating X.

X now requests rulings granting it permission to make a late QSub election for Y, effective Date 3, as well as relief from the subsequent terminations of X and Y as an S corporation and QSub, respectively, attributable to the sale of X stock to the ineligible S corporation shareholders on Date 4.

X represents that it has acted reasonably and in good faith, that granting relief will not prejudice the interests of the government, and that it is not using hindsight in making the QSub election.

LAW AND ANALYSIS

Section 301.9100-1(c) gives the Commissioner discretion to grant reasonable extensions of time to make regulatory elections under the rules of §§ 301.9100-2 and

301.9100-3. Under § 301.9100-1(b), a regulatory election includes an election whose due date is prescribed by a regulation published in the Federal Register.

Section 301.9100-3 sets forth the standards that the Commissioner uses to determine whether to grant a discretionary extension of time. These standards indicate that the Commissioner should grant relief when the taxpayer provides evidence proving to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the Government.

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 1 class of stock.

Section 1362(a)(1) provides, in general, 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(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

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 1361(b)(3)(A) provides that a QSub shall not be treated as a separate corporation, and 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 1.1361-3(a) of the Income Tax Regulations prescribes the time and manner for making an election to be classified as a QSub. Section 1.1361-3(a)(4) provides that an election to treat an eligible subsidiary as a QSub may be effective up to two months and 15 days prior to the date the election is filed or not more than 12

months after the election is filed. The proper form for making the election is Form 8869, Qualified Subchapter S Subsidiary.

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 § 1362(d)(3), § 1361(b)(3)(C), or § 1361(c)(1)(B)(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 qualified subchapter S subsidiary, 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 qualified subchapter S subsidiary, 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 qualified subchapter S subsidiary, as the case may be during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that, for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that Y has satisfied the requirements of §§ 301.9100-1 and 301.9100-3. As a result, X is granted an extension of time of 60 days from the date of this letter to make an election

under § 1.1361-3 to treat Y as a QSub within the meaning of § 1361(b)(3)(B), effective on Date 3. Pursuant to § 1.1361-4, the deemed liquidation of Y into X is treated as occurring immediately after the deemed purchase of Y's assets on Date 3.

We further conclude that X's S corporation election terminated on Date 4, but that the termination was inadvertent within the meaning of § 1362(f). As a result, X is treated as continuing to be an S corporation within the meaning of § 1361(a)(1) from Date 4 forward, provided that X's S corporation election is not otherwise terminated under § 1362(d). Additionally, we conclude that Y's QSub election terminated on Date 4, but that the termination was inadvertent within the meaning of § 1362(f). Accordingly, Y will be treated as continuing to be a QSub from Date 4 forward, provided that Y's QSub election is not otherwise terminated.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

In accordance with the power of attorney on file with this office, a copy of this letter will be sent to your authorized representative.

Sincerely,

William P. O'Shea

William P. O'Shea
Associate Chief Counsel
(Passthroughs and Special Industries)

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

cc: