

Internal Revenue Service

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Person to Contact:

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Refer Reply To:

CC:PSI:2 - PLR-167562-01

Date:

March 18, 2002

X =

Y =

A =

B =

C =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

D7 =

D8 =

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Accounting Firm1 =

Accounting Firm2 =

Law Firm =

Year 1 =

Year 2 =

Dear :

This letter responds to a letter dated December 11, 2001, submitted on behalf of X by X's authorized representative, requesting that X be given an extension of time under § 301.9100 of the Procedure and Administrative Regulations in which to elect to treat its subsidiary as a qualified subchapter S subsidiary (QSub). The letter also requests a ruling that a disproportionate distribution by X to its shareholders did not terminate X's S election .

The information submitted states that A, B, and C are the shareholders of X. X was incorporated on D1 and elected to be an S corporation, effective D2. Y was incorporated on D3 and elected to be an S corporation, effective D3. Pursuant to advice from X's accountants, Accounting Firm1, on D4, A and B transferred 100 percent of their stock in Y to X. Through this restructuring, Y became a wholly owned subsidiary of X. C, the chief financial officer of X, represents that it was intended for X to treat Y, a wholly owned subsidiary of X, as a QSub effective D4. X relied on Accounting Firm1 and Law Firm to advise X of any necessary elections. However, X was not advised of the need to file a QSub election and thus, no QSub election was filed. In D5, in the course of preparing X's tax return extensions, Accounting Firm2 discovered that X had not filed an election to treat Y as a QSub.

Additionally, in Year 1, and from D4 to D7 of Year 2, X made disproportionate distributions to A and B. On D6, X issued shares to C. However, during the period from D6 to D8, X made distributions to A and B, but failed to make distributions to C. C represents that these disproportionate distributions were made due to a clerical oversight.

In the course of reviewing X's QSub ruling, Accounting Firm2 discovered the disproportionate distributions to A and B. Upon further examination, the shareholders of X determined that the disproportionate distributions may have caused a termination of X's S election. At that time, steps were taken to equalize the distributions. Moreover, X and its shareholders have agreed to make such adjustments (consistent

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with the treatment of X as an S corporation) as may be required by the Secretary.

C represents that X's Articles of Incorporation and By-laws provide for a single class of voting common stock with no preferences as to either voting, dividends, or distributions among the shares of stock. C represents there was no other binding agreement that any shareholder of X would be entitled to any preference with respect to the distributions made by X.

Section 1362(a) of the Internal Revenue Code 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 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)(3)(B) defines the term "qualified subchapter S subsidiary" (QSub) as a domestic corporation which 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. The statutory provision does not, however, provide guidance on the manner in which the QSub election is made or on the effective date of the election.

A taxpayer makes a QSub election with respect to a subsidiary by filing a Form 8869, Qualified Subchapter S Subsidiary Election, with the appropriate service center. The election may be effective on the date the Form 8869 is filed or up to two months and 15 days prior to the filing of the form, provided that date is not before the parent's first taxable year beginning after December 31, 1996, and that the subsidiary otherwise qualifies as a QSub. If a valid QSub election is made, the subsidiary is not treated as a separate corporation, and all assets, liabilities, and items of income, deduction, and credit of the QSub are treated as assets, liabilities, and items of income, deduction, and credit of the parent S corporation.

Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in § 301.9100-3 to make a regulatory election. Section 301.9100-1(b) defines a regulatory election to include an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the Government. Section 301.9100-3(a).

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Section 1361(a)(1) provides that the term “S corporation” means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for that year.

Section 1361(b)(1)(D) provides that a small business corporation cannot have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation generally is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds. Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Based solely on the facts submitted and representations made, we conclude that the requirements of § 301.9100-3 have been satisfied. As a result, X is granted an extension of time of 60 days from the date of this letter to file Form 8869 with the appropriate service center to elect to treat Y as a QSub effective D4. A copy of this letter should be attached to the Form 8869.

In addition, based on the information submitted and the representations made, we conclude that because X's stock has identical distribution rights under its governing provisions, the difference in timing between X's disproportionate distributions and the remedial distributions does not cause X to have more than one class of stock for purposes of § 1361(b)(1)(D). However, such disproportionate and remedial distributions must be given appropriate tax effect. Under these circumstances, we conclude that X's S election did not terminate because of the disproportionate distributions.

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, including whether X was or is a small business corporation under § 1361(b) and whether Y was or is a QSub for federal tax purposes.

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

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

Sincerely,
Paul F. Kugler
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes