

Internal Revenue Service

Number: **200633004**

Release Date: 8/18/2006

Index Number: 1361.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

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Refer Reply To:

CC:PSI:B01

PLR-107642-06

Date: May 9, 2006

LEGEND

X =

Y =

Month =

D1 =

D2 =

D3 =

D4 =

State =

Dear :

This responds to your letter dated January 25, 2006, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated on D1 in accordance with the laws of State. Y was incorporated on D2 in accordance with the laws of State. X elected to be an S corporation effective D3. Additionally, X made an election to treat Y

as a qualified subchapter S subsidiary (QSub) effective D3. In Month, X discovered that X did not own 100 percent of the stock of Y. Therefore, X's election to treat Y as a QSub was ineffective because Y was ineligible to be a QSub under § 1361(b)(3)(B). X represents that it was not aware that it did not own 100 percent of the stock of Y at the time X elected to treat Y as a QSub. From D3 and thereafter, X and its shareholders treated Y consistent with being a QSub. On D4, the outstanding shares in Y that were not held by X were redeemed. After this action was taken, X owned 100 percent of the stock of Y.

X represents that the circumstances resulting in the ineffectiveness of X's election to treat Y as a QSub were inadvertent and that X and X's shareholders did not intend to engage in tax avoidance or retroactive tax planning. X, X's shareholders, and Y have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of Y as a QSub.

LAW AND ANALYSIS

Section 1362(a) generally provides that a small business corporation may elect to be treated as an S corporation.

Section 1361(b)(3)(B) defines a QSub as a domestic corporation that 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 1362(f) provides that if (1) an election under § 1361(b)(3)(B)(ii) by any corporation was not effective for the taxable year for which made (determined without regard to § 1361 (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 QSub, and (4) the corporation for which the election was made, 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, such corporation shall be treated as a qualified subchapter S subsidiary during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's election to treat Y as a QSub was ineffective for the taxable year beginning on D3 because Y failed to meet the requirements of § 1361(b)(3)(B)(i). We further conclude

that X's election to treat Y as a QSub was an inadvertent ineffective election within the meaning of § 1362(f).

Therefore, under the provisions of § 1362(f), Y will be treated as a QSub of X from D3, and thereafter, provided that the QSub election was otherwise valid and has 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. Specifically, no opinion is expressed on whether X is a valid S corporation or whether Y is otherwise eligible to be treated as a 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Audrey W. Ellis
Senior Counsel, Branch 1
(Passthroughs & Special Industries)

cc: