Internal Revenue Service

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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date: OCT 14 1999

Legend

X =

Y =

Z =

State A =

State B =

D1 =

D2 =

This responds to the letter dated June 10, 1999, submitted on behalf of X, requesting a waiver of the five-year waiting period imposed by § 1361(b)(3)(D) of the Internal Revenue Code to permit X to make a subchapter S election under § 1362(a).

FACTS

X was incorporated under State A law. Y was incorporated under State B law. On D1, pursuant to an overall business plan, Y merged with and into X. Prior to D1, Z, an S corporation, was the sole shareholder of X and Y, and had filed a qualified

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subchapter S subsidiary (QSUB) election with respect to Y. Upon completing the merger and pursuant to the overall business plan, all of the outstanding shares of X stock were distributed to Y's shareholders, effective D1.

On or about D2, X filed a subchapter S election, to be effective D1.

LAW AND ANALYSIS

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

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) 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 the S corporation, and the S corporation elects to treat the corporation as a QSUB.

Section 1361(b)(3)(C) provides that for purposes of the Code, if any corporation which was a QSUB ceases to meet the requirements of § 1361(b)(3)(B), the corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the cessation from the S corporation in exchange for its stock.

Section 1361(b)(3)(D) provides that if a corporation's status as a QSUB terminates, such corporation (and any successor corporation) shall not be eligible to make (i) an election under § 1361(b)(3)(ii) to be treated as a QSUB, or (ii) an election under § 1362(a) to be treated as an S corporation, before the 5th taxable year for which the termination was effective, unless the Secretary consents to the election.

In explaining § 1361(b)(3)(D), the Joint Committee on Taxation states as follows:

> It is expected that the Secretary will provide waivers of the five-year rule in appropriate instances. For example, if the stock of the [QSUB] is distributed to the individual shareholders of the subsidiary's parent, the subsidiary will no longer be a [QSUB] and would be subject to the five-year rule. If the parent corporation retains its subchapter S election and the Secretary determines

that the distribution was not made for tax avoidance, it would seem appropriate for the Secretary to waive the five-year rule.

Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 104th Congress (JCS-12-96), 104th Cong., 2d Sess. 120 (1996).

CONCLUSION

Based solely on the facts submitted and the representations made, the Service waives the five-year waiting period imposed by § 1361(b)(3)(D) and consents to X's S election under § 1362(a), effective D1, and thereafter unless otherwise terminated.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express no opinion on whether X otherwise qualifies as an S corporation. Furthermore, no opinion is expressed or implied concerning the tax consequences of the merger and reorganization discussed above.

Temporary or final regulations pertaining to one or more issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion in the ruling. See § 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6. However, when the criteria in § 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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

Pursuant to the Power of Attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,

Dianna K. Miosi

Dianna K. Miosi
Chief, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
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