

INTERNAL REVENUE SERVICE

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December 16, 1999

X =

Y =

State =

Date 1 =

Dear :

This letter responds to your letter dated June 17, 1999, requesting a ruling that waives the five-year waiting period imposed by section 1361(b)(3)(D) of the Internal Revenue Code in order to permit X to make an S election under section 1362(a).

The information submitted states that X, a corporation organized under the laws of State, is a wholly-owned subsidiary of Y. Y is an S corporation as defined in section 1361(a)(1) of the Code. Y filed an election under section 1361(b)(3)(B)(ii) to treat X as a qualified subchapter S Subsidiary ("QSSSub"), effective on Date 1.

Y's shareholders intend to sell all of the outstanding shares of Y. Pursuant to the sale, certain assets unrelated to Y's core business will be excluded from the sale and distributed to the shareholders prior to the closing of the sale. Such assets consist of the X stock and certain real property. Y intends to effectuate the distribution of the X stock and the real property by contributing the real property to X and then distributing the X stock to Y's shareholders in partial redemption of their Y stock. As a result of this transaction, Y's election to treat X as a QSSSub will terminate.

Section 1361(b)(3)(A) of the Code provides that except as provided in regulations prescribed by the Secretary, for purposes of the Code (i) a corporation which is a QSSSub shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSSSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) of the Code 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 QSSSub. The statutory provision does not, however, provide guidance on the manner in which the QSSSub election is made or the effective date of the election.

Section 1361(b)(3)(D) of the Code provides that if a corporation's status as a QSSSub

terminates, such corporation (and any successor corporation) shall not be eligible to make (i) an election under subparagraph (B)(ii) to be treated as a QSSSub, or (ii) an election under section 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 section 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 QSSSub is distributed to the individual shareholders of the subsidiary's parent, the subsidiary will no longer be a QSSSub 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), Rep. No. 244, 104th Cong. 2d Sess. 120 (1996).

Based solely on the foregoing facts and law, the Service waives the five-year waiting period imposed by section 1361(b)(3)(D) and consents to X's election under section 1362(a) to be an S corporation effective for its first taxable year beginning on the date of its deemed formation resulting from the termination of its QSSSub election.

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 section 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47. However, when the criteria in section 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) of the Code 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 letter is being sent to X.

Sincerely yours,
J. THOMAS HINES
Acting Branch Chief, Branch 2
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures: Copy of this letter
Copy for section 6110 purposes