Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200218017**
Release Date: 5/3/2002
Index Number: 1362.01-02

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Date:
January 29, 2002

Legend

X =

Y =

A =

B =

S1 =

S2 =

S3 =

T1 =

T2 =

T3 =

D1 =

D2 =

Dear :

This letter responds to a letter dated September 21, 2001, written on behalf of X, requesting a ruling that X be granted consent to make a subchapter S election prior to the termination of the five-year waiting period imposed by section 1362(g) of the Internal Revenue Code.

The information submitted states that Y, an S corporation and X, a C corporation, were under common ownership by shareholders A and B. On D1, Y was merged into X in a section 368(a)(1)(A) reorganization. At the time of the merger, Y had a valid subchapter S election in place. The book value of Y's assets was approximately 4.37 percent of the total book value of X after the merger. X has three direct subsidiaries, S1, S2, and S3. S3 has three wholly-owned subsidiaries, T1, T2, and T3. X desires to make a subchapter S election effective D2, which is less than five years from the date of merger. If X becomes an S corporation, X plans to elect qualified subchapter S subsidiary status for S1 and S3 and each wholly owned subsidiary of S3.

Section 1362(g) provides that if a small business corporation has made an election under section 1362(a) and if the election has been terminated under section 1362(d), the corporation (and any successor corporation) shall not be eligible to make an election under section 1362(a) for any taxable year before its fifth taxable year which begins after the first taxable year for which the termination is effective, unless the Secretary consents to the election.

Section 1.1362-5(b) of the Income Tax Regulations defines a successor corporation as a corporation where (1) 50 percent or more of the stock of the corporation (the new corporation) is owned, directly or indirectly, by the same persons who, on the date of the termination, owned 50 percent or more of the stock of the corporation whose election terminated (the old corporation); and (2) either the new corporation acquires a substantial portion of the assets of the old corporation, or a substantial portion of the assets of the new corporation were assets of the old corporation.

In Rev. Rul. 64-94, 1964-1 (Part 1) C.B. 317, the Internal Revenue Service ruled that the statutory merger, within the meaning of section 368(a)(1)(A) of the Code, of an electing small business corporation into a second corporation did not terminate the election of the electing corporation for its final taxable year. The Rev. Rul. cites section 381(b)(1), which provides that the taxable year of an acquired corporation in a statutory merger ends with the date of the merger. The Rev. Rul. holds that while the electing corporation's status as a small business corporation was terminated by the merger, the merger also terminated the corporation's final taxable year and hence the corporation did not cease to be a small business corporation during that final taxable year within the meaning of section 1372(e), currently section 1362(d).

The reasoning embodied in Rev. Rul. 64-94 was followed in Rev. Rul. 70-232,

1970-1 C.B. 178, in which the Service held that the consolidation of two electing small business corporations into a new corporation does not terminate their prior elections with respect to their final taxable year and the restriction on re-election specified in section 1372(f), currently section 1362(g), of the Code is not applicable.

Based upon the information submitted, and the representations set forth above, the restriction on re-election, specified in section 1362(g) of the Code, is not applicable to X. As a result, X is eligible to make the election provided for in section 1362(a) without prior approval. X is eligible to have such election effective D2, provided X meets all the requirements enumerated in section 1361 of the Code.

Except for the specific rulings above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding X's eligibility as a small business corporation under section 1361(b) to make the election under section 1362(a), or the eligibility of X to elect qualified subchapter S subsidiary status for its subsidiaries.

This ruling is directed only to the taxpayer on whose behalf it was requested. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter will be sent to X and X's second authorized representative.

Sincerely yours,
J. Thomas Hines
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
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