

**Internal Revenue Service**

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B1  
PLR-132075-08

Date:  
January 12, 2009

Legend

X =

Y =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

A =

aa =

Dear :

This responds to a letter dated June 16, 2008, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code and section 301.9100-3 of the Procedure and Administration Regulations.

Facts

The information submitted states that X is an S corporation for federal tax purposes. X acquired all of the outstanding stock of Y on Date 1. X intended for Y to be treated as a QSub, effective Date 1. However, due to inadvertence, Y failed to timely file Form 8869, Qualified Subchapter S Subsidiary Election.

Between Date 2 and Date 3, Y issued stock options to several of its employees. The exercise price of these stock options was less than their fair market value. On Date 4, A, an employee of Y, exercised a stock option in Y and received aa shares in Y. Y has cancelled all outstanding options and has repurchased the stock from A.

X represents that X, Y, and the shareholders of X were unaware that the issuance of the options could cause Y to have an owner other than X. X further represents that X was not motivated by tax avoidance or retroactive tax planning and that X and each of its shareholders have filed all returns consistent with X's S election remaining in effect since Date 1. Upon discovery of the problem, X submitted a request for a ruling under § 1362(f). X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation and consistent with the treatment of Y as a QSub with respect to the period specified by § 1362(f).

### Law and Analysis

Section 1362(a) provides that, except as provided in section 1362(g), a small business corporation may elect, in accordance with the provisions of section 1362, to be an S corporation.

Section 1361(b)(3)(A) provides that, a QSub shall not be treated as a separate corporation, and 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 any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), in which 100 percent of the stock of such corporation is held by the S corporation, and the S corporation elects to treat such corporation as a QSub.

Section 1.1361-3(a)(4) of the Income Tax Regulations provides that a QSub election will be effective on the date specified on the election form or on the date the election form is filed if no date is specified. The effective date specified on the form cannot be more than two months and 15 days prior to the date of filing and cannot be more than 12 months after the date of filing. A taxpayer makes a QSub election with respect to a subsidiary by filing Form 8869 with the appropriate service center.

Section 1.1361-3(a)(6) provides that an extension of time to make a QSub election may be available under the procedures applicable under §§ 301.9100-1 and 301.9100-3.

Under § 301.9100-1(c), the Commissioner may grant a reasonable extension of time to make a regulatory election, or a statutory election (but no more than six [\*3] months except in the case of a taxpayer who is abroad), under all subtitles of the Code, except E, G, H, and I. Section 301.9100-1(b) defines the term "regulatory election" as including an election whose deadline is prescribed by a regulation published in the Federal Register.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2. 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 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 the requirements of section 301.9100-3 have been satisfied. X is granted an extension of time of 60 days from the date of this letter to file a Form 8869 to elect to treat Y as a QSub effective Date 1. A copy of this letter should be attached to the election.

We also conclude that X's election to treat Y as a QSub may have terminated under § 1361(b)(3)(B)(i) on Date 2 or thereafter because the stock options issued by Y

resulted in less than 100 percent of the stock of Y from being held by X. We conclude that this termination would have been inadvertent within the meaning of § 1362(f). If X's election to treat Y as a QSub did not otherwise terminate under § 1361(b)(3)(B)(i), we conclude that the election terminated on Date 4 when A exercised the stock option. We conclude that such a termination would have been inadvertent within the meaning of § 1362(f).

Therefore, under the provisions of § 1362(f), Y will be treated as a QSub of X from Date 1, and thereafter, provided that the QSub election was otherwise valid and has not otherwise terminated, and provided that X files Form 8869, as described above.

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 representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

*Curt G. Wilson*

Curt G. Wilson  
Associate Chief Counsel  
(Passthroughs & Special Industries)

cc: