

# Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:CORP:2-PLR-108764-02  
Date:  
September 30, 2002

## Legend

Taxpayer =

Holding =

Sub #1 =

Sub #2 =

Sub #3 =

Sub #4 =

Sub #5 =

Sub #6 =

Sub #7 =

Sub #8 =

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Sub #9 =

Sub #10 =

Sub #11 =

LLC =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

Dear :

This is in response to your letter dated February 6, 2002, requesting a ruling on behalf of Taxpayer that, under § 1504(a)(3)(B) of the Internal Revenue Code (the "Code"), the Service waive the general rule of § 1504(a)(3)(A) of the Code with respect to Holding, Sub #2, Sub #3, and the Lower-Tier Subsidiaries. Additional information was received in letters dated June 6, 2002, and August 27, 2002. A conference of right was held on August 20, 2002.

The information submitted indicates that, prior to Date 1, Taxpayer was the common parent of an affiliated group of corporations that filed a consolidated federal income tax return on the basis of a fiscal year ending on the last day of February. Immediately prior to Date 1, Taxpayer owned % of the stock of Sub #1, Sub #2, Sub #3, and Sub #4; Sub #2 owned % of the stock of Sub #5, Sub #6, and Sub #7. Sub #5 owned % of the stock of Sub #8 and Sub #9. Sub #3 owned % of the stock of Sub #10. Sub #4 owned % of the stock of Sub #11. (In this letter, Sub #5, Sub #6, Sub #7, Sub #8, Sub #9, Sub #10, and Sub #11 are sometimes referred to as the "Lower-Tier Subsidiaries.") On or about Date 1, Taxpayer formed Holding and contributed to Holding % of the stock of Sub #2, Sub #3, and Sub #4 in exchange for all of the stock of Holding. Also on Date 1, Sub #4 was merged with and into LLC, a limited liability company wholly owned by Holding and disregarded as an entity separate from Holding for federal income tax purposes.

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Effective Date 2, Taxpayer elected to be an S corporation and elected to treat Sub #1, a first-tier subsidiary of Taxpayer, as a qualified subchapter S subsidiary, pursuant to § 1361(b)(3) of the Code. At that time, Taxpayer changed its taxable year from a year ending on the last day of February to a calendar year.

Effective Date 3 (a date before the 61<sup>st</sup> month beginning after the taxable year that includes Date 2), certain shareholders of Taxpayer transferred their stock in Taxpayer to certain trusts that are not permissible S corporation shareholders under §§ 1361(b)(1)(B) and 1361(c)(2). Accordingly, the Taxpayer's S election terminated on Date 3, and Taxpayer and Sub #1 became C corporations. Holding, Sub #1, Sub #2, Sub #3, and the Lower-Tier Subsidiaries therefore became reaffiliated with Taxpayer beginning on Date 3. Effective Date 4, all of the shareholders of Taxpayer sold 100% of the outstanding stock of Taxpayer to an unrelated corporation.

Taxpayer requested a waiver under Rev. Proc. 91-71, 1991-2 C.B. 900 for Holding, Sub #2, Sub #3, and the Lower-Tier Subsidiaries to be included in a consolidated return to be filed with Taxpayer as the common parent for the period Date 3 through Date 4. Rev. Proc. 2002-32, 2002-20 I.R.B. 959 clarified and superseded Rev. Proc. 91-71. Section 9 of Rev. Proc. 2002-32 provides that Section 7 of Rev. Proc. 2002-32 applies to all letter ruling requests postmarked, or if not mailed, received, after May 20, 2002. Section 9 of Rev. Proc. 2002-32 further provides that the Service may ask the taxpayer to submit information specified in that revenue procedure for any ruling requests postmarked, or if not mailed, received, before that date. In accordance with this provision, Taxpayer was asked to furnish additional information and representations as set out in Rev. Proc. 2002-32.

Section 1501 of the Code confers on an affiliated group of corporations the privilege of filing a consolidated return, in lieu of separate returns, with respect to the income tax imposed by chapter 1. The condition for making a consolidated return under § 1501 is that all corporations that at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under § 1502 prior to the last day prescribed by law for the filing of such return.

Section 1504(a)(3)(A) of the Code provides in part that if a corporation is included (or required to be included) in a consolidated return filed by an affiliated group and such corporation ceases to be a member of such group, such corporation (and any successor of such corporation) may not be included in any consolidated return filed by the affiliated group (or by another affiliated group with the same common parent or a successor of such common parent) before the 61<sup>st</sup> month beginning after its first taxable year in which it ceased to be a member of such affiliated group. Section 1504(a)(3)(B) of the Code provides that the Secretary may waive the application of subparagraph (A) for any corporation for any period subject to such conditions as the Secretary may prescribe.

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Section 3 of Rev. Proc. 91-71, 1991-2 C.B. 900, grants an automatic waiver of the general rule of § 1504(a)(3)(A) of the Code for taxpayers requesting a waiver and meeting the requirements of Rev. Proc. 91-71. Section 5 of Rev. Proc. 91-71 specifies the information and representations to be included in a request for an automatic waiver. Section 5.11 of Rev. Proc. 91-71 provides that the request for an automatic waiver must include a representation that the disaffiliation and reconsolidation will not provide a benefit of a reduction in income, increase in loss, or any other deduction, credit, or allowance that would not otherwise be secured or have been secured had the disaffiliation and reconsolidation not occurred, including, but not limited to, the use of a net operating loss or credit that would have otherwise expired. Section 5.11 further provides that in determining whether the disaffiliation and reconsolidation will provide a benefit, the net tax consequences to all parties are considered. Section 8 of Rev. Proc. 91-71 provides that if a deconsolidated corporation cannot qualify for an automatic waiver, a waiver under § 1504(a)(3)(B) may only be obtained through a letter ruling request. Section 8 of Rev. Proc. 91-71 further provides that the ruling request should include the information set forth in Section 5 of Rev. Proc. 91-71.

Section 5 of Rev. Proc. 2002-32 specifies the information and representations to be included in a request for an automatic waiver. Section 5.03 of this revenue procedure provides in part that, if the common parent of the current group is the common parent of the group from which the deconsolidated corporation(s) disaffiliated, the request for the waiver must include a representation that such former common parent was not an S corporation at any time during the period of its disaffiliation. Section 5.14 of Rev. Proc. 2002-32 provides in part that the request must include a representation that the disaffiliation and subsequent consolidation has not provided and will not provide a benefit of a reduction in income, increase in loss, or any other deduction, credit, or allowance (a federal tax savings) that would not otherwise be secured or have been secured had the disaffiliation and subsequent consolidation not occurred, including, but not limited to, the use of a net operating loss or credit that would otherwise have expired, or the use of a loss recognized on a disposition of stock of the deconsolidated corporation or a predecessor of such corporation. Section 5.13 of Rev. Proc. 2002-32 further provides that in determining whether the disaffiliation and subsequent consolidation provided or will provide a federal tax savings, the net tax consequences to all parties, taking into account the time value of money, are considered.

Section 7 of Rev. Proc. 2002-32 provides that if a deconsolidated corporation cannot qualify for an automatic waiver, a waiver under § 1504(a)(3)(B) may only be obtained through a letter ruling request. Section 7 of Rev. Proc. 2002-32 further provides that the ruling request should include the information set forth in Section 5 of Rev. Proc. 2002-32. Section 7 of Rev. Proc. 2002-32 further provides that, to the extent that the representations set forth in Section 5.03 or 5.13 of Rev. Proc. 2002-32 cannot be made, however, the letter ruling request must: (1) contain information establishing that federal tax savings was not a purpose of the disaffiliation, and that the amount of

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any federal tax savings attributable to the disaffiliation or a subsequent consolidation is not significant; and (2) state whether the deconsolidated corporation or a predecessor of such corporation was, at any time during the period of disaffiliation, in the effective control of any member (or successor of any member) of the current group or the former group.

In the instant case, Taxpayer's Date 2 election to be an S corporation was the event that caused the disaffiliation of Holding, Sub #2, Sub #3, and the Lower-Tier Subsidiaries. Since Taxpayer elected to be an S corporation, the representation required by Section 5.03 of Rev. Proc. 2002-32 cannot be made. As of Date 3, the date upon which Taxpayer's S corporation election terminated, Holding, Sub #2, Sub #3, and the Lower-Tier Subsidiaries became reaffiliated with Taxpayer. Thus, a PLR waiver is necessary for Holding, Sub #2, Sub #3, and the Lower-Tier Subsidiaries to be eligible to join in a consolidated return filed by Taxpayer for the period Date 3 through Date 4. The information submitted does not demonstrate that Taxpayer's Date 2 election to be an S corporation and its election to treat Sub #1 as a qualified subchapter S subsidiary pursuant to § 1361(b)(3) did not result in a federal tax savings as defined in Section 5.14 of Rev. Proc. 2002-32.

Based on the information submitted and representations made, it is therefore concluded that:

Taxpayer's request for a waiver of the general rule of § 1504(a)(3)(A) of the Code with respect to Holding, Sub #2, Sub #3, and the Lower-Tier Subsidiaries is denied. Holding, Sub #2, Sub #3, and the Lower-Tier Subsidiaries therefore may not be included in a consolidated return with Taxpayer as the common parent prior to the 61<sup>st</sup> month following the taxable year that includes Date 1, and must file separate returns for the period Date 3 through Date 4.

Although no opinion was requested regarding termination of the group and appropriate returns to be filed, the following is noted: As a result of Taxpayer's S corporation election, the Taxpayer consolidated group terminated, and Holding, Sub #2, Sub #3, and the Lower-Tier Subsidiaries qualified as a new affiliated group of which Holding was the common parent. A short period consolidated return was due for Taxpayer and its includible subsidiaries for the period from the beginning of the Taxpayer group's taxable year until Date 2. The affiliated group of which Holding was the common parent was eligible to file a short period consolidated return for the remainder of Year 1 and consolidated returns for subsequent years.

No opinion is expressed about the tax treatment of the transaction under any other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling.

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Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusions in the ruling. See § 12.04 of Rev. Proc. 2002-1, 2002-1 I.R.B. 1. However, when the criteria in § 12.05 of the Rev. Proc. are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

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

A copy of this letter should be attached to the federal income tax return of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

Sincerely yours,

*Edward S. Cohen*

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Edward S. Cohen  
Chief, Branch 2  
Office of Associate Chief Counsel (Corporate)