

LTR9746011

**Section 1363 — Election's Effect**

**Summary**

No LIFO Recapture on Inventory Transferred to Sub

The Service has ruled that a parent S corporation's transfer of its LIFO inventory to its wholly owned qualified subchapter S subsidiary will not be subject to LIFO recapture under section 1363(d).

The parent S corporation plans to transfer automobile inventory to its subsidiary. The parent corporation accounts for its inventory under the LIFO method, and the sub also will use the LIFO method.

**Full Text**

Date: August 12, 1997

In Reference to: CC:DOM:P&SI:3 PLR-109363-97

LEGEND:

Parent = \* \* \*

Subsidiary = \* \* \*

Dear \* \* \*

[1] This letter responds to a letter, dated May 6, 1997, that was submitted on Parent's behalf. In the letter, Parent, an S corporation, requested a ruling that it will not be subject to LIFO recapture under section 1363(d) of the Internal Revenue Code on the transfer to Subsidiary of inventory accounted for under the last-in, first-out method of accounting.

FACTS

[2] Parent is an S corporation as defined in section 1361. Parent has established Subsidiary, a subsidiary wholly owned by Parent that Parent has elected to treat as a qualified subchapter S subsidiary (a QSSS). The election is effective January 1, 1997. As part of a lending transaction, Parent plans to transfer certain assets, including automobile inventory, to Subsidiary. Parent accounts for its automobile inventory under the last-in, first-out (LIFO) method of accounting. Subsidiary will also use the LIFO method to account for the automobile inventory.

[3] Subsidiary will continue Parent's business as an automobile dealer engaged in retail sales of the transferred inventory. The asset transfer will insulate Subsidiary from any credit problems of Parent, allowing Subsidiary to borrow on a more advantageous basis than Parent could directly. Subsidiary will pledge the automobile inventory and other assets as security for a loan from an unrelated lender. The loan proceeds will be used for general corporate purposes.

LAW AND RULING

[4] An S corporation is allowed to own the stock of a QSSS. Section 1361(b)(3)(B) defines a QSSS as any domestic corporation that is not an ineligible corporation if (i) 100 percent of the stock of such corporation is held by the S corporation and (ii) the S corporation elects to treat such corporation as a QSSS.

[5] Section 1361(b)(3)(A) provides that (i) a QSSS is not treated as a separate corporation and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSSS are treated as assets, liabilities, and such items (as the case may be) of the S corporation.

[6] Section 1363(d)(1) provides that (A) if an S corporation was a C corporation for the last taxable year before the first taxable year for which the election under section 1362(a) was effective, and (B) the corporation inventoried goods under the LIFO method for such last taxable year, then the LIFO recapture amount is includible in the gross income of the corporation for such last taxable year.

[7] Section 1.1363-2(a) of the Income Tax Regulations provides that a corporation is subject to LIFO recapture under section 1363(d) if (1) it inventoried assets under the LIFO method for its last taxable year before its S election became effective, or (2) it inventoried assets under the LIFO method during the taxable year that it transferred LIFO assets to an S corporation in a nonrecognition transaction in which the transferred assets were transferred basis property.

[8] After applying the relevant law to the facts represented by Parent, we rule that Parent's transfer of its LIFO inventory to Subsidiary is not subject to LIFO recapture under section 1363(d).

[9] Except for the above ruling, we express no opinion on the federal tax consequences of the represented facts under any other provision of the Code. We specifically express no opinion on Parent's qualification as an S corporation under section 1361, whether subsidiary qualifies as a QSSS, or the validity of the election to have Subsidiary treated as a QSSS.

[10] This ruling is directed only to the taxpayer who requested it. Under section 6110(j)(3), this ruling may not be used or cited as precedent. Temporary or final regulations regarding the issue addressed in this ruling have not yet been adopted. Therefore, this ruling may 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. 97-1, 1997-1 I.R.B. 11, 43. However, when the criteria in section 12.05 of Rev. Proc. 97-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

[11] Under the power of attorney submitted with the ruling request, we are sending a copy of this letter to the representatives listed on the power of attorney.

Sincerely yours,

Brian M. Blum  
Assistant to the Chief,  
Branch 3  
Office of the Assistant Chief  
Counsel (Passthroughs and  
Special Industries)

Enclosure: 6110 copy