Subsidiaries

Accounting 551T - Lecture 12
Schlesinger: Chapter 14
Robert A. Scharlach

Subsidiaries Before 1996

- S Corporation Could Not Own 80% of the Stock of Another Corporation
- Law Changed in 1996 to Allow Unlimited Ownership of Stock by an S Corporation

 Qualified Subchapter S Subsidiaries

- Any Domestic Corporation That Is Not an Ineligible Corporation if
  - An S corporation holds 100% of the subsidiary
  - The S corporation elects to treat the subsidiary as a Q sub
Qualified Subchapter S Subsidiaries

- Requirements for Establishing a Q Sub
  - Must be a domestic corporation
  - Must not be an ineligible corporation
  - Must have 100% of its stock held by its S corporation parent
  - Parent must elect for it to be a Q sub

Effect of Q Sub Election

- Subsidiary Considered to Have Liquidated into the Parent Under Section 332

Insolvent Subsidiaries

- Sec. 332 Applies Only where the Parent Receives Something of Value in the Liquidation
Q Subs and Built-In Gains

- Q Sub is Subject to the Built-In Gains Tax

Q Subs and LIFO Inventory Recapture

- Q Sub is Subject to the Tax on the LIFO Recapture Amount if it Uses LIFO Before the Q Sub Election

Net Operating Loss Carryover

- An NOL Carryover Can Not Be Used After a Q Sub Election
### Recognition of Deferred Gain on Intercompany Transactions

- Must Be Recognized Upon the Liquidations of a Sub in a Consolidated Return
- Q Sub Election Triggers Recognition of the Gain
- Don’t Have to Make the Q Sub Election for All Subs

### Termination of a Q Sub Election

- Q Sub Status Continues Until Terminated
- Can Terminate in Three Ways -
  - Voluntary revocation
  - Termination of parent's S corp. status
  - Sub becomes an ineligible corporation

### Voluntary Revocation

- File a Statement with the IRS
- Effective Date of Revocation
  - Effective date can not be more than two months and 15 days prior to the date on which the statement is filed
  - Effective date can not be more than 12 months after the date on which the statement is filed
Termination of Parent’s S Election

- Q Sub Status is Terminated at Same Time as Parent’s S Status is Terminated

Sub Becomes Ineligible

- Parent Sells Some Stock of the Sub
- Q Sub Issues Stock to an Entity Other Than Its Parent
- Q Sub Becomes an Ineligible Corp.
- Q Sub Reorganizes into a Foreign Corp.

Effect of Termination on Q Sub Election

- Assets Are Considered Transferred to a New Corporation
  - Sec. 351 will apply if the control requirements are met
  - If not met, transfer will be taxable
Inadvertent Termination

- Relief Is Available in the Same Manner As if an S Corp. Inadvertently Lost Its S Election

Re-Election After QSub Termination

- Can't elect S corp. status or Qsub status for 5 years

Subs of S Corporations

- S corps. Can now own any percentage of another corporation
- S corp. can not file a consolidated return
- Dividends from C corp. subs