STATE OF LOUISIANA
DEPARTMENT OF REVENUE
POLICY SERVICES DIVISION

M. J. "MIKE" FOSTER, JR.
Governor

CYNTHIA BRIDGES
Secretary

Historical Note: Subsequent to the issuance of this private letter ruling, 2002 La. Acts 17 enacted La. Rev. Stat. Ann. § 47:287.732(C) and La. Rev. Stat. Ann. § 47:287.732.1, which address the taxation of the income of qualified Subchapter S subsidiary corporations. For taxable periods beginning after December 31, 2002, these statutory provisions will apply.

Private Letter Ruling 01-009
Redacted Version
Taxation of a Qualified Subchapter S Subsidiary Corporation
Corporation Income Tax
March 8, 2002

A Private Letter Ruling was requested to address the income tax treatment of a Qualified Subchapter S Subsidiary (QSub) created as a result of a reorganization. Following the reorganization Individual A will be the sole owner of Corporation P, an S corporation. Corporation P will be the parent of Corporation Q, which will be a QSub. Under the proposed reorganization, this Private Letter Ruling addresses the following questions:

a. "Following the effective date of [Corporation Q's] election to be a QSub, will [Corporation Q] be treated, for Louisiana income tax purposes, as: (1) a "corporation" pursuant to La. R.S. 47:287.11; or (2) a "disregarded entity" and not an entity separate and apart from [Corporation P], the owner of all the [Corporation Q] stock?

b. Following the effective date of [Corporation Q's] election to be a QSub, if [Corporation Q] is treated as a corporation and not as a disregarded entity, will all of [Corporation Q's] items of income, deduction and credit be allocated away from [Corporation Q] and to [Corporation P] and will all of [Corporation Q's] assets and operations be combined with and reported as the assets and operations of [Corporation P], for Louisiana income tax purposes?

c. Following the effective date of [Corporation Q's] election to be a QSub, will [Corporation Q] be considered and treated as a corporation having no items of income and deduction (and thus no taxable income) and credit and no assets and operations, for Louisiana income tax purposes?

d. Following the effective date of [Corporation Q's] election to be a QSub, will [Corporation P] be considered and treated as an S corporation having items of income, deduction and credit consisting of its own items combined with those of [Corporation Q] but eliminating all intercompany items between [Corporation Q] and [Corporation P], including intercompany interest and dividends?"

The relevant statements of fact provided were as follows:

a. Current Facts as of the date of the request:

(1) "[Corporation Q] is a Louisiana corporation that has elected S corporation status for federal income taxation purposes pursuant to Section 1361(a) of the Internal Revenue Code.

(2) [Individual A], a Louisiana resident, is the sole shareholder and owner of 100% of the outstanding stock of [Corporation Q]."

b. It is proposed that:

(1) "[Individual A] will form and be the sole owner of a new entity ('[Corporation P]'), which will be treated as a corporation and make an S corporation election for federal income tax purposes.

(2) [Individual A] will make a capital contribution of 100% of his [Corporation Q] stock to [Corporation P] in a transaction that should qualify as a tax free exchange under Section 351 of the Internal Revenue Code and/or as a reorganization under Section 368(a)(1)(F) of the Internal Revenue Code.

(3) [Corporation P] and [Corporation Q] will make an election to treat [Corporation Q] as a QSub for federal income tax purposes pursuant to Section 1361(b)(3) of the Internal Revenue Code."

c. Following completion of all steps of the Proposed Reorganization:

(1) "[Individual A] will be the sole 100% owner of [Corporation P];

(2) [Corporation P] will be the owner of 100% of [Corporation Q]."

The situation that will be addressed by this ruling is that which will exist after the reorganization and elections outlined in the statements of fact have occurred. At that point, Individual A will be the sole owner of Corporation P (an S corporation) and Corporation P will be the sole owner of Corporation Q (a QSub).

The analysis of this situation begins with the provisions of La. Rev. Stat. Ann. §47:287.732 (West 2001). Under this section, treatment of an S corporation is different than the treatment for federal income tax purposes. It requires the S corporation to apply the Louisiana income tax as if it had been required to file an income tax return with the Internal Revenue Service as a C corporation for the current and all prior years. In that statutorily deemed environment, Corporation P would include only its own income and expenses on its return. It would not include the income of Corporation Q. At the same time, Corporation Q, as a disregarded entity for federal income tax purposes, would not be an S corporation for federal income tax purposes. Corporation Q would be a corporation for Louisiana income tax purposes, using its federal items of income and expense as the starting point for computing its Louisiana taxable income. Corporation Q would have no items of federal income or expense because for federal income tax purposes it is a disregarded entity. The result, absent action by the Secretary, would be that Corporation P would pay Louisiana income tax on its own income, computed without inclusion of Corporation Q income, and Corporation Q would not pay Louisiana tax on any income it may have. It is readily apparent Louisiana income would not be clearly reflected.

Louisiana Revised Statute Annotated §47:287.480 contemplates instances in which the operation of other provisions of law alone would not clearly reflect Louisiana income. This section grants the authority to the Secretary to require adjustments and methods of reporting that will clearly reflect income. Under the facts presented, the Secretary will require Corporation P and Corporation Q to compute Louisiana taxable income on a consolidated statement, including the income, deductions, credits, assets, sales, revenues and other attributes of both corporations. The Louisiana taxable income so computed must be spread to the separate returns of the two corporations. Unique to the QSub fact pattern, the Department would attribute all the income to Corporation P in keeping with the federal income tax treatment. It is likely the taxpayers will find it advantageous to attribute all the income to Corporation P because

Corporation P is eligible for the S corporation exclusion provided by La. Rev. Stat. Ann. §47:287.732(B) (West 2001).

Addressing your specific questions:

a. Following the effective date of Corporation Q's election to be a QSub, Corporation Q will be treated as an entity subject to Louisiana income and franchise tax. However, the taxable income will be the amount spread to Corporation Q from the consolidated statement. This amount will be zero unless the taxpayer presents compelling reasons to the Department why Louisiana taxable income should be attributed partly to Corporation Q.

b. Following the effective date of Corporation Q's election to be a QSub, Corporation Q will not be treated as a "disregarded entity." It will be treated as an entity separate and apart from Corporation P and must file its own separate income and franchise tax returns. However, it will be consolidated with Corporation P for consolidated statement purposes as part of the computation of its separate income tax. The consolidated statement consolidates the items of income, deduction and credit as well as the assets and operations of both corporations, but does not attribute them to either. The apportionment factors used on the consolidated statement reflect the consolidated apportionment factor items, such as revenue, wages, and property. The consolidated statement is a device to determine the Louisiana income of both corporations, then the Louisiana income so computed is attributed to the separate corporations. As previously noted, the Department would normally attribute all the income computed on the consolidated statement to Corporation P, in keeping with the federal income tax treatment of QSub's. The consolidated statement would be an attachment to the Louisiana income tax returns of both corporations.

c. As noted above, the use of a consolidated statement does not attribute the operations of one corporation to another corporation; rather it makes the attribution irrelevant in this situation. In other situations, not involving a QSub and its parent, each corporation would have its own apportionment factor items, and those items would often be used in determining how much of the Louisiana income computed on the consolidated statement is attributed to each corporation. Under the fact pattern at hand, the consolidated statement determines the Louisiana income of both corporations. The fact that the distribution of that income is between an S corporation parent and its QSub causes the Department to attribute all Louisiana income to the S corporation and none to the QSub.

d. Following the effective date of Corporation Q's election to be a QSub, Corporation P will be considered and treated as an S corporation for purposes of La. Rev. Stat. Ann. §47:287.732(B) (West 2001). As noted above, there is no specific attribution to it of the items of Corporation Q, other than the income of Corporation Q effectively being attributed to Corporation P. In the consolidated statement all intercompany items are eliminated, including intercompany interest and dividends.

This private letter ruling is limited to, and based upon, the facts presented.

Cynthia Bridges
Secretary

By: ____________________________
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A Private Letter Ruling (PLR) is issued under the authority of LAC 61:III.101(C). A PLR provides guidance to a specific taxpayer at the taxpayer's request. It is a written statement issued to apply principles of law to a specific set of facts or a particular tax situation and is limited to the matters specifically addressed. A PLR does not have the force and effect of law and may not be used or cited as precedent. A PLR is binding on the Department only as to the taxpayer making the request and only if the facts provided with the request were truthful and complete and the transaction was carried out as proposed. The Department's position concerning the particular tax situation addressed remains in effect for the requesting taxpayer until a subsequent declaratory ruling, rule, court case, or statute supersedes it.