Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B01 – PLR-110004-03
Date:
Nov 17 2003

Legend:

X =

Z =

State A =

State B =

H =

D1 =

D2 =

D3 =

a =

Dear

This letter responds to the letter dated February 5, 2003 and related correspondence, written on behalf of X, requesting a ruling under §1362(f) of the Internal Revenue Code for inadvertent termination of S corporation election, and an

extension of time under §301.9100-1 and §301.9100-3 of the Procedure and Administration Regulations to file an entity classification election under §301.7701-3(c).

FACTS

The information submitted discloses that X was incorporated originally under the laws of State A. H was the initial sole shareholder of X. X elected to be treated as an S corporation for federal tax purposes effective D1. Subsequently, H organized Z as a limited liability company under the laws of State A. H transferred *a* percent of the shares of X in exchange for all of the membership interest of Z. Z was treated as a disregarded entity separate from X for federal tax purposes.

On D2, X converted to a limited partnership under the laws of State A, with Z as the general partner and H as the limited partner. In connection with the conversion, X made an election by filing Form 8832, Entity Classification Election, to be treated as an association taxable as a corporation for federal tax purposes, effective D2. Following the conversion, on D3, a holding corporation was incorporated under the laws of State B. H was the sole shareholder of the holding corporation. H transferred to the holding corporation all of the membership interests in Z and the State A limited partnership. As a result, for state law purposes, X was a tiered structure with a State B corporation holding interests in a State A limited liability company, with which it owned a State A limited partnership.

Further, X claims that it made a timely election by filing Form 8832 to treat the State A limited partnership as a disregarded entity for federal tax purposes, effective D3. If timely received, the election would have permitted X's existence for federal tax purposes to continue through the State B holding corporation. However, the service center has no record of having received the election.

In addition, X claims that the conversion on D2 may have created a second class of stock, terminating X's S corporation election.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation that has more than one class of stock does not qualify as a small business corporation.

Section 1362(d)(2)(A) provides that an election under §1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the day of the cessation. §1362(d)(2)(B).

Section 1362(f), in relevant part, provides that, if: (1) an election under §1362(a) by any corporation was terminated under §1362(d); (2) the Secretary determines that the termination was inadvertent; (3) no later than a reasonable period of time after discovery of the event resulting in the termination, steps were taken so that the corporation is once more a small business corporation; and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to §1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the terminating event, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

The Committee reports accompanying the Subchapter S Revision Act of 1982 explain §1362(f) as follows:

> If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and the shareholders agree to be treated as if the election had been in effect for such period.
>
> The committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequence of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that the taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers . . . . It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24; H.R. Rep. No. 826, 97th Cong., 2d Sess. 12 (1982), 1982-2 C.B. 730, 735.

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under §301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes. Elections are necessary only when an eligible entity does not want to be classified under the default classification or when an eligible entity chooses to change its classification.

Section 301.7701-3(b)(1)(ii) provides that unless a domestic eligible entity elects otherwise, the entity is disregarded as an entity separate from its owner if it has a single owner.

Section 301.7701-3(c)(1)(i) provides that an eligible entity may elect to be classified other than as provided under §301.7701-3(b) by filing Form 8832, Entity Classification Election, with the appropriate service center. Under §301.7701-3(c)(1)(iii), this election will be effective on the date specified by the entity on Form 8832 or on the date filed if no such date is specified. The date specified on Form 8832 cannot be more than 75 days prior to the date on which the election is filed.

Under section 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 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 Internal Revenue Bulletin.

Sections 301.9100-2 and 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.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that, if the conversion from a State A corporation to a State A limited partnership on D2 created a second class of stock for X and thereby terminated the S election, the termination constituted an “inadvertent termination” within the meaning of §1362(f). X will be treated as continuing to be an S corporation from D2 to D3, and thereafter,

provided that X's S election is not otherwise terminated under §1362(d) and the shareholder of X treats X as an S corporation during this period.

Further, X has satisfied the requirements of §§301.9100-1 and 301.9100-3 and, therefore, it is granted an extension of time of sixty (60) days from the date of this letter to file a new Form 8832 to elect to treat its wholly owned state law limited partnership as a disregarded entity separate from X, effective D3, with the appropriate service center. A copy of this letter should be attached to the election. A copy is enclosed for that purpose.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Internal Revenue Code. Specifically, no opinion is expressed concerning whether X is a valid S corporation.

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 mailed to your authorized representatives.

Sincerely,

/s/ Heather C. Maloy

Heather C. Maloy
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes

cc: