Internal Revenue Service

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Department of the Treasury
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Date:
March 02, 2005

LEGEND

X =
TIN:

Y =

Z =
TIN:

A =
SSN:

State1 =

State2 =

D1 =

D2 =

D3 =

D4 =

Dear :

This letter responds to a letter dated August 13, 2004, submitted by X's authorized representative on behalf of X, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State1 on D1 and elected to be as an S corporation effective on D1. On D2, X converted to a State1 limited partnership and also elected be treated as an association taxable as a corporation. X believed that the conversion would be treated for federal income tax purposes as a reorganization under § 368(a)(1)(F), and therefore, no new Form 2553, Election to be an S corporation, was filed. On D2, X's S corporation election was terminated when Y, an ineligible shareholder, became the general partner of the limited partnership. Moreover, this conversion may have created a second class of stock. The following two remedial actions were taken: on D3, Y converted to Z, a limited liability company treated as disregarded from its owner, A, for federal tax purposes, and on D4, X reorganized as a State2 limited liability partnership.

X represents that it was unaware that the conversion to a limited partnership and the admission of Y as a general partner could potentially cause its S election to terminate. X represents that it had no intention of terminating its S corporation election and that during the termination period it has timely and consistently filed it tax returns consistent with its treatment as an S corporation. X and its shareholders have agreed to make such adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

LAW AND ANALYSIS

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

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2) or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2) 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 a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such 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 circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSIONS

Based solely on the facts represented, we conclude that X's S corporation election was terminated on D2 when Y, an ineligible shareholder, acquired X stock. We also conclude that this termination was inadvertent within the meaning of § 1362(f). In addition, if X's conversion from a State1 corporation to a State1 limited partnership did create a second class of stock, the consequent termination of X's S corporation election was inadvertent within the meaning of § 1362(f). Therefore, we rule that X will continue to be treated as an S corporation for the period from D2 and thereafter, unless X's S election otherwise terminates under § 1362(d).

Except as specifically ruled above, we express no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding X's eligibility to be an S corporation or the validity of its S corporation election.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

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.

Sincerely,

Beverly Katz
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: (3)
2 Copies of this letter
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