Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:
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Date:
June 02, 2005

LEGEND

A =

B =

C =

D =

E =

F =

G =

H =

X =

Y =

Z =

Holdco =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

State =

Dear

This letter responds to a letter dated January 11, 2005, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that Y was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation effective Date 1. Pursuant to a plan of reorganization under § 368(a)(1)(F), on Date 2, Y converted to X, a State limited partnership that elected to be classified as an association taxable as a corporation for federal tax purposes. X intended to continue Y's S election. A, B, C, D, E, F, G and H became limited partners of X. Z, a State corporation was formed to serve as X's general partner. A owns all of the Z stock. Although, through inadvertence, no actual interests in X were transferred to Z in the reorganization, by having a corporation as the general partner, X may have terminated its S election. On Date 3, A formed LLC, a single member State limited liability company, that is classified as an entity disregarded as separated from its owner, to replace Z as X's general partner. On Date 3, X redeemed any interest Z may have had in X, replaced Z with LLC as its general partner, and issued LLC a 1% interest in X.

X requests a ruling under § 1362(f) that the possible termination was inadvertent and that X will be treated as an S corporation for the period Date 2 to Date 3. X was advised that pursuant to § 5.05 of Rev. Proc. 2005-3, 2005-1 I.R.B. 126, the Service would not rule on whether a state law limited partnership has more than one class of stock for purposes of § 1361(b)(1)(D), and thus would not grant § 1362(f) relief to a limited partnership asserting S corporation status. Accordingly, X revised its plan of reorganization and all its shareholders formed Holdco, a State general partnership, as of Date 4. Holdco will make an election to be classified as an association taxable as a corporation for federal tax purposes and will elect to be treated as an S corporation, both elections to be effective Date 4. On Date 5, A contributed 100% of LLC interest and all of A's directly held X interest for an interest in Holdco. B, C, D, E, F, G and H also contributed their interests in X for interests in Holdco. Holdco will elect for X to be treated as a qualified subchapter S subsidiary (QSub), effective Date 5.

X represents that neither tax avoidance nor retroactive tax planning motivated the possible termination of X's S corporation election. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation from Date 2 to Date 5.

Section 1361(a)(1) of the Code 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 (1) if an election under § 1362(a) was terminated under § 1362(d)(2) or (3), (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.

Based solely on the information submitted and the representations made, we conclude that X's S corporation election may have terminated on Date 2, (1) when Z, an ineligible shareholder, became a partner of X; or (2) if X's conversion from a State corporation to a State limited partnership created a second class of stock, and further, we conclude that any such termination was inadvertent within the meaning of § 1362(f).

Additionally, we hold that under the provisions of § 1362(f), X will be treated as an S corporation from Date 2, to Date 5, provided that X's S election was valid and was not otherwise terminated. A will be treated as the owner of X with respect to any interest Z may have owned in X from Date 2 to Date 3.

Accordingly, all of the shareholders of X, in determining their respective income tax liabilities for the period beginning Date 2 and thereafter must include their pro rata share of the separately stated and non-separately computed items of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code. Specifically, no opinion is expressed on whether X was otherwise eligible to be treated as an 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 sent to X's authorized representative and second authorized representative.

Sincerely yours,

J. Thomas Hines
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
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