Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 – PLR-152836-05

Date:
February 13, 2006

X =

LLC =

State =

Dear

This letter responds to a letter dated October 10, 2005, requesting rulings regarding a proposed transaction, including rulings under subchapter S of the Internal Revenue Code and that the proposed transaction qualifies as a reorganization under § 368(a)(1)(F).

FACTS

X is a corporation organized under the laws of State and is a calendar year S corporation that files its tax returns on an accrual basis. X has three individual shareholders (Shareholders) who are citizens of the United States. X is primarily an investor with holding in marketable equity, debt securities, and an interest in a publicly traded partnership. For business reasons, X wishes to reorganize as a limited liability company under the laws of State and proposes to engage in the following transactions. X's shareholders will form LLC, a new State limited liability company. LLC will elect under § 301.7701-3 of the Procedure and Administration Regulations to be treated as an association taxable as a corporation for federal tax purposes, effective from the date of formation. Concurrently with or shortly after the formation and entity classification election of LLC, X will merge into LLC under State law, with LLC surviving. LLC's

members and percentage membership interests will be identical to the shareholders and percentage shareholder interests of X. All LLC members will have identical rights.

LLC's Operating Agreement provides that membership interest in LLC will be determined by a "Sharing Ratio" which is defined as a fraction, the numerator of which is a member's initial capital contribution and the denominator of which is the total sum of all members' initial capital contributions. The Sharing Ratio may be adjusted pursuant to the agreement to reflect increases and decreases in capital. The LLC Operating Agreement further provides that distributions will be made in accordance with the Sharing Ratio as will distributions in complete liquidation of LLC after LLC's liabilities are paid.

The taxpayer has made the following representations in connection with the proposed transaction:

(a) The fair market value of the LLC membership interest that each Shareholder will receive in the merger will be equal to the fair market value of the X stock that will be surrendered in the exchange. The Shareholders will receive no consideration other than LLC membership interests for their X stock.

(b) There is no plan or intention by any Shareholder to sell, exchange, or otherwise dispose of any of the LLC membership interests that he or she will receive in the merger.

(c) Immediately after the merger, the Shareholders of X will own all of the membership interests of LLC and will own such interests solely by reason of their ownership of X stock immediately prior to the merger.

(d) LLC has no plan or intention to issue additional LLC membership interests following the merger.

(e) Immediately after the merger, LLC will possess all of the assets and liabilities as those possessed by X immediately prior to the merger. No assets will be distributed, and there will be no dissenting shareholders.

(f) At the time of the merger, X will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in X.

(g) LLC has no plan or intention to reacquire any of its membership interests issued in the merger.

(h) LLC has no plan or intention to sell or otherwise dispose of any of the assets of X acquired in the merger, except for dispositions made in the ordinary course of business.

(i) The liabilities of X to be assumed by LLC plus the liabilities, if any, to which the assets to be transferred are subject were incurred by X in the ordinary course of its business and are associated with the assets transferred.

(j) Following the merger, LLC will conduct the same business as that conducted by X prior to the merger.

(k) The Shareholders will pay their expenses, if any, incurred in connection with the formation of LLC and the merger.

(l) X is not presently under the jurisdiction of any court in a Title 11 or similar case within the meaning of § 368(a)(3)(A) of the Internal Revenue Code.

(m) Immediately after the merger, LLC will not be under the jurisdiction of any court in a Title 11 or similar case within the meaning of § 368(a)(3)(A) of the Internal Revenue Code.

(n) LLC's election under § 301.7701-3 to be treated as an association taxable as a corporation will be effective as of the date of its formation such that LLC will never exist as a partnership for federal tax purposes.

LAW and ANALYSIS

Section 368(a)(1)(F) provides that the term “reorganization” means a mere change in identity, form, or place of organization of one corporation, however effected.

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) 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 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1.1361-1(l)(1) provides that a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2) provides that the determination of whether all outstanding shares of stock confer identical right to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law and binding agreements relating to distribution and liquidation proceeds.

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 as provided in § 301.7701-3. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Rev. Rul. 64-250, 1964-2 C.B. 333, concludes that when an S corporation merges into a newly formed corporation in a transaction qualifying as a reorganization under § 368(a)(1)(F), and the newly formed surviving corporation also meets the requirements of an S corporation, the reorganization does not terminate the S election. Thus, the S election remains in effect for the new corporation.

Rev. Rul. 73-526, 1973-2 C.B. 404, concludes that the identifying number previously assigned to the transferor corporation should be used by the surviving corporation in a statutory merger qualifying as reorganization under § 368(a)(1)(F).

CONCLUSIONS

Based solely on the information submitted and the representations as set forth above, we hold as follows:

(1) The merger of X into LLC pursuant to State law and LLC's election to be treated as an association taxable as a corporation for federal tax purposes, which will be in effect on the date of the proposed transaction, qualifies as a reorganization under § 368(a)(1)(F).

(2) X will not recognize any gain or loss on the exchange (§§ 361(a) and 357(a)). The basis of the assets of X in the hands of LLC will be the same as the basis of such assets in the hands of X immediately prior to the proposed transaction (§ 362(b)). The holding period of the X assets held by LLC will include the period during which such assets were held by X (§ 1223(2)).

(3) The basis of the interests in LLC received by the shareholders will be the same as the basis of the shares of X surrendered in the exchange (§ 358(a)(1)). The holding period of the interests in LLC to be received by the shareholders will include the period during which the shares of X surrendered therefore were held, provided that the shares are held as capital assets on the date of the exchange (§ 1223(1)).

(4) LLC's Operating Agreement, once executed in a substantially identical form, will be considered a governing provision for purposes of § 1.1361-1(l)(2)(i), since it will be a binding agreement that defines the members' rights to distribution and liquidation proceeds. Further, the LLC Operating Agreement once executed, does not, by its terms, create equity interests that would be treated as different classes of stock for purposes of § 1361(b)(1)(D) because it does not create different rights to current distributions or liquidation proceeds.

(5) X's S election will not terminate as a result of the reorganization under § 368(a)(1)(F) if LLC meets the requirements of an S corporation under § 1361. See Rev. Rul. 64-250, 1964-2 C.B. 333.

(6) LLC will retain X's previously assigned identifying number (EIN). See Rev. Rul. 73-526, 1973-2 C.B. 404.

These rulings are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While we have not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, this ruling expresses no opinion regarding the existence of any other document or arrangement that could be considered a governing provision under § 1.1361-1(l)(2)(i). In addition, any arrangement that allows the owners to share in current distributions and liquidating proceeds in a manner that differs from their stated ownership percentage interests could potentially be considered to create a second class of stock.

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.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this

letter is being sent to X's authorized representatives.

Sincerely,

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

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes