Internal Revenue Service

Number: **200649005**
Release Date: 12/8/2006
Index Number: 1362.04-00

Department of the Treasury
Washington, DC 20224

Person To Contact:

ID No.

Telephone Number:

Refer Reply To:
CC:PSI:2 – PLR-113502-06
Date: August 22, 2006

LEGEND

Dear :

This letter responds to a letter dated January 31, 2006, and subsequent correspondence, submitted by X's authorized representative on behalf of X, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated under the laws of State on D1 and elected to be an S corporation effective D2. On D3, X converted to a State limited partnership. 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 by a Small Business Corporation, was filed. This conversion may have created a second class of stock. Additionally, X intended that the limited partnership would be classified as an association taxable as a corporation. However, due to inadvertence, no Form 8832, Entity Classification Election, was filed.

Also on D3, X's S corporation election was terminated when A, an ineligible shareholder, became the general partner of the limited partnership. The following two remedial actions were taken: on D4, X filed Articles of Correction naming B, an individual, as the general partner of the limited partnership, and on D5, X was converted back to a State corporation.

X represents that it was unaware that the conversion to a limited partnership and the admission of A as a general partner could cause its S corporation election to terminate. X represents that it did not intend to terminate its S corporation election and that it has consistently filed its 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 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

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 D3 when A, 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 State corporation to a State 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 conclude that X will continue to be treated as an S corporation for the period from D3 and thereafter, provided that X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d). During the period from D3 and thereafter, B will be treated as the owner of the X stock acquired by A. The shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void.

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 representative.

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,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)