Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-140404-06
Date:
January 25, 2007

Legend:

X =

State =

D1 =

Dear :

This letter responds to a letter dated August 10, 2006, submitted on behalf of X, requesting rulings regarding a proposed transaction, including rulings under sections 368 and 1361 of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on D1. X made an S election effective D1. For business reasons, X intends to reorganize as a limited liability company (LLC) under the laws of State. The newly formed 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 the LLC, X will merge into the LLC under State law, with the LLC surviving. The LLC members and their percentage membership interests in the LLC will be identical to X shareholders and their percentage shareholder interests in X.

The LLC will be manager managed. The LLC managers are, in this case, the equivalent of corporate officers. Managers can be elected and removed by majority vote of the members. With respect to the LLC, its members will have identical rights (other than the ability to bind the LLC in contract as to third parties, which right will be limited to the elected managers). With respect to the LLC, all items of income and loss will be allocated among the members pro rata in accordance with their percentage membership interests in the LLC, and all distributions (both liquidating and non-liquidating) will be made to the members pro rata in accordance with their percentage membership interests.

The fair market value of the LLC membership interests that the shareholders of X will receive in the merger will be equal to the fair market value of X shares surrendered in the exchange. The shareholders will receive no consideration other than LLC membership interests for their X shares. There is no plan or intention by any of the shareholders to sell, exchange, or otherwise dispose of any LLC membership interest that he or she will receive in the merger. The LLC has no plan or intention to issue LLC membership interests following the merger. Immediately following the consummation of the merger, the shareholders will own all of the membership interests of the LLC and will own such interests solely by reason of their ownership of X stock immediately prior to the merger. Immediately following the merger, the LLC will possess all of the assets and liabilities as those possessed by X immediately prior to the transaction. No assets will be distributed, and there will be no dissenting shareholders. At the time of the merger, X will not have outstanding any warrants, options, convertible securities, or any other type of right by which any person could acquire stock in X. The LLC has no plan or intention to reacquire or redeem any of its membership interests issued in the merger. The LLC has no plan or intention to sell or otherwise dispose of any of the assets of X acquired in the proposed transaction, except for dispositions made in the ordinary course of business. The liabilities of X to be assumed by the LLC plus the liabilities, if any, to which the assets to be transferred are subject were incurred by X in the ordinary course of business and are associated with the assets transferred. Following the merger, the LLC will conduct the same business that was conducted by X prior to the merger. The shareholders will pay their expenses, if any, incurred in connection with the transaction. X is not currently under the jurisdiction of any court in a Title 11 case or similar case within the meaning of § 368(a)(3)(A) of the Internal Revenue Code. Immediately after the merger, the LLC will not be under the jurisdiction of any court in a Title 11 case or similar case within the meaning of § 368(a)(3)(A) of the Internal Revenue Code.

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 agreement relating to distribution and liquidation proceeds (collectively, the governing provisions). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the arrangement is to circumvent the one class of stock requirement of § 1361(b)(1)(D) and § 1.1361-1(l).

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 a reorganization under § 368(a)(1)(F).

Conclusions

Based solely on the information submitted and the representations as set forth above, we conclude that the merger of X into the LLC pursuant to State law and the 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). X will not recognize any gain or loss on the exchange (§§ 361(a) and 357(a)). The basis of X assets in the hands of the 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 X assets held by the LLC will include the period during which such assets were held by X (§ 1223(2)). The basis of the LLC interests received by the shareholders will be the same as the basis of X shares surrendered in the exchange (§ 358(a)(1)). The holding period of the LLC interests to be received by the shareholders will include the period during which X shares surrendered therefore were held, provided that the shares are held as capital assets on the date of the exchange (§ 1223(1)). The LLC's 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 liquidating proceeds. Further, the LLC agreement, once executed, will not, by its terms, cause X to have a second class of stock within the meaning of § 1361(b)(1)(D). The LLC will retain X's previously assigned identifying number (EIN). See Rev. Rul. 73-526, 1973-2 C.B. 404.

Except as specifically set forth herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed 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.

In accordance with the power of attorney on file with this office, a copy of this letter is being mailed to your authorized representative.

Sincerely,

Audrey W. Ellis
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

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