Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:
December 14, 2007

Company =

A =

B =

C =

State =

LLC =

LLC2 =

a =

b =

c =

d =

e =

f =

Dear :

We received a letter dated March 12, 2007, and subsequent correspondence submitted on behalf of Company, requesting a ruling under § 1361(f) of the Internal Revenue Code. This letter responds to that request.

FACTS

Company incorporated under the laws of State on a, and elected to be an S corporation effective on b. Company's current owners are individuals A and C.

On c, pursuant to a plan of conversion, Company converted to a State limited partnership and made an election under § 301.7701-3 of the Administration and Procedure Regulations to be classified as an association taxable as a corporation. Prior to the conversion, Company's shareholders were A, B, and C. Upon the conversion, Company's limited partners were A, B, and C; and Company's general partner was LLC, which was owned by A, B, and C and treated as a partnership. After its conversion, Company continued to be treated as an S corporation and conducted all activities consistent with that status.

On d, Company and its partners first became aware that as a result of the conversion, Company terminated its S corporation election. To remedy the terminating event, C purchased B's membership interest in LLC. LLC redeemed C's membership interest in LLC for half of LLC's general partner interest in Company. C then transferred the general partner interest in Company to LLC2 in exchange for all of the membership interests in LLC2. Thus, LLC and LLC2 became disregarded entities wholly owned by A and C respectively. On e, B transferred all of B's stock in Company to C. Finally, on f, LLC and LLC2 transferred all of their stock in Company to their respective member, and Company converted back to a corporation under State law. As a result of these transfers, Company is owned by A and C.

Company represents that neither A, B, nor C realized that Company's conversion to a State limited partnership taxable as a corporation could result in the termination of Company's S corporation election. In addition, Company represents that the possible terminating event was not motivated by tax avoidance or retroactive tax planning. Company and its shareholders agree to make any necessary adjustments consistent with the treatment of Company as an S corporation.

LAW

Section 1361(b)(1) 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-- (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) of the Income Tax Regulations provides, in part, that a corporation that has more than one class of stock does not qualify as a small business corporation. Except as provided in § 1.1361-1(l)(4), 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 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

For S corporation elections made and terminations occurring before January 1, 2005, § 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents; 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 the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that Company's S corporation election terminated on c, upon the conversion of Company to a State limited partnership, which resulted in Company having an ineligible shareholder, LLC, and which may have created a second class of stock. In addition, we

conclude that the termination was inadvertent within the meaning of § 1362(f). Consequently, we rule that Company will continue to be treated as an S corporation from c, and thereafter, provided Company's S corporation election is not otherwise terminated under § 1362(d). Accordingly, Company's shareholders must include their pro rata shares of the separately and nonseparately computed items in their income as provided in § 1366, make adjustments to the stock basis of those shares as provided in § 1367, and take into account any distributions with respect to those shares as provided in § 1368.

Except for the specific ruling above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding Company's eligibility to be an S corporation.

Under a power of attorney on file with this office, we are sending a copy of this letter to Company's authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/

CHRISTINE ELLISON
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

enclosures: copy of this letter
copy for § 6110 purposes

cc: