Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-140333-07

Date:
February 28, 2008

Legend:

X =

A =

B =

C =

LLC =

a =

b =

c =

State =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Dear :

We received the letter dated August 31, 2007, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code. This letter responds to that request.

Facts

X incorporated under State law on Date1. Pursuant to a plan of conversion, X converted to a State limited partnership on Date2 and made an election under § 301.7701-3 of the Procedure and Administration Regulations to be treated as an association taxable as a corporation for federal income tax purposes. Upon conversion, X's general partner was LLC, and its limited partners were A, B, and C. LLC's members were A, B, and C, owning a, b, and c of LLC, respectively. X elected under § 1362(a) to be treated as an S corporation effective Date3.

On or about Date4, X learned that its S corporation election was ineffective because LLC was an ineligible S corporation shareholder. X converted to a State limited liability company on Date5. Upon conversion, X's members were A, B, and C. Also upon conversion, X elected to continue to be treated as an association taxable as a corporation.

X requests inadvertent ineffective S corporation election relief under § 1362(f), and that it be treated as an S corporation effective Date3.

Law

Section 1361(a) provides that the term "S corporation" means, with respect to any taxable year, 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 which is not an ineligible corporation and which 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 1 class of stock.

Section 1362(a)(1) provides, in general, that except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a), 1361(b)(3)(B)(ii), or § 1361(c)(1)(A)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) 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 § 1362(d)(3), § 1361(b)(3)(C), or § 1361(c)(1)(D)(iii), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation or a qualified subchapter S subsidiary, as the case may be during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that, for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

Conclusion

Based on the facts submitted and representations made, we conclude that X's S corporation election was ineffective on Date3 because LLC was an ineligible S corporation shareholder under § 1361(b)(1)(B). We also conclude that the termination was inadvertent within the meaning of § 1362(f). Consequently, we conclude that X will be treated as an S corporation from Date3 and thereafter, provided that X's S corporation election was valid and was not, except for the event described on Date3, otherwise terminated.

Accordingly, all of the shareholders of X, in determining their respective income tax liabilities for the period beginning Date3 and thereafter, must include their pro rata share of separately 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 make by X as provided in § 1368.

LLC must not be treated as a shareholder for any period it held an interest in X. Accordingly, this ruling is conditioned on the members of LLC treating themselves as shareholders of X, directly owning X stock they owned indirectly through LLC, as represented by their LLC ownership percentages. In addition, this ruling is conditioned on the conversion of X from a limited partnership taxable as a corporation for federal income tax purposes to a limited liability company taxable as a corporation for federal income tax purposes qualifying as a § 368(a)(1)(F) reorganization. If X or its shareholders fail to treat themselves as described above, this ruling shall be null and void.

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, no opinion is expressed or implied concerning whether X's conversion into a State limited partnership created a second class of stock under § 1361(b)(1)(D). In addition, no opinion is expressed or implied concerning whether X was eligible to make the S corporation election or whether X otherwise qualifies as an S corporation. Further, no opinion is expressed or implied concerning whether the conversion of a limited partnership taxable as a corporation for federal income tax purposes to a limited liability company taxable as a corporation for federal income tax purposes qualifies as a § 368(a)(1)(F) reorganization.

Under a 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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter
A copy for § 6110 purposes