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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
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March 20, 2009

Legend:

X =

Y =

LLC1 =

LLC2 =

Individual1 =

Individual2 =

State1 =

State2 =

Dear :

This letter responds to a letter dated September 17, 2008, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1361 of the Internal Revenue Code (Code).

Facts

X is a State1 corporation that has elected to be treated as an S corporation. X has two equal shareholders: Individual1 and Individual2. Individual1 will transfer his shares in X to LLC1, Individual1's wholly-owned State2 limited liability company (LLC). Individual2 will also transfer his shares in X to LLC2, Individual2's wholly-owned State2 LLC.

Individual1 and Individual2 will manage their respective LLCs. Individual1 and Individual2 will also retain all financial interests (rights to any profits, losses, and distributions) in LLC1 and LLC2, respectively (collectively, the LLCs). Individual1 and Individual2 will transfer certain management rights in the LLCs to Y. These rights are defined as all rights to participate in the management of the business and affairs of the LLCs, including without limitation the right to vote on or to approve whether the LLCs: engage in businesses or activities not listed in the LLCs' agreements; consolidate or merge, or sell substantially all of the assets of the LLCs, institute or consent to bankruptcy actions, or otherwise liquidate the LLCs; borrow money, incur indebtedness, or guarantee any indebtedness; make distributions to members of the LLCs; amend the LLCs' agreements; and convey any portion of the LLCs' interests to a third party, except for certain family members. Y also has the right to appoint new managers of the LLCs should Individual1 and Individual2 die while acting as managers of the LLCs. Y will not be admitted as a member in the LLCs.

X requests a ruling under § 1361(b) that X's S corporation election will not terminate after the shares in X are transferred to LLC1 and LLC2.

Law and Analysis

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 one class of stock.

Section 301.7701-1(a)(1) of the Procedure and Administration Regulations provides that the Code prescribes the classification of various organizations for federal tax purposes. Whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law.

Section 301.7701-1(a)(4) provides that under §§ 301.7701-2 and 301.7701-3, certain organizations that have a single owner can choose to be recognized or disregarded as entities separate from their owners.

Section 301.7701-2(a) provides that for purposes of §§ 301.7701-2 and 301.7701-3, a business entity is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3) that is not properly classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

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.

Section 301.7701-3(b)(1) provides that except as provided in § 301.7701-3(b)(3), unless the entity elects otherwise, a domestic eligible entity is (i) a partnership if it has two or more members; or (ii) disregarded as an entity separate from its owner if it has a single owner.

Since LLC1 and LLC2 are domestic eligible entities and have not elected to be treated as associations taxable as corporations, their federal classification depends on whether the LLCs have one member or more than one member. In this case, Y has no rights to any profits, losses, or distributions of the LLCs. Y only holds certain management rights in the LLCs as defined above. These rights do not cause Y to be a member of either LLC1 or LLC2 for federal tax purposes. Thus, LLC1 and LLC2 will be treated as owned by Individual1 and Individual2, respectively, and will be disregarded as entities separate from their individual owners for federal tax purposes.

An owner of an LLC that is disregarded for federal tax purposes is treated as owning the LLC's assets directly. Thus, in determining whether a corporation is eligible to elect to be an S corporation or to continue its eligibility as an S corporation, any shares held by a single-member LLC are treated as being owned directly by the LLC's owner.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that provided that LLC1 and LLC2 do not elect to be associations taxable as corporations under § 301.7701-3, LLC1 and LLC2 will be disregarded as entities separate from their owners for federal tax purposes. Accordingly, we conclude that the transfers of X shares to LLC1 and LLC2 do not cause X to have ineligible shareholders under § 1361(b) and, thus, do not terminate X's S corporation election. Therefore, X will continue to qualify as an S corporation after shares of X stock are transferred to LLC1 and LLC2.

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation for federal tax purposes. In addition, we express or imply no opinion concerning the entity classification of Y for federal tax purposes.

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

The ruling contained in this letter is 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 ruling request, it is subject to verification on examination.

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,

/s/

Mary Beth Carchia
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

cc: