199946029

Internal Revenue Service

Department of the Treasury

Index Number: 7701.00-00; 1362.04-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:03-PLR-107408-99
Date:
August 5, 1999

Legend

Company =

Corporation =

State =

A =

B =

d1 =

d2 =

d3 =

d4 =

d5 =

158

Dear

This letter responds to a letter dated d5, on behalf of Company, requesting relief under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, Company was incorporated under the laws of State on d1 and elected to be treated as an S corporation as defined in § 1361(a) effective on d1.

On d2, Company converted to a limited partnership under the laws of State with the shareholders (A and B) retaining their proportionate interests. Pursuant to the conversion, Corporation also contributed cash to Company in exchange for an interest. For purposes of local law, Corporation was considered the sole general partner while A and B were considered limited partners, however, all interests provided identical rights to operating and liquidating distributions. On or about d3, Company filed a Form 8832 (Entity Classification Election) electing to be classified as an association taxable as a corporation for all federal tax purposes effective for the start of its existence as a State law limited partnership. Company represents that the conversion was a reorganization within the meaning of § 368(a)(1)(F).

In conjunction with the preparation of the Form 8832, Company became aware that Corporation was an ineligible shareholder. On d4, A and B (acting through their respective disregarded limited liability companies), acquired Corporation's interest in Company.

Company did not know that admitting Corporation as a general partner would terminate its S election. Company's admission of Corporation was not motivated by federal income tax avoidance or retroactive federal income tax planning. Company and each of its shareholders who were shareholders during the termination period agree to make any adjustments consistent with the treatment of Company as an S corporation.

LAW AND ANALYSIS

Company converted from a corporation to a limited partnership under the laws of State and elected under § 301.7701-3 to be classified as an association taxable as a corporation for federal tax purposes. Company has represented that the conversion qualified as a reorganization under § 368(a)(1)(F). If the conversion qualified as a reorganization under § 368(a)(1)(F), then the conversion would not have terminated

Company's S corporation election provided Company still met the requirements of an S corporation under § 1361. See Rev. Rul. 64-250, 1964-2 C.B. 333.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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.

Section 1362(d)(2) specifies that a corporation's election under § 1362(a) will terminate whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides in part that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (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 the 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 the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that 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.

CONCLUSION

After applying the relevant law to the facts submitted and the representations made, we conclude that Company's election to be an S corporation terminated as of d2 when Corporation acquired an interest in Company. We also hold that the termination was inadvertent within the meaning of § 1362(f).

We further hold that under the provisions of § 1362(f), Company will be treated as an S corporation during the period of d2 through d4, and thereafter, provided Company's S corporation election does not otherwise terminate under § 1362(d). Accordingly, in determining their federal tax liability for the period from d2 to d4, the shareholders (A and B) and Corporation must include their pro rata share of the separately and nonseparately computed items of Company under § 1366, make adjustments to stock basis under § 1367, and take into account any distributions made

by Company under § 1368. If Company, A, B, or Corporation fail to treat Company as described above, this ruling shall be null and void.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision in the Code. In particular, no opinion is expressed on whether the conversion qualified as a reorganization under § 368(a)(1)(F).

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

(signed) William P. O'Shea

William P. O'Shea
Chief,
Branch 3
Office of the Assistant
Chief Counsel
(Passthroughs and Special
Industries)

Enclosures (2)
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