Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200043001**
Release Date: 10/27/2000
Index Number: 1362.00-00; 7701.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:3-PLR-104494-00
Date:
July 21, 2000

Legend

Company =
State =
d1 =
d2 =
Shareholders =

Dear

This letter responds to a letter dated February 22, 2000, and subsequent correspondence, on behalf of Company, requesting a ruling under § 1362(d) of the Internal Revenue Code. Specifically, Company requests a ruling that its election to be classified as an S corporation would not terminate as a result of its liquidation under local law.

FACTS

According to the information submitted, Company incorporated under the laws of State on d1. It subsequently elected to be treated as an S corporation as defined in § 1361(a) effective on d2. Company owns a multi-story building that is leased to a variety of tenants. Company provides services beyond those necessary for maintenance and repair, including (but not limited to) security services and improvements on behalf of tenants. At the time of the proposed transaction, Company will be owned by the Shareholders.

It is proposed that Company will liquidate under local law, causing its property to be held by the Shareholders as tenants-in-common. As co-tenants, the Shareholders will retain their proportionate interests for the foreseeable future. The Shareholders will have equal rights to operating and liquidating proceeds based upon those proportionate interests. The co-tenancy will provide the same services to the tenants as previously provided by the corporation. The co-tenancy will file 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 co-tenancy. Company represents that it will continue to meet the requirements of an S corporation under § 1361 after this transaction.

LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect. Section 1361(b)(1) defines the term “small business corporation” to mean a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate and other than 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 1362(c) states that an election under § 1362(a) is effective for the taxable year of the corporation for which it is made and for all succeeding taxable years of the corporation, until such election is terminated under § 1362(d).

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) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) shall be effective on and after the date of cessation.

Company will liquidate under local law, causing all of Company’s property to be held by Shareholders as tenants-in-common. Section 301.7701-1(a)(1) of the Procedure and Administration Regulations indicates that whether an organization is recognized 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. Thus, a co-tenancy’s recognition as a separate business entity under local law is not determinative for federal tax purposes.

Section 301.7701-1(a)(2) states that while mere co-ownership of property that is maintained, kept in repair, and rented does not constitute a separate entity for federal tax purposes, a joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. As an example, the regulation specifically indicates that a separate entity exists if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent. In the present situation, the Shareholders represent that sufficient services will be provided so that the co-tenancy will constitute a business entity for federal tax purposes.

A business entity that is not otherwise classified as a corporation can elect its classification for federal tax purposes. Section 301.7701-3(a). 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. Section 301.7701-3(a). The co-tenancy, as a federal business entity, will elect under § 301.7701-3(c) to be classified as an association taxable as a corporation effective with its inception under local law. Thus, for federal tax purposes, Company’s business operations will be

conducted through a corporation at all times. Company represents that this transaction qualifies as a reorganization under § 368(a)(1)(F). If this transaction qualifies as a reorganization under § 368(a)(1)(F), then Company will continue and its S corporation election will not terminate provided Company still meets the requirements of an S corporation under § 1361. See Rev. Rul. 64-250, 1964-2 C.B. 333.

CONCLUSION

Based on Company's representations; including the representation that Company currently satisfies the requirements of § 1361(b)(1) and will continue to do so after the transaction, we conclude that the proposed transaction will not terminate Company's election to be an S corporation.

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.

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 services Company provides are beyond those customary for the maintenance and repair of the property. Additionally, no opinion is expressed on whether the conversion will qualify as a reorganization under § 368(a)(1)(F). Finally, no opinion is expressed regarding the nature of any income realized by Company for purposes of §§ 1362(d)(3) and 1375.

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.

Pursuant to a power of attorney on file with this office, copies of this letter are being sent to Company's authorized representatives.

Sincerely yours,
Robert G. Honigman, Branch 3
Acting Assistant to the Branch Chief
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

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