Internal Revenue Service

Department of the Treasury

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Legend

X =

A =

B =

C =

State 1 =

State 2 =

D1 =

m% =

n% =

This responds to the letter dated August 30, 2000, submitted by your representative on behalf of X, requesting a ruling that the proposed restructuring described below will not terminate X's subchapter S corporation status under § 1362(d)(2)(A) of the Internal Revenue Code.

FACTS

X was incorporated under State 1 law. Effective D1, X elected to be treated as a subchapter S corporation. A, B, and C are the individual shareholders of X.

Pursuant to an overall business plan, each of the individual shareholders intends to engage in the following transactions. The transactions are described only with respect to shareholder A with the understanding that B and C will engage in exactly the same

transactions with their own newly formed entities.

A will form its own single member limited liability company under State2 law. A will exchange m% of its ownership interest in X for a 100% ownership interest in the limited liability company. A will also form a limited partnership under State2 law. A will transfer its remaining interest in X to the limited partnership, and at the same time the limited liability company will transfer its entire interest in X to the limited partnership. In the exchange, A will receive a n% limited partnership interest and the limited liability company will receive a m% general partnership interest in the limited partnership.

None of the limited liability companies or limited partnerships formed by A, B, and C will elect to be treated as an association taxable as a corporation for federal income tax purposes. Rather, these entities will exist according to their default classification under § 301.7701-3 of the Procedure and Administration Regulations.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code defines an S corporation as a small business corporation for which an election under § 1362(a) is in effect. Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1361(b)(1)(B) provides that to be a small business corporation, a corporation must be a domestic corporation which does not have as a shareholder a person (other than an estate, a trust described in subsection (c), or an organization described in subsection (c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an S corporation election 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. Any termination shall be effective on and after the date of cessation. Section 1362(d)(2)(B).

Section 301.7701-3(a) of the Procedure and Administration Regulations provides that a business entity not automatically classified as a corporation can elect its classification for federal tax purposes. An eligible entity with a single owner can elect to be classified as an association taxable as a corporation or to be disregarded as an entity separate from its owner.

Section 301.7701-3(b) provides a default classification for an eligible entity that does not make an election. Under § 301.7701-3(b)(1)(ii), a domestic eligible entity with a single owner, unless it elects otherwise, is disregarded as an entity separate from its owner. If the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner. Section 301.7701-2(a).

Here, after completing the proposed reorganization, each of the individual shareholders of X will be the sole owner of the limited partnership that the individual shareholder formed, owning m% through the respective individual's limited liability company, a disregarded entity, and n% directly. Because each of the limited partnerships are treated as owned by a single owner, they will be disregarded for federal tax purposes and each individual shareholder will be treated as directly owning the X stock held by their respective limited partnership.

CONCLUSIONS

Based solely on the facts submitted and representations made, and provided that A, B, and C are eligible S corporation shareholders, we conclude that A's, B's, and C's ownership of X stock through each's respective limited liability company and limited partnership, as described above, will not terminate X's S corporation election.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning whether X otherwise satisfies the S corporation eligibility requirements.

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

Pursuant to the Power of Attorney on file with this office, a copy of this ruling is being sent to your representative.

Sincerely,
Dianna K. Miosi
Chief, Branch 1
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
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cc: