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LEGEND

X =

Y =

State =

d1 =

d2 =

d3 =

d4 =

d5 =

S1 =

S2 =

S3 =

Dear

This letter responds to a letter dated March 15, 2001, from your authorized representative on behalf of Y, requesting inadvertent termination relief for Y under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, Y was incorporated under the laws of State on d1, and elected to be treated as an S corporation effective d2. Y decided to convert to a State limited partnership under the State Revised Limited Partnership Act.

To effect the conversion, S1 and S2, two shareholders of Y, each formed a State

law single-member limited liability company (LLC). S1 and S2 each contributed a single share of Y stock to their respective LLC in exchange for all of the interests in the LLCs. On d3, Y converted to a State law partnership (X). The two LLCs were named the general partners of X, and S1, S2, and S3 were the limited partners. Each shareholder received one unit in X for each share held in Y. The units held by the limited partners and general partners carried the same economic rights, pro rata according to the number of units held.

At the time of the conversion, X simultaneously filed an election under § 301.7701-3 of the Procedure and Administration Regulations to be treated as an association taxable as a corporation. Although X believed that the conversion would be treated for federal income tax purposes as a reorganization under § 368(a)(1)(F), and thus, a continuation of the original S corporation, X filed a protective Form 2553, Election by a Small Business Corporation, "reaffirming" its S corporation election.

In early d4, X learned that the Internal Revenue Service would not rule on whether a state law limited partnership electing to be classified as an association for federal tax purposes has more than one class of stock under § 1361(b)(1)(D). See § 5.05 of Rev. Proc. 2001-3, 2001-1 I.R.B. 111, 119. Realizing for the first time that Y's conversion to a State limited partnership might have terminated its S corporation election, X converted back to a State corporation on d5.

Y represents that its motive for the conversion was the reduction of its State franchise tax and not avoidance of federal tax. Moreover, Y represents that it had no intention of terminating its S corporation election.

LAW AND ANALYSIS

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

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides 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 termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in 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 regarding this period, then, notwithstanding the circumstances resulting in termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that 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.

According to the legislative history of § 1362(f)--

> If the Internal Revenue Service determines that a corporation's subchapter S election is inadvertently terminated, the Service can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and the shareholders agree to be treated as if the election had been in effect for such period.
>
> The committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that taxpayers and the government will work out agreements that protect the revenues without undue hardship to taxpayers.... It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for subchapter S treatment, depending on the facts.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982); 1982-2 C.B. 718, 723-24.

The Service is studying the issue of whether a state law limited partnership electing under § 301.7701-3 to be classified as an association taxable as a corporation has more than one class of stock for purposes of § 1361(b)(1)(D). Until the Service resolves this issue through published guidance, letter rulings will not be issued. The Service will treat any request for a ruling on whether a state law limited partnership is eligible to elect S corporation status as a request for a ruling on whether the partnership complies with § 1361(b)(1)(D). Rev. Proc. 2001-3, § 5.05, 2001-1 I.R.B. 111, 119, based on Rev. Proc. 99-51, 1999-2 C.B. 760.

CONCLUSIONS

Based solely on the facts as represented by Y in this ruling request, we conclude that if Y's conversion from a State corporation to a State limited partnership did create a second class of stock, the consequent termination of Y's S corporation election was inadvertent within the meaning of § 1362(f).

Therefore, we rule that Y will continue to be treated as an S corporation for the period from d3 to d5, and thereafter, unless Y's S election otherwise terminates under § 1362(d).

Except for the specific ruling above, no opinion is expressed or implied concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding Y's eligibility to be an S corporation or the validity of its S corporation election.

In accordance with the 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.

Sincerely,
Mary Beth Collins
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure(1):
Copy for § 6110 purposes