Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200346016**
Release Date: 11/14/2003
Index Number: 1362.01-03

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B1-PLR-125774-03

Date:
August 11 2003

Legend:

X =

Date 1 =
Date 2 =
Date 3 =
State1 =
State2 =

Dear :

This responds to your representative's letter dated April 9, 2003, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code.

FACTS

X incorporated under the laws of State1 on Date 1, and elected to be treated as an S corporation. On Date 2, X converted from a State1 corporation to a State1 limited partnership, electing to be treated as an association taxable as a corporation. This conversion may have created a second class of stock which would have terminated X's S corporation election. X and its owners intended that X would continue to be treated as an S corporation. When advised that the conversion may have caused X's S election to terminate, X reorganized as a State2 corporation on Date 3.

X was unaware that the conversion to a State1 limited partnership could potentially terminate X's S corporation election. X represents that it did not intend to terminate its S corporation election and that during the termination period it has timely and consistently filed its tax returns consistent with its treatment as an S corporation.

LAW AND ANALYSIS

Section 1361(a)(1) defines an S corporation as a small business corporation for which an election under section 1362(a) is in effect. Section 1361(b)(1) defines "small business corporation" as 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 eState1, other than a trust described in section 1361(c)(2), and other than an organization described in (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(d)(2)(A) of the Code provides that an election to be treated as an S corporation terminates whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation. The termination is effective on and after the date the S corporation ceases to meet the requirements of a small business corporation. Section 1362(d)(2)(B).

Section 1362(f) of the Code provides that if (1) an election to be treated as an S corporation was terminated under section 1362(d)(2) or (3), (2) the Secretary determines that the termination was inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in such termination, steps were taken so that the corporation is once more 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 this subsection, agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to that period, then, notwithstanding the terminating event, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

S. Rep. No. 640, 97th Cong., 2d Sess. 12-13 (1982), 1982-2 C.B. 718, 723-24, in discussing section 1362(f) of the Code, provides, in part, as follows:

> 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.

Based on Rev. Proc. 99-51, 1999-52 I.R.B. 760 (December 27,1999) Section 5.03 of Rev. Proc. 2003-3, 2003-1 I.R.B. 113 (January 6, 2003), provides that the Service will not rule on the following issue because it is being studied:

> Section 1361. -- Definition of a Small Business Corporation. -- Whether a State1 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). The Service will treat any request for a ruling whether a State1 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).

CONCLUSION

Based upon the information submitted and the representations set forth above, we conclude that if X's conversion from a State1 corporation to a State1 limited partnership created a second class of stock and thereby terminated X's S corporation election, that the termination was inadvertent within the meaning of section 1362(f).

Pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided that X's subchapter S election is not otherwise terminated under section 1362(d).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code. In particular, no opinion is expressed or implied concerning whether X's S election was valid under section 1362.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to the your authorized representative.

Sincerely,

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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