Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Company A:

Company B:

Company C:

Shareholder:

State:

State Law:

Provision 1:

Provision 2:

Provision 3:

Provision 4:

a:

b:

c:

Dear

This letter responds to a letter from your authorized representatives dated March 12, 1999, submitted on behalf of Company A, requesting various rulings relating to Company A's contemplated conversion under State Law from a corporation to a limited partnership. Company represents the following facts.

Company A was incorporated in State on a and elected under § 1362(a) to be an S corporation that same date. Shareholder owns 100 percent of Company A's stock.

Company A intends to become a limited partnership under State Law, which permits a change in the type of entity without a disruption or interruption of the entity's existence. The intent of State Law, as represented by Company, is to allow entities to use a conversion transaction as an alternative to a merger.

Before the conversion, Shareholder will form Company B, a State limited liability company. Company B will contribute cash or other assets to Company A in exchange for a b percent interest in Company A. Company A then will become a State limited partnership (Company C) by filing articles of conversion with State pursuant to Provisions 1-4 (State Law). Company B will be the general partner, with a b percent interest in Company C, and Shareholder will be the limited partner, with a c percent interest.

On the date of conversion, Company C (Company A prior to conversion) will elect under § 301.7701-3 of the Procedure and Administration Regulations and § 301.7701-3T of the Temporary Regulations (the "check-the-box" regulations) to continue to be classified as an association taxable as a corporation for federal tax purposes. Company intends the conversion transaction to be a § 368(a)(1)(F) reorganization. See Rev. Rul. 64-250, 1964-2 C.B. 333, which provides that a reorganization under § 368(a)(1)(F) does not terminate a company's S corporation election.

Section 1361(a) of the Internal Revenue Code provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for that year.

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

Except as provided in § 301.7701-3(b)(3) [regarding eligible entities in existence before January 1, 1997], § 301.7701-3(b)(1) provides that, unless the entity elects otherwise, a domestic eligible entity is (i) a partnership if it has two or more members; or (ii) disregarded as an entity separate from its owner

if it has a single owner. Section 301.7701-3T(a) of the Temporary Regulations defines an eligible entity as a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (a per se corporation).

Company B is a State limited liability company with a single owner. It is not a per se corporation. Thus, Company B is disregarded as an entity separate from its owner, Shareholder, who is treated as owning Company B's assets directly. The b percent interest in Company A owned by Company B is treated as being owned directly by Shareholder.

Section 1.1361-1(l)(1) provides that, except as provided in § 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock.

Section 1.1361-1(l)(2) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

The partnership agreement provides for equal allocations of profits, distributions of cash from operations, and distributions upon dissolution. The main differences between the respective interests of the partners relate to management and liability:

a) Under the partnership agreement, Company B has voting rights and all rights and powers necessary to manage Company C, whereas Shareholder, with some exceptions, has no rights or powers to participate in Company C's management and control.

b) Under the State limited partnership statute, Company B can be made liable for claims against Company C, whereas

Shareholder is not liable for Company C's obligations unless it participates in control of the business.

c) Under the partnership agreement, Company B shall be indemnified for claims made against it by third parties relating to any liability or damage incurred because of the performance or omission of any authorized act by Company B relating to the business of Company C.

d) Under the partnership agreement, Company B may be removed as general partner of Company C by a vote of 90 percent of the partners' sharing ratio.

Both partners of Company C will have identical rights to partnership distributions and liquidation proceeds under the partnership agreement. Thus, the two different interests in Company C (general and limited) will not constitute more than one class of stock for purposes of § 1361(b)(1)(D).

Section 301.7701-3T(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in this section. 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, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Under State Law, a State corporation may convert to any other type of entity, including a limited partnership. Provision 1. The conversion is effective when State issues a certificate of conversion. Provision 3. Upon issuance of the certificate, the converting entity continues to exist, without interruption, but in the organizational form of the converted entity rather than in its prior organizational form. Provision 4. All rights, title, and interests in property owned by the converting entity continue to be owned by the converted entity without reversion or impairment, and without any transfer or assignment having occurred. Id. All liabilities and obligations of the converting entity continue to be liabilities and obligations of the converted entity without impairment or diminution. Id.

Based solely on the facts as presented in this ruling request, and viewed in light of the applicable law and regulations, we rule that Company A's conversion under State Law to Company C, and the concurrent election by Company C to

continue to be classified as an association taxable as a corporation for federal tax purposes, will not terminate Company C's election under § 1362(a) to be an S corporation.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding Company A's eligibility under § 1361 to be an S corporation, as well as the validity of its election under § 1362(a).

In accordance with the power of attorney on file with this office, we are sending you the original of this letter and a copy to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

WILLIAM P. O'SHEA
Chief, Branch 3
Office of Assistant
Chief Counsel
(Passthroughs and
Special Industries)

encl: copy for § 6110 purposes

cc: