Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3 PLR-111005-01
Date:
December 22, 2001

Legend

Company =

Holdco =

New Sub =

State =

Date =

Dear

We received a letter dated February 15, 2001, and subsequent correspondence, submitted on behalf of Company requesting rulings under § 1361 of the Internal Revenue Code. This letter responds to that request.

FACTS

Company was formed as a corporation under the laws of State and elected S corporation status effective Date. Company represents that all of its shareholders are eligible shareholders under § 1361.

For business reasons, Company wants to restructure by undertaking the following transactions:

First, Company's shareholders organize a new limited liability partnership (Holdco) under the laws of State. Holdco will file an election under § 301.7701-3 to be classified as an association taxable as a corporation and will make an S corporation election.

Second, Holdco forms New Sub, a new qualified subchapter S subsidiary (QSUB) that will be disregarded under § 1361(b)(3).

Third, the shareholders of Company contribute their existing stock in Company to Holdco. Holdco contributes 1 percent of Company's stock to New Sub.

Fourth, Company coverts under State law to a limited partnership, with New Sub as a 1 percent general partner and Holdco as a 99 percent limited partner.

Company makes the following representations concerning these transactions: 1) these transactions are intended to constitute and qualify as a reorganization under § 368(a)(1)(F); 2) Holdco will have fewer than 75 owners, none of which would be ineligible shareholders or nonresident aliens; 3) State law does not require different rights to distributions or liquidation proceeds among the owners of Holdco; and 4) Holdco's operating agreement will ensure identical rights to distributions and liquidation proceeds.

Company requests the following rulings: 1) Holdco is eligible to be treated as an S corporation, and 2) Holdco's partnership agreement does not create a second class of stock.

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 1361(b)(2) identifies an ineligible corporation as any corporation which is (A) a financial institution which uses the reserve method of accounting for bad debts described in section 585, (B) an insurance company subject to tax under subchapter L, (C) a corporation to which an election under section 936 applies, or (D) a DISC or former DISC. According to the representations made, neither Holdco nor Company is an ineligible corporation as defined in § 1361(b)(2).

Section 1361(b)(3)(B) defines a QSUB as a domestic corporation which is not an ineligible corporation, if 100 percent of the stock of the corporation is owned by the S corporation, and the S corporation elects to treat the corporation as a QSUB.

Section 1361(b)(3)(A) provides that generally a QSUB shall not be treated as a separate corporation, and that all assets, liabilities, and items of income, deduction, and credit of a QSUB shall be treated as assets, liabilities, and such items of the S corporation.

Section 1.1361-3(a)(2) of the Income Tax Regulations provides that an S corporation may elect to treat an eligible subsidiary as a QSUB by filing a completed form to be prescribed by the Service. The Service prescribes that QSUB status may be elected through a Form 8869. Section 1.1361-3(a)(4) provides guidance on when a QSUB election will be effective.

Section 7701(a)(3) indicates that, unless otherwise distinctly expressed or manifestly incompatible with the intent thereof, “corporation” includes associations, joint-stock companies, and insurance companies. Section 301.7701-3(a) 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). 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). In the absence of an election to be classified as an association, a domestic eligible entity with a single member will be disregarded as an entity separate from its owner if it has a single owner. Section 301.7701-3(b)(1)(ii).

A corporation’s S election will not terminate during a reorganization under § 368(a)(1)(F) if the surviving corporation meets the requirements of an S corporation under § 1361. See Rev. Rul. 64-250, 1964-2 C.B. 333.

In State, a limited liability partnership is a partnership formed under State’s version of the Uniform Partnership Act. State law provides, as a general rule, that no partner is liable for debts and obligations of the partnership incurred while the partnership is a registered limited liability partnership. Exceptions to the general rule exist for debts and obligations attributable to errors, omissions, negligence, incompetence, or malfeasance where the particular partner is involved in the activity leading to those acts, or where the individual partner had knowledge of those acts and failed to take reasonable steps to prevent or cure the errors, omissions, negligence, incompetence, or malfeasance. Accordingly, under State law, all interests in a limited liability partnership provide the same liability protections, and do not present the distinctions in equity interests (limited vs. general) presented by a typical limited partnership.

CONCLUSION

Based on the information submitted and representations made, we conclude that 1) Holdco is eligible to be treated as an S corporation and 2) Holdco’s partnership agreement does not create a second class of stock.

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, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed or implied as to whether Company is a valid S corporation prior to these transactions or whether the described transactions constitute a reorganization under § 368(a)(1)(F). Furthermore, no opinion is expressed on the effect that any modifications in Holdco's partnership agreement would have under § 1361(b).

Under a 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 who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,
Christine Ellison
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (1)
Copy for section 6110 purposes

cc: