

**INTERNAL REVENUE SERVICE**

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October 17, 2000

X =  
Y =  
A =  
B =  
C =  
State =  
Date 1 =  
Date 2 =  
Date 3 =

Dear :

This is in reply to a letter dated April 26, 2000, submitted on behalf of X requesting a ruling under § 1362(f) of the Internal Revenue Code.

X was incorporated on Date 1, under the laws of State. X elected to be an S corporation effective Date 1. The current shareholders of X are A, B, and C. On Date 2, X converted from a State corporation to State limited partnership. The shareholders of X intended that X would continue to be treated as an S corporation following the conversion. With the conversion, Y, a State corporation was admitted as a nominal general partner of X. The admission of Y as a member may have resulted in the termination of X's S corporation election. When advised that the admission of Y as a partner of X might result in the termination of X's status as an S corporation, Y transferred its rights in X to the individual limited partners of X. When X was subsequently advised that its conversion to a State limited partnership may have caused its S election to terminate, X converted back to a State corporation on Date 3.

X was unaware that the admission of Y as a nominal partner or the conversion to a State limited partnership could

potentially terminate X's S corporation election. X represents that it did not intend to terminate its S corporation election.

B, as the president of X, represents that the terminating event was not part of a plan to terminate X's S election or for tax avoidance purposes. X and its shareholders have agreed to make any adjustments that the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides, in part, that the term "small business corporation" means a domestic corporation which is not an ineligible corporation.

Section 1362(d)(2)(A) provides that an election under § 1361(a) 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.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based on Rev. Proc. 99-51, 1999-52 I.R.B. 760 (December 27, 1999) Section 5.26 of Rev. Proc. 2000-3, 2000-1 I.R.B. (January 3, 2000), 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 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). The Service will treat any request for a ruling 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).

Based solely on the facts submitted and the representations made, we hold that if X's election to be an S corporation terminated on Date 2, as a result of the acquisition by Y of the stock in X or as a result of X's conversion from a State corporation to a State limited partnership that termination was inadvertent within the meaning of § 1362(f).

We further hold that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 2, to Date 3, and thereafter, provided that X's election to be an S corporation was otherwise valid and was not otherwise terminated under § 1362(d). Therefore, the shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provisions of the Code.

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 letter is being sent to your authorized representatives.

Sincerely yours,  
J. THOMAS HINES  
Acting Branch Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2  
Copy of this letter  
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