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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B02  
PLR-112218-05

Date:  
July 07, 2005

A =

B =

Oldco =

Newco =

LLC =

State =

Date 1 =

a% =

Dear :

This letter responds to a letter dated February 24, 2005, submitted on behalf of Oldco by its authorized representative, requesting rulings under § 368 and § 1361 of the Internal Revenue Code.

The information submitted states that Oldco is a State corporation that elected to be an S corporation effective Date 1. Currently, A owns the shares of Oldco and B, A's wife, has a community property interest in the shares. For business reasons, Oldco wants to restructure by undertaking the following transactions. A and B will form Newco as a State general partnership. Newco will file Form 8832, Entity Classification Election, and elect to be classified as an association taxable as a corporation for Federal income

tax purposes. Newco will file Form 2553, S corporation election, to be an S corporation. A and B will partition the outstanding 1000 shares of stock in Oldco into 500 shares each of separate property, so that each A and B own one-half of Oldco as separate property. A and B will contribute all the stock of Oldco to Newco in exchange for all the interests in Newco. Newco will immediately file a Form 8869, Qualified Subchapter S Subsidiary Election, to elect to have Oldco treated as a Qualified Subchapter S Subsidiary (QSub) within the meaning of § 1361(b)(3)(B). Newco will form LLC, a single member State limited liability company that is disregarded as an entity separate from Newco in accordance with § 301.7701-3(b)(1) of the Procedure and Administration Regulations. Newco will contribute to LLC a% its stock in Oldco. Oldco will convert from a corporation to a limited partnership under State law. Pursuant to this State law conversion, LLC will be the general partner of Oldco, and Newco will hold the limited partnership interest in Oldco.

A, the president of Oldco, represents that the fair market value of the Newco Stock and other consideration received by each Oldco shareholder will be approximately equal to the fair market value of the Oldco stock surrendered in the proposed transaction. Additionally, A represents that there is no plan or intention by the shareholders of Oldco who own 1 percent or more of the Oldco stock, and to the best of the knowledge of management of Oldco, there is no plan or intention on the part of the remaining shareholders of Oldco, to sell, exchange, or otherwise dispose of any of the Newco Stock received in the proposed transaction.

A further represents that immediately following consummation of the proposed transaction, the shareholders of Oldco will own all of the outstanding Newco Stock and will own such Newco Stock solely by reason of their ownership of Oldco stock immediately prior to the proposed transaction. Newco has no plan or intention to issue additional Newco Stock following the proposed transaction. Immediately following consummation of the proposed transaction, Newco will possess the same assets and liabilities, except for assets used to pay expenses incurred in connection with the proposed transaction, as those possessed by Oldco immediately prior to the proposed transaction. Assets used to pay expenses, in the aggregate, constitute less than one percent of the net assets of Oldco. At the time of the proposed transaction, Oldco will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Oldco.

Additionally, A represents that Newco has no plan or intention to reacquire any Newco Stock issued in the proposed transaction. Newco has no plan or intention to sell or otherwise dispose of any of the assets of Oldco acquired in the proposed transaction, except for dispositions made in the ordinary course of business. The liabilities of Oldco assumed by Newco, plus the liabilities, if any, to which the transferred assets are subject were incurred by Oldco in the ordinary course of its business and are associated with the assets transferred. Following the proposed transaction, Newco will continue the historic business of Oldco or use a significant portion of Oldco's historic business assets in a business. The shareholders of Oldco will pay their respective expenses, if

any, incurred in connection with the proposed transaction. Oldco is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

A represents that Newco's election under § 301.7701-3 to be treated as an association taxable as a corporation will be effective as of the date of the formation of Newco, such that Newco will never exist as a partnership for federal tax purposes.

Section 368(a)(1)(F) provides that the term "reorganization" means, among other things, a mere change in identity, form, or place of organization, however effected.

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 100 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 § 585, (B) an insurance company subject to tax under subchapter L, (C) a corporation to which an election under § 936 applies, or (D) a DISC or former DISC.

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. Section 1.1361-3(a)(4) provides guidance on when a QSub election will be effective.

Section 301.7701-3(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. A "business entity" is any entity recognized for federal tax purposes that is not properly classified as a trust under § 301.7704 or otherwise subject to special treatment under the Internal Revenue Code. Section 301.7701-2(a). 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.

Section 301.7701-3(b)(1)(ii) provides that 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.

Based solely on the facts and representations submitted, we conclude that Newco will be eligible to elect to be an S corporation. Additionally, Oldco is eligible to be a QSub.

Furthermore, based solely on the facts and representations submitted, we conclude that the proposed transaction will qualify as a reorganization described in § 368(a)(1)(F). Oldco and Newco will each be “a party to a reorganization” within the meaning of § 368(b). No gain or loss will be recognized by Oldco upon the exchange of its assets and liabilities for Newco Stock (§§ 361(a) and 357(a)). Newco will not recognize any gain or loss on the receipt of the assets and liabilities of Oldco in exchange for the Newco Stock (§ 1032(a)). The basis of the Oldco property in the hands of Newco will be the same as the basis of the assets in the hands of Oldco immediately prior to the proposed transaction (§ 362(b)).

Additionally, Newco’s holding period of the assets it holds as a result of the proposed transaction will include the period during which such assets were held by Oldco (§ 1223(2)). Each Oldco shareholder’s holding period in Newco Stock received will include the period during which the shareholder held the Oldco stock exchanged therefore, provided the Oldco stock surrendered was held by such shareholder as a capital asset on the date of the exchange (§1223(1)). The Oldco shareholders will not recognize any gain or loss on the exchange of their Oldco stock for Newco Stock (§ 354(a)). The basis of the Newco Stock received by each Oldco shareholder will be the same as such shareholder’s basis in the Oldco stock surrendered in the exchange (§ 358(a)(1)). For the purposes of § 381, Newco will be treated as if there had been no reorganization. Accordingly, the taxable year of Oldco shall not end on the effective date of the proposed transaction (§ 1.381(b)-1(a)(2)).

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 Oldco is a valid S corporation prior to the proposed transactions. Furthermore, no opinion is expressed on the effect that any modifications in Newco’s partnership agreement would have under § 1361(b).

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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Oldco's authorized representative.

Sincerely,

J. Thomas Hines  
Chief, Branch 2  
Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure (2)  
Copy of letter  
Copy for § 6110 purposes