

Section 3.01(30) of Rev. Proc. 2003-4, 2004-1 I.R.B. 114, provides that the Service will not rule on the qualification of a transaction as a reorganization under section 368(a)(1)(F) unless the Service determines that there is a significant issue that is not clearly and adequately addressed by published authority. The taxpayer, an S corporation, requested guidance addressing the significant issue of whether its conversion into a general partnership that elects corporate entity classification and continues to be taxed as an S corporation constitutes a reorganization under section 368(a)(1)(F).

SUMMARY OF FACTS

Corporation A is organized under the laws of State Y and is a calendar year S corporation that files its tax returns on an accrual basis. Corporation A is engaged in Business X. All of the single class of common stock of Corporation A is owned by the Shareholders.

For business reasons, Corporation A wishes to reorganize as a general partnership under the laws of State Y in a transaction that will qualify for tax-free treatment under § 368(a)(1)(F). Accordingly, the Shareholders will form a new State Y general partnership ("New GP") that will elect under Treas. Reg. § 301.7701-3 to be treated as an association taxable as a corporation for federal tax purposes. Consistent with the rulings below, New GP will continue to be taxed as an S corporation for federal income tax purposes. Pursuant to State Y corporation law, Corporation A will merge into New GP with New GP surviving.

Article II of the partnership agreement provides that a partner shall not be entitled to interest on his capital contribution, or to withdraw any part of his capital account, or to receive a distribution from the partnership, except as specifically provided herein. Article 8.1 of the partnership agreement commits the decision of whether to pay dividends and the division of funds available for dividends to the discretion of an executive board. Article VIII of the partnership agreement provides that upon liquidation any profits or losses incurred since the last accounting shall be divided amongst the partners and added to distributions to which the partners are entitled. After paying partnership liabilities and establishing reserves for unknown liabilities the partnership will distribute any remaining liquidation proceeds to the partners based upon their percentage interest.

REPRESENTATIONS

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) The fair market value of the New GP interests and other consideration received by each Shareholder will be approximately equal to the fair market value of the Corporation A stock surrendered in the transaction.
- (b) There is no plan or intention by the Shareholders of Corporation A to sell, exchange, or otherwise dispose of any of the interests of New GP received in the transaction, with the exception that one or more Shareholders may give interests to their descendants.
- (c) Immediately following consummation of the transaction, for federal tax purposes, the Shareholders of Corporation A will own all of the membership interests in New GP and will own such interests solely by reason of their ownership of Corporation A stock immediately prior to the transaction.
- (d) New GP has no plan or intention to issue additional membership interests following the transaction.
- (e) Immediately following consummation of the transaction, New GP will possess the same assets and liabilities as those possessed by Corporation A immediately prior to the transaction. No assets will be distributed and there will be no dissenting shareholders.
- (f) At the time of the transaction, Corporation A will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Corporation A.
- (g) New GP has no plan or intention to reacquire any of its membership interests issued in the transaction.
- (h) New GP has no plan or intention to sell or otherwise dispose of any of the assets of Corporation A acquired in the transaction, except for dispositions made in the ordinary course of business.
- (i) The liabilities of Corporation A assumed by New GP plus the liabilities, if any, to which the transferred assets are subject, were incurred by Corporation A in the ordinary course of its business and are associated with the assets transferred.
- (j) Following the transaction, New GP will continue the historic business of Corporation A or use a significant portion of Corporation A's historic business assets in a business.
- (k) The Shareholders will pay their respective expenses, if any, incurred in connection with the transaction.

- (l) Corporation A is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of section 368(a)(3)(A) of the Internal Revenue Code.
- (m) New GP's election under Treas. Reg. § 301.7701-3 to be treated as an association taxable as a corporation will be effective as of the date of the transaction such that New GP will never exist as a partnership for federal tax purposes.

RULINGS

Based solely on the information submitted and the representations as set forth above, we hold as follows:

- (1) The merger of Corporation A into New GP pursuant to State Y law and New GP's election to be treated as an association taxable as a corporation for federal tax purposes effective as of the date of the proposed transaction qualifies as a reorganization under section 368(a)(1)(F).
- (2) Corporation A will not recognize any gain or loss on the exchange (section 361(a) and 357(a)). The basis of the assets of Corporation A in the hands of New GP will be the same as the basis of such assets in the hands of Corporation A immediately prior to the proposed transaction (section 362(b)). The holding period of the Corporation A assets held by New GP will include the period during which such assets were held by Corporation A (section 1223(2)).
- (3) The basis of the interests in New GP received by the Shareholders will be the same as the basis of the shares of Corporation A surrendered in exchange therefor (section 358(a)(1)). The holding period of the interests in New GP to be received by the Shareholders will include the period during which the shares of Corporation A surrendered therefor were held, provided that the shares are held as capital assets on the date of the exchange (section 1223(1)).
- (4) The partnership agreement is considered a governing provision for purposes of § 1.1361-1(l)(2)(i) because it is a binding agreement that defines the members' rights to distribution and liquidation proceeds.
- (5) The partnership agreement does not, by its terms, create equity interests that would be treated as different classes of stock for purposes of § 1361(b)(1)(D) because it does not create different rights to current distributions or liquidation proceeds.
- (6) Corporation A's S election will not terminate as a result of the

reorganization under section 368(a)(1)(F) if New GP meets the requirements of an S corporation under section 1361. See Rev. Rul. 64-250, 1964-2 C.B. 333.

- (7) New GP will retain Corporation A's previously assigned identifying number (EIN). See Rev. Rul. 73-526, 1973-2 C.B. 404.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, this ruling expresses no opinion regarding the existence of any other document or arrangement that could be considered a governing provision under § 1.1361-1(l)(2)(i). In addition, any arrangement that allows the owners to share in current distributions and liquidating proceeds in a manner that differs from their stated ownership percentage interests could potentially be considered to 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.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Mark S. Jennings

Mark S. Jennings
Chief, Branch 1
Office of Associate Chief Counsel
(Corporate)