August 29, 2023

Ms. Holly Porter
Associate Chief Counsel
Passthroughs & Special Industries
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

RE: S Corporation Reorganizations Under Section 368(a)(1)(F)

Dear Ms. Porter:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) in providing guidance in Revenue Ruling 2008-18[1] (the "Ruling") regarding a reorganization under Internal Revenue Code (IRC) section 368(a)(1)(F)[2] (an "F Reorganization") as described therein, including certain consequences as to the employer identification numbers ("EIN") and S corporation election of the involved entities. The AICPA respectfully submits recommendations on matters that involve S corporations desiring to undertake an F Reorganization in a similar, but different form than the Ruling.

Background

Section 368(a)(1)(F) provides that an F Reorganization is "a mere change in identity, form, or place of organization of one corporation, however effected." Treasury Reg. § 1.381(b)-1(a)(2) provides that in an F Reorganization the acquiring corporation is treated as the transferor corporation would have been treated if there had been no reorganization.

The IRS provides guidance in the Ruling on how F Reorganizations affect unique aspects of S corporations (e.g., S elections, qualified subchapter S subsidiary ("QSub") elections, and the use of EINs). The Ruling provides that (i) the newly formed successor corporation inherits the S election of the contributed corporation (whether contributed directly as shown in Situation 1 or to or via merger in Situation 2); and (ii) the contributed corporation retains its historic EIN while the newly formed successor corporation must obtain a new EIN. This guidance, however, is restricted to transactions that align with Situation 1 and Situation 2 in the Ruling.

In contrast to the situations in the Ruling, some taxpayers do not elect to treat the contributed S corporation as a QSub and instead cause the contributed S corporation to convert to a limited liability company (LLC) under a state law conversion statute (a "Conversion") shortly after the contribution.

[1] Rev. Rul. 2008-18, CB 2008-1 674 (March 7, 2008).
[2] Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.

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Recommendation

The AICPA recommends that Treasury and the IRS provide guidance (e.g., a new "Situation 3") confirming that when the contributed S corporation is converted to an LLC as part of a plan of reorganization that occurs in a single day: (i) the reorganization will be treated as an F Reorganization pursuant to which the contributed corporation will retain its historic EIN; and (ii) the contributed corporation will not be treated as a C corporation for any period of the reorganization.

Analysis

In contrast to Situation 1 and Situation 2 in the Ruling, some taxpayers do not make a QSub election for a contributed S corporation and instead cause it to undergo a Conversion to an LLC shortly after it is contributed to the newly formed successor corporation. As a result of the Conversion, the status of the contributed entity defaults to a disregarded entity for United States federal income tax purposes.

From an S election and EIN perspective, this fact pattern should have the same results as Situation 1 of the Ruling in which the S election of the contributed corporation carries over to the new corporation, the new corporation is required to obtain a new EIN, and the resulting LLC retains the EIN of the contributed corporation. Conversely, a QSub election should not be required as it would not be effective for the newly converted LLC.

The integrated contribution and Conversion described in this recommendation are occasionally referred to as a "two-step reorganization." If the first and second step occur the same day, guidance providing that the contributed corporation is not a C corporation for any period during the reorganization would be consistent with other published guidance.[3]

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[3] Treas. Reg. § 1.1361-4(b)(3)(ii); Treas. Reg. §1.1361-5(c)(3), Example 1; and Rev. Rul. 2009-15.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Kris Hill, Chair, AICPA S Corporation Taxation Technical Resource Panel, at (510) 525-4797, or krishill@krishillcpa.com; Arlene Schwartz, AICPA Senior Manager – Tax Policy & Advocacy at (202) 434-9218, or Arlene.Schwartz@aicpa-cima.com; or me, at (830) 372-9692, or bvickers@alamo-group.com.

Sincerely,

Blake Vickers, CPA, CGMA
Chair, AICPA Tax Executive