Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:03
PLR-105473-20

Date:
August 28, 2020

Legend

X =

LLC =

A =

B =

C =

D =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

State 1 =

State 2 =

a =

b =

c =

d =

e =

Dear :

This letter responds to a letter dated December 19, 2019, submitted on behalf of X, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

Facts

According to the information submitted and representations made within, X was incorporated on Date 1, under the laws of State 1, and made a valid S election effective Date 1.

Immediately prior to Date 2, X was owned by the following eligible shareholders: a% by LLC and b% by C and D, a husband and wife. Also immediately prior to Date 2, LLC was wholly owned by Trust 1, also an eligible shareholder. A and B, a husband and wife, were the co-grantors and co-trustees under the laws of State 2, a community property state, of Trust 1.

On Date 2, Trust 1 sold the following issued and outstanding membership interest in LLC: c% to Trust 4, d% to Trust 3, and e% to Trust 2. Property owned by Trust 2, Trust 3, and Trust 4 did not qualify as community property with respect to A and B under State 2 law. As a result of the sale, LLC became regarded as a partnership for federal income tax purposes on Date 2, because the LLC interest held by Trust 2, Trust 3, and Trust 4 were no longer community property owned by A and B.

On Date 3, X discovered that LLC had been an ineligible shareholder and that had caused X's S election to termination effective Date 2. Thereafter, on Date 4, X, A, B, Trust 1, Trust 2, Trust 3, and Trust 4 made corrective steps to ensure the corporation only had eligible shareholders.

X represents that if its S corporation election terminated it was inadvertent and

was not motivated by tax avoidance or retroactive tax planning. X also represents that X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) of the Code that may be required by the Secretary. X further represents that X and its shareholders have filed consistently with X continuing to be a valid S corporation.

Law and Analysis

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 the year. Section 1361(b)(1) defines a ""small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(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 in part that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period of inadvertent termination of the S election, agrees to makes 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 the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Rev. Proc. 2002-69, 2002-2 C.B. 831, provides guidance on the classification of a business entity owned by a husband and wife as community property. If the husband and wife treat a qualified entity as a disregarded entity for federal income tax purposes, the Service will respect that treatment. If the husband and wife treat a qualified entity as a partnership for federal income tax purposes and file the appropriate partnership returns, the Service will respect that treatment. A change in reporting position will be treated as a conversion of the entity. A business entity is a qualified entity if (1) it is wholly owned by a husband and wife as community property under the laws of a state, a foreign country, or a possession of the United States; (2) no person other than one or both spouses would be considered an owner for federal tax purposes; and (3) the

business entity is not treated as a corporation under § 301.7701-2.

Conclusion

Based solely on the facts submitted and representations made, we conclude the existence of an ineligible shareholder under § 1361(b)(1)(B) caused X's S election to terminate on Date 2. We further conclude that the circumstances resulting in the termination on Date 2 were inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), X will be treated as an S corporation from Date 2, provided X's S corporation election was otherwise valid and has not otherwise terminated under § 1362(f).

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was otherwise a valid S corporation.

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

Pursuant to a power of attorney on file, we are sending a copy of this letter to X's authorized representative.

The ruling contained in this letter is 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 rulings requested, it is subject to verification on examination.

Sincerely,

By:_____
Richard T. Probst
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for §6110 purposes

cc: