Internal Revenue Service

Number: **202219005**
Release Date: 5/13/2022

Index Number: 1362.04-00

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:B03
PLR-116916-21

Date:
February 03, 2022

LEGEND:

Sub =

X =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

s =

Dear :

This letter responds to a letter dated August 20, 2021, and subsequent correspondence, submitted on behalf of X by its authorized representative requesting a

ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that Sub, was organized on Date 1 as a limited liability company under the laws of State 1. Sub elected to be an S corporation effective Date 2.

On Date 1, Sub adopted an operating agreement ("Agreement") that included provisions in contemplation of Sub being treated as a partnership for Federal income tax purposes. The partnership provisions applied irrespective of whether X was a partnership. For instance, sections 7.3 and 10.2 of Agreement provide, in part, that the proceeds from liquidation will be allocated to member with positive balances in their respective capital accounts, pro rata, in proportion to the positive balances in those capital accounts.

Sub represents that Agreement did not confer identical rights to distribution and liquidation proceeds and, therefore, Sub had more than one class of stock under § 1361(b)(1)(D), causing its S corporation status to terminate. Sub requests relief pursuant to § 1362(f) due to its governing provisions creating more than one class of stock.

The shareholders of Sub formed X, a State 2 corporation, on Date 3. On Date 4, incident to what X represents was part of a reorganization under § 368(a)(1)(F), Sub shareholders contributed all the stock in Sub to X, thereby causing Sub to become a wholly owned subsidiary of X. Consistent with Rev. Rul. 2008-18, 2008-1 C.B. 674, X would have been treated as the successor S corporation to Sub for federal tax purposes and therefore would not have had to make a new S corporation election. Since the original S election for Sub was ineffective, Sub as a limited liability company was by default classified as a disregarded entity for federal tax purposes instead of as a corporation. Consequently, X made an S corporation election effective Date 3.

X filed an election to treat Sub as a qualified subchapter S subsidiary ("QSub") effective Date 4. However, X's election to treat Sub as a QSub was ineffective because Sub was not a corporation (as defined by § 301.7701-2(b) of the Procedure and Administration Regulations) on Date 4, and therefore, failed to meet all the requirements of § 1361(b)(3)(B) at the time the election was made and for all periods for which the election was to be effective.

X sold s% interest in Sub to an unrelated buyer on Date 5.

The information provided also states that for the period that Sub filed as an S corporation (from Date 2 to Date 4) all ownership units were treated identically with respect to distribution and liquidation proceeds. Similarly, from Date 2 to Date 4, Sub represents that Sub and its shareholders have filed tax returns consistent with Sub

having a valid S corporation election in effect as of Date 2. Since Sub is not represented to be an S corporation at this time, Sub will not alter its Agreement provisions.

X represents that represents that the circumstances which led to the ineffective S corporation election and ineffective QSub election were inadvertent and not the result of tax avoidance or retroactive tax planning. The Sub shareholders and Sub agree to make any adjustments that may be required by the Secretary under 1362(f) consistent with the treatment of Sub as an S corporation effective Date 2 and later as a QSub effective Date 4.

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 § 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)(3)(A) provides that, except as provided in regulations prescribed by the Secretary, for purposes of the Code-(i) a corporation which is a QSub shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that the term "QSub" means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a QSub.

Section 1.1361-1(l)(1) provides, in part, that a corporation that has more than one class of stock does not qualify as a small business corporation. Except as provided in § 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides, in part, that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws,

applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1.1361-3(a)(1) of the Income Tax Regulations provides that the corporation for which a QSub election is made must meet all the requirements of § 1361(b)(3)(B) at the time the election is made and for all periods for which the election is to be effective.

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) 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 (B) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation or a QSub, as the case may be, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder of 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 or a QSub, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

CONCLUSION

Based on the representations made and information submitted, we conclude that Sub's S corporation election was ineffective on Date 2 because Sub had more than one class of stock due to the partnership provisions in Agreement. We conclude, however, that the circumstances resulting in the termination of X's S corporation election were inadvertent within the meaning of § 1362(f). Accordingly, § 1362(f), Sub will be treated as an S corporation from Date 2 to Date 4 provided that Sub's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

In addition, we conclude that X's election to treat Sub as a QSub effective Date 4 was ineffective. We also conclude that the circumstances resulting in the ineffectiveness of the QSub election were inadvertent within the meaning of § 1362(f). Thus, under the provisions of § 1362(f), Sub will be treated as a QSub from Date 4, to Date 5 provided that the QSub election was otherwise valid and not otherwise terminated under § 1361(b)(3)(C).

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion on whether Sub was otherwise eligible to be an S corporation and a QSub.

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 ruling request, it is subject to verification on examination.

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

Pursuant to a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

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

Enclosure:
Copy for § 6110 purposes

cc: