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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:B01
PLR-108168-22

Date:
October 12, 2022

LEGEND

X =

Y =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Dear :

This letter responds to a letter dated April 6, 2022, submitted on behalf of Taxpayer by its authorized representative, requesting a ruling under § 1362(f) of the Internal

Revenue Code (Code).

FACTS

According to the information submitted and representations made within, X was organized under the laws of State 1 on Date 1 as a limited liability company. X was originally treated as a partnership for Federal tax purposes. Effective Date 3, X elected to be an association treated as an S corporation.

Effective Date 5, X engaged in a tax-free reorganization under section 368(f) of the Code and filed an election to be treated as a qualified subchapter S subsidiary within the meaning of § 1361(b)(3)(B) wholly owned by Y. Effective Date 6, X filed an election to be treated as an entity disregarded as separate from Y. On Date 5, Y was organized under the laws of State 2 as a corporation and is treated as an S corporation for Federal tax purposes. X and Y are hereinafter collectively referred to as the Taxpayer.

Effective Date 2, the owners of Taxpayer entered in an Original Operating Agreement. Original Operating Agreement included provisions in contemplation of Company being treated as a partnership for federal income tax purposes; however, the applicability of those provisions was not limited to such a situation. The Original Operating Agreement included the following partnership provisions: (1) Section 5.8 providing for the maintenance of capital accounts; (2) Section 6.1 providing, in part, for allocations of net profits, net losses, and other items of income, gain, loss, deduction, and credit to take into account any Treasury regulations requirements; (3) Section 6.3 providing, in part, that the members of [Taxpayer] "may make distributions to the [m]embers from time to time in amounts that it deems appropriate"; (4) Section 6.4 providing, in part, that the members of Taxpayer "may make distributions in the form of regulation allotments (salary) to a [m]ember proportionate to his or her time spent in direct contribution to [Taxpayer] regardless of said [m]ember's" ownership percentage in Taxpayer; (5) Section 8.2(a) providing, in part, that liquidating distributions "to Members shall be made in accordance, and proportion, with the [m]embers' relative [c]apital [a]ccount balances."

On Date 4, but effective on Date 3, Taxpayer adopted Revised Operating Agreement. Taxpayer represents that Revised Operating Agreement does not create a second class of stock. Taxpayer represents that the invalidity of its S election was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Taxpayer also represents that Taxpayer 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. Taxpayer and its shareholders represent that they have filed all returns consistent with Taxpayer being an S corporation.

Law and Analysis

Section 1362(a) 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 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 such year.

Section 1361(b)(1) provides that the term “small business corporation” means 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, 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 1.1361-1(l)(1) of the Income Tax Regulations provides, in part, that a corporation is generally 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 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 laws, and binding agreements relating to distribution and liquidation proceeds (collectively, governing provisions).

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(d)(2)(B) further provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) 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), (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 the 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, 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) 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 during the period specified by the Secretary.

Conclusion

Based on the facts submitted and representations made, we conclude that Taxpayer's S election was inadvertently invalid on Date 2 because Taxpayer had more than one class of stock due to the partnership provisions in the Original Operating Agreement.

We also conclude that the invalidity of Taxpayer's S election as a result of the Original Operating Agreement creating a second class of stock was inadvertent. Accordingly, under § 1362(f), Taxpayer will be treated as an S corporation from Date 2, and thereafter, provided the S election for Taxpayer is otherwise valid and has not terminated under § 1362(d).

Except as specifically ruled on 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, no opinion is expressed or implied concerning whether Taxpayer otherwise qualifies as an S corporation for federal tax purposes.

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

The ruling contained in this letter is based on information and representations submitted by the Taxpayer and accompanied by 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.

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

Sincerely,

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Caroline E. Hay
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure
Copy for § 6110 purposes

cc: