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:B3
PLR-113464-22

Date:
January 11, 2023

Legend

X =

Y =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This responds to a letter dated July 12, 2022, and subsequent correspondence, submitted on behalf of X by X's authorized representatives, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information and representations submitted, X was formed as a limited lability company under the laws of State 1 on Date 1 and elected to be treated as an S corporation effective Date 2.

On Date 3, Y was formed as a corporation under the laws of State 2. On Date 4, in a transaction intended to qualify as a reorganization under § 368(a)(1)(F), the members of X transferred their entire interests in X to Y. Y filed Form 8869, Qualified Subchapter S Subsidiary Election, in which it elected to treat X as a qualified subchapter S subsidiary ("QSub") effective Date 4.

X represents that X's S corporation election, and X's QSub election were ineffective because X had a second class of stock due to X's operating agreement that allowed for disproportionate distributions to its members upon dissolution. X represents that it has amended its operating agreement to correct the operating agreement.

Y represents that X's ineffective S corporation election was inadvertent and was not motivated by tax avoidance. Y also represents that X's ineffective QSub election was inadvertent and was not motivated by tax avoidance. Y further represents that X, Y, and its members agree to make any adjustments required as a condition of obtaining relief under the inadvertent invalid election rule as provided under § 1362(f) that may be required by the Secretary.

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 such 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 1 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) defines a QSub as a domestic corporation which is not an ineligible corporation, if 100 percent of the stock of the corporation is held by the S corporation, and the S corporation elects to treat the corporation as a QSub.

Section 1.1361-3(a) of the Income Tax Regulations prescribes the time and manner for making a QSub election. Section 1.1361-3(a)(4) provides that a QSub election cannot be effective more than two months and 15 days prior to the date of filing. The proper form for making a QSub election is Form 8869, Qualified Subchapter S Subsidiary Election.

Section 1.1361-3(a)(6) provides that an extension of time to make a QSub election may be available under §§ 301.9100-1 and 301.9100-3.

Section 1361(b)(3)(D) provides that if a corporation's status as a QSub terminates, such corporation (and any successor corporation) shall not be eligible to make an election under § 1361(b)(3)(B)(ii) to be treated as a QSub before its fifth taxable year which begins after the first taxable year for which such termination was effective, unless the Secretary consents to such election.

Section 1.1361-1(l)(1) 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, 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 laws, and binding agreements relating to distribution and liquidation proceeds (collectively, governing provisions).

Section 1.1361-5(c)(2) provides, in part, that in the case of a QSub election effective after December 31, 1996, if a corporation's QSub election terminates, the corporation may, without requesting the Commissioner's consent, have a QSub election made with respect to it before the expiration of the five-year period described in § 1361(b)(3)(D) and § 1.1361-5(c)(1), provided that (i) immediately following the termination, the corporation is otherwise eligible to have a QSub election made for it; and (ii) the relevant election is made effective immediately following the termination of the QSub election.

Section 1362(d)(2) provides that an S corporation election will be terminated whenever (at any time on or after the first day of the first 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 § 1361(b)(3)(B)(ii) by any corporation (A) was not effective for the taxable year for which made

(determined without regard to § 1361(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or (B) was terminated under § 1361(b)(3)(C), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a QSub, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as a QSub) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as a QSub during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election was ineffective as of Date 2, because X had a second class of stock. We further conclude that that the ineffectiveness was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation effective Date 2, and thereafter, provided X's S corporation election is otherwise valid and is not otherwise terminated under § 1362(d).

Additionally, we conclude that the QSub election for X was ineffective because Y was not a valid S corporation on Date 4. We further conclude that the circumstances resulting in the ineffective QSub election for X was inadvertent within the meaning of § 1362(f). Consequently, under § 1362(f), we rule that, provided the QSub election for X was otherwise valid and had not otherwise terminated under § 1361(b)(3)(C), X will be treated as a valid QSub from Date 4, and thereafter.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation, X's eligibility to be a QSub, or whether the reorganization qualified as a reorganization under § 368(a)(1)(F).

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 who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

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

Sincerely,

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

Enclosure:
Copy of this letter for § 6110 purposes

cc: