

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B03  
PLR-104401-23

Date:  
August 28, 2023

Legend

X =

Y =

A =

B =

State =

Date 1 =

Date 2  
=

Date 3 =

Dear :

This letter responds to a letter dated February 27, 2023, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### FACTS

According to the information submitted, X, a State limited liability company, elected to be an S corporation effective Date 1. Y, an association taxable as a corporation for federal tax purposes, owned an interest in X. On Date 1, Y liquidated and transferred its interest in X to individuals, A and B. Under § 1.1377-1(a)(2)(ii) of the Income Tax Regulations, Y was treated as a shareholder of X on Date 1. Because Y was an ineligible S corporation shareholder under § 1361(b)(1)(B), X's S corporation election was ineffective on Date 1.

Additionally, X's operating agreement, effective Date 1, contained terms causing X to have more than one class of stock under § 1361(b)(1)(D). The agreement failed to provide for identical distribution and liquidation rights. During Date 2, X learned that its S corporation election was ineffective on Date 1. Subsequently, on Date 3, X amended its operating agreement to reflect its intent to be treated as an S corporation and to provide that all shares of its stock confer identical rights to distribution and liquidation proceeds.

X represents that the circumstances resulting in the termination of its S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed all federal tax returns consistent with X's status as an S corporation. Finally, X and its shareholders have agreed to make any adjustments (consistent with the treatment of X as an S corporation) as 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 one class of stock.

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

Section 1362(a) provides that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) 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(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 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); (2) the Secretary determines that the circumstances resulting in the ineffectiveness were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness, steps were taken so that the corporation for which the election was made is a small business corporation; and (4) the corporation for which the election was made, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such ineffectiveness, the corporation will be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's S corporation election was ineffective on Date 1 because, on Date 1, X had an ineligible shareholder under § 1361(b)(1)(B) and had more than one class of stock under § 1361(b)(1)(D). We conclude, however, that the circumstances resulting in the ineffectiveness were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), X will be treated as an S corporation from Date 1 and thereafter, provided that X's S corporation election was valid and has not otherwise terminated under § 1362(d).

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 and the regulations thereunder. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be an S corporation.

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. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representatives.

Sincerely,

*Mary Beth Carchia*

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Mary Beth Carchia  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure

Copy of this letter for § 6110 purposes

cc: