

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **202422006**
Release Date: 5/31/2024

Third Party Communication: None
Date of Communication: Not Applicable

Index Number: 1362.00-00, 1362.01-00

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-117063-23

Date:
March 01, 2024

LEGEND

X =

State =

Agreement 1 =

Agreement 2 =

Date 1 =

Date 2 =

Date 3 =

Year 1 =

Year 2 =

Dear :

This letter responds to a letter dated August 24, 2023 and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X was formed as a limited liability company organized under the laws of State on Date 1. X filed Form 8832, Entity Classification Election, to be classified as an association taxable as a corporation effective Date 1. X's operating agreement, Agreement 1 effective Date 1, included provisions relevant to treating X as a partnership for federal income tax purposes.

Effective Date 2, X filed Form 2553, Election by a Small Business Corporation, for X to be treated as an S corporation. X represents that certain provisions of Agreement 1 inadvertently created a second class of stock, causing its S election to be ineffective.

From Year 1 to Year 2, X also made disproportionate distributions and did not allocate its income and other tax items pro rata among its shareholders.

X took corrective action by adopting a new operating agreement, Agreement 2, on Date 3, which eliminated the provisions that caused X to have a second class of stock. X represents it will make corrective distributions for the prior disproportionate distributions made in Year 1 and through and including Year 2.

X represents that the invalid S election was inadvertent and not motivated by tax avoidance or retroactive tax planning. X also represents that X and its shareholders have consistently treated X as an S corporation since Date 2 and agree 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) 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 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 that the determination 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).

Section 1362(a)(1) provides that a small business corporation may elect to be an S corporation. Section 1361(c) provides that an S election shall be effective for the taxable year of the corporation for which it is made and for all succeeding taxable years of the corporation, unless such election is terminated under § 1362(d).

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates 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) and the regulations thereunder provide relief for an ineffective S corporation election (i.e., treating the ineffective election as effective) or inadvertent termination of an S corporation election provided the following conditions are met: (A) the corporation made an election under § 1362(a) that was ineffective or was terminated; (B) the Service determines that the circumstances resulting in the ineffectiveness or termination were inadvertent; (C) steps were taken by the corporation to qualify it as a small business corporation within a reasonable period of time after discovery of the ineffectiveness or termination event; and (D) the corporation and all shareholders agree to any adjustments that the Service may require for the period.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that the ineffectiveness of X's S election on Date 2, as a result of Agreement 1 creating a second class of stock was inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f) X will be treated as an S corporation from Date 2, and thereafter, provided the S election for X is otherwise valid and has not terminated under § 1362(d).

Accordingly, X's shareholders, in determining their respective income tax liabilities, must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account distributions made by X as provided by § 1368. As an additional condition to this letter, X and its shareholders must take the steps as indicated above to correct the possible terminating event. This ruling is contingent on X making corrective distributions.

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied on whether X was or is otherwise eligible to be treated as 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 request for ruling, it is subject to verification on examination.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

Robert D. Alinsky
Branch Chief, Branch 3
(Passthroughs & Special Industries)

Enclosure:

Copy of this letter for § 6110 purposes

cc: