Internal Revenue Service

Number: **202548006**
Release Date: 11/28/2025

Index Number: 1362.00-00, 1362.02-00, 1362.02-02, 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:PT&E:B03
PLR-100781-25

Date:
July 10, 2025

LEGEND

X =

Y =

Z =

Trust =

A =

B =

State 1 =

State 2 =

Date 1 =

Date 2 =

Dear :

This letter responds to a letter dated December 11, 2024, submitted on behalf of X by its authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code (the Code).

FACTS

The information submitted states that X, a State 1 corporation, elected to be an S corporation effective on Date 1. Prior to Date 2, Trust, a grantor trust and eligible S corporation shareholder under § 1361(c)(2)(A)(i), owned shares of X through Y, a State 1 limited liability company. A and B, husband and wife, were the co-grantors and co-trustees of Trust under the laws of State 2, a community property state. A and B treated Y as a disregarded entity for federal tax purposes in accordance with the procedures of Rev. Proc. 2002-69.

On Date 2, Trust transferred all its interest in Y to Z, a State 1 limited liability company treated as a partnership for federal tax purposes. Because Z was an ineligible shareholder under § 1361(b)(1)(B), X's S corporation election terminated on Date 2 under § 1362(d)(2). After X discovered the transfer to Z and that the transfer caused its S corporation election to terminate, X and its shareholders took remedial action to ensure X's shares were all owned by eligible S corporation shareholders.

X represents that the termination of its S corporation election was not motivated by tax avoidance or retroactive tax planning. Further, X represents that X and its shareholders continued to file its income tax returns consistent with being an S corporation after its S corporation election terminated. 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 Commissioner with respect to the period specified by § 1362(f).

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) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that 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 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 1362(d)(2)(A) provides that an election under § 1362(a) shall 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) provides that any termination under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides, in 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 to obtain shareholder consents 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 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.

Rev. Proc. 2002-69, 2002-2 C.B. 831, provides guidance on the classification of a business entity owned by a husband and wife as community property. If the husband and wife treat a qualified entity as a disregarded entity for federal income tax purposes, the Service will respect that treatment. If the husband and wife treat a qualified entity as a partnership for federal income tax purposes and file the appropriate partnership returns, the Service will respect that treatment. A change in reporting position will be treated as a conversion of the entity. A business entity is a qualified entity if (1) it is wholly owned by a husband and wife as community property under the laws of a state, a foreign country, or a possession of the United States; (2) no person other than one or both spouses would be considered an owner for federal tax purposes; and (3) the business entity is not treated as a corporation under § 301.7701-2.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's S corporation election terminated on Date 2 when Z, an ineligible S corporation shareholder under § 1361(b)(1)(B), acquired an interest in X. However, we conclude that the circumstances resulting in the termination of X's S corporation election were

inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), X will be treated as continuing to be an S corporation from Date 2 and thereafter, provided X's S corporation election was valid and has not otherwise terminated under § 1362(d).

This ruling is contingent on X and its shareholders filing, within 120 days from the date of this letter, all required federal income tax returns (including amended returns) for all open years consistent with the requested relief. A copy of this letter should be attached to any such returns.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provisions of the Code. Specifically, we express or imply no opinion as to whether X was or is otherwise eligible to be an S corporation.

This ruling is directed only to the taxpayer requesting it. According to § 6110(k)(3) of the Code, this ruling may not be used or cited as precedent.

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.

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

Sincerely,

Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

By: _____
Brian J. Barrett
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure
Copy for § 6110 purposes

cc: