

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **202612005**
Release Date: 3/20/2026

Third Party Communication: None
Date of Communication: Not Applicable

Index Number: 83.00-00, 1032.00-00,
1361.00-00, 1361.01-02,
1362.02-00, 1362.02-02

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PT&E:B01
PLR-112688-25
PLR-112690-25

Date:
December 19, 2025

LEGEND

X =

Y =

Z =

Individual =

State 1 =

State 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Plan 1 =

Plan 2 =

Dear :

This responds to a letter dated June 23, 2025, submitted on behalf of Y and Z by their authorized representatives, requesting a ruling under § 1362(d)(2)(A) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, X was organized under the laws of State 1 on Date 1 and made an election to be treated as an S corporation on Date 2.

As part of a transaction intended to qualify as a reorganization under § 368(a)(1)(F), X formed Y, a corporation organized under the laws of State 2, on Date 3 and X shareholders exchanged all their stock in X for all the stock in Y. Y filed a Form 8869, Qualified Subchapter S Subsidiary Election, for X to be treated as a qualified subchapter S subsidiary (QSub) within the meaning of § 1361(b)(3). Following the transaction, all Y stock has been owned by Individual and other U.S. individuals, including certain employees of X.

Consistent with Rev. Rul. 64-250, 1964-2 C.B. 33 and Rev. Rul. 2008-18, 2008-1 C.B. 674, Y succeeded in X's election to be treated as an S corporation as of Date 2. On Date 4, X converted to a limited liability company.

Z was organized under the laws of State 2 on Date 5 and made an election to be treated as an S corporation effective Date 5. Since its formation, all Z stock has been owned by Individual and other U.S. individuals, including certain employees of X. Z acquired interests in X on Date 5, and X was treated as a partnership for federal tax purposes effective Date 5.

Y and Z adopted equity compensation plans, Plan 1 and Plan 2, respectively, pursuant to which X employees would have the right to purchase shares thereof at fair market value.

With respect to Y, X employees received shares pursuant to the Plan 1 on Date 6, Date 7, Date 8, and Date 9 (collectively, “Y Plan Equity Grants”).

With respect to Z, X employees received shares pursuant to the Plan 2 on Date 9 (“Z Plan Equity Grant”, and collectively with Y Plan Equity Grants, the “Plan Equity Grants”).

Each Plan Equity Grant allowed X to provide cash to Y and Z such that Y and Z could issue shares to employees on behalf of X as compensation for services provided to X.

The operation of Plan 1 and Plan 2 and § 1.83-6(d) and § 1.1032-3(a)-(c) (or the principles of such sections), as described below, would cause X to be deemed a momentary owner of the stock of Y and Z, as the case may be. X, treated as a partnership for federal income tax purposes at the time of each Plan Equity Grant, is an ineligible S corporation shareholder.

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 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(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 83(h) and § 1.83-6(a)(1) of the Income Tax Regulations provide that, in the case of a transfer of property to which § 83 applies, the person for whom were performed the services in connection with which the property was transferred is allowed a deduction in an amount equal to the amount included under § 83(a), (b), or (d)(2) in the gross income of the person who performed the services.

Section 1.83-6(d)(1) provides that a transfer of property by a shareholder of an employer to a service provider or employee as payment for services is treated as a

capital contribution by the shareholder to the corporation and then a transfer from the corporation to the service provider of such property. Section 1.83-6(d)(1) cross references § 1.1032-3 in discussing the treatment of a corporation transferring its own shares as compensation to someone who provides services to another corporation or partnership.

Section 1.1032-3(a) provides that the recharacterization of transactions under § 1.1032-3 applies to transactions in which a corporation or a partnership (the acquiring entity) acquires money or other property in exchange, in whole or in part, for stock of another corporation (the issuing corporation).

Section 1.1032-3(b) provides that if the rules of § 1.1032-3 apply, then the “transaction is treated as if, immediately before the acquiring entity disposes of the stock of the issuing corporation, the acquiring entity purchased the issuing corporation’s stock from the issuing corporation for fair market value with cash contributed to the acquiring entity by the issuing corporation (or, if necessary, through intermediate corporations or partnerships).” Section 1.1032-3(e) provides examples illustrating how these rules apply in the context of a compensatory arrangement in which stock is issued to a service provider of a subsidiary entity of the issuing company (see Examples 4 and 5).

Section 1.1032-3(c) provides that the recharacterization of transactions under § 1.1032-3 applies to transactions only when the acquiring entity acquires issuing corporation stock in a transaction in which the acquiring entity’s basis in the stock would otherwise be determined with respect to the issuing corporation’s basis in the stock under § 362(a) or § 723; the acquiring entity immediately transfers the stock to acquire money or other property; the party receiving the stock from the acquiring entity does not receive a substituted basis; and the issuing corporation stock is not exchanged for stock of the issuing corporation.

While §§ 83 and 1032 and the regulations thereunder may not be directly applied to each Plan Equity Grant, the transactions described herein may be governed by their principles.

Section 83(h) and § 1.83-6(a)(1) function to match the timing of the service recipient’s deduction for compensation paid to the timing of the income recognized by the service provider that receives the compensation. The deemed transaction created by § 1.83-6(d) directly links the parties receiving and providing services in exchange for the compensation and establishes the timing match for income and deduction related to compensation paid. Section 1.1032-3 extends the nonrecognition treatment of § 1032 to cover a subsidiary’s use of parent stock to acquire property and pay compensation if certain specified conditions are satisfied. Section 1.1032-3 allows the purchase of property by a subsidiary using parent stock to be treated the same as the purchase of the property by the parent using its own stock followed by the parent transferring the

property to its subsidiary. This treatment is achieved by characterizing the transaction, if certain specified conditions described in § 1.1032-3(c) are satisfied, as a deemed contribution of cash from a parent to its subsidiary and then the immediate deemed purchase of stock of the parent by the subsidiary with the deemed contributed cash. This approach is also adopted by section 1.1032-3 for compensatory payments by a subsidiary using its parent's stock and by cross-reference in § 1.83-6. The approach in these regulations gives the subsidiary a cost basis in the parent stock immediately before using it to purchase property or compensate a service provider so the subsidiary does not recognize gain on the transfer of the parent stock. The deemed transactions and resulting momentary ownership solely created by § 1.83-6 and § 1.1032-3 are transitory, created to solve timing and basis concerns arising from §§ 83 and 1032, and were not intended to impact S corporation election status.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that the Plan Equity Grant transfers of Y or Z stock by X to employees that provide services to X under Plan 1 and Plan 2 cause momentary ownership of stock of Y and Z by ineligible S corporation shareholders pursuant to § 1.83-6(d) and § 1.1032-3(a)-(c) (or the principles of such sections). Solely for purposes of § 1361, the momentary ownership by such ineligible shareholders resulting from the operation of § 1.83-6(d) and § 1.1032-3(a)-(c) (or the principles of such sections), which is insignificant and transitory, does not result in a termination of Y or Z's S elections under § 1362(d)(2).

Except as specifically ruled on above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion concerning the application of §§ 83 and 1032 and the regulations thereunder, or the principles of such sections, to Plan 1 and Plan 2 beyond that they could apply in certain instances where Y and Z shares are transferred to service providers of X, an ineligible shareholder, to cause deemed momentary ownership of Y and Z stock by X. We also express or imply no other opinion as to the federal income tax consequences to X, Y, and Z of the transfer of Y and Z stock pursuant to Plan 1 and Plan 2.

The ruling contained in this letter is based on 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 requested 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.

PLR-112688-25,
PLR-112690-25

6

Pursuant to a power of attorney on file, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Caroline E. Hay
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure:
Copy of this letter for section 6110 purposes

cc: