Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.

Telephone Number:

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PLR-116556-25

Date:
April 17, 2026

LEGEND

X =

Y =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Agreement 1 =

Agreement 2 =

Agreement 3 =

Dear :

This responds to a letter dated September 17, 2025, and subsequent correspondence, submitted on behalf of X by its authorized representatives, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states that X was formed as a State limited liability company on Date 1. X made an election to be treated as an S corporation effective Date 2.

X's owners executed an operating agreement, Agreement 1, effective Date 3. Effective Date 4, X's owners executed Agreement 2, which replaced Agreement 1 as X's operating agreement.

Agreement 1 and Agreement 2 did not provide for identical rights to liquidation proceeds and may not have provided for identical rights to distributions. Specifically, Agreement 1 provided that on X's liquidation, the remaining assets of X would be distributed in accordance with the positive balance, if any, in each owner's capital account, and that any distributions in respect of the capital accounts must be made, to the extent practicable, in accordance with the requirements of § 1.704-1(b)(2)(ii)(b)(2). Agreement 2 contained the same provision for liquidation proceeds as Agreement 1.

Although Agreement 1 provided for the creation and maintenance of capital accounts, Agreement 1 stated that annual distributions of cash should be made in proportion to each owner's respective ownership percentage. Agreement 2 contained the same provision for distribution rights as Agreement 1. X represents that Agreement 1 and Agreement 2 provided identical rights to distributions. Nonetheless, X made disproportionate distributions under Agreement 1 and Agreement 2.

X represents that Agreement 1 and Agreement 2 caused X to have more than one class of stock under § 1361(b)(1)(D) and therefore, caused X's S corporation election to terminate. Effective Date 6, X's owners executed Agreement 3. Agreement 3 did not contain the provisions that caused X to have more than one class of stock.

On Date 5, X's owners formed Y as a State corporation. Effective Date 5, Y made an election to be treated as an S corporation. On Date 7, X's owners contributed all the interests of X to Y. Effective Date 7, Y made an election to treat X as a qualified subchapter S subsidiary (QSub) under § 1361(b)(3). X and Y represent that these transactions were intended to be a reorganization under § 368(a)(1)(F) and Revenue Ruling 2008-18, 2008-1 C.B. 674.

Y represents that it made corrective distributions so that all distributions made to X's owners under Agreement 1 and Agreement 2 were in the same proportion as their ownership interests.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and not motivated by tax avoidance or retroactive tax planning. X represents that for each taxable year since X elected to be an S corporation, X and its owners filed federal income tax returns consistent with X having a valid S corporation election.

X and its owners agree to make any adjustments required by the Secretary as a condition of obtaining relief under § 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) 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, 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 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 estate laws, and binding agreements relating to distribution and liquidation proceeds (collectively, governing provisions).

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) 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 the terminations will 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 (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 (B) was terminated under § 1362(d)(2), (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 termination occurred is a small business corporation, and (4) the corporation for which the election was made or 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 the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such 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 terminated on Date 3 because Agreement 1 created a second class of stock. However, such termination was inadvertent within the meaning of § 1362(f). Accordingly, X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided its S corporation election did not otherwise terminate under § 1362(d) or as stated below.

If X's S corporation election had not terminated on Date 3, we conclude that it would have terminated on Date 4 because Agreement 2 created a second class of stock. However, such termination would have been inadvertent within the meaning of § 1362(f). Accordingly, X will be treated as continuing to be an S corporation from Date 4 and thereafter, provided its S corporation election did not otherwise terminate under § 1362(d).

This ruling is subject to the conditions that within 120 days from the date of this letter, X and its owners file any necessary original or amended returns for all open taxable years consistent with the relief granted in this letter. A copy of this letter should be attached to any original or amended returns.

If the above conditions are not met, then this ruling is null and void. Also, if these conditions are not met, X must notify the service center where its S corporation election was filed that the election terminated on Date 3.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code and the regulations thereunder, including whether X or Y were otherwise valid S corporations. Further, we express or imply no opinion on the validity of the reorganization under § 368(a)(1)(F) and Revenue Ruling 2008-18 and its tax consequences.

The ruling contained in this letter is based on information and representations submitted by X, Y, and X's owners 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 requesting 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 your authorized representative.

Sincerely,

Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

____

Elizabeth V. Zanet
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure
Copy for § 6110 purposes

cc: