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Date:

July 27, 2026

LEGEND

X =

Sub =

A Corp =

State 1 =

State 2 =

A =

B =

C =

D =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Dear :

This responds to a letter dated December 3, 2025, and subsequent correspondence submitted on behalf of X and Sub by their authorized representatives, requesting rulings under § 1362(f) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, Sub was incorporated under the laws of State 1 and elected to be an S corporation effective Date 1. Initially, A and B, each an individual, owned all of the stock of Sub.

On Date 2, Sub entered a funding agreement with C, a business entity that is ineligible to own S corporation stock. On Date 3, Sub entered a funding agreement with D, a business entity that is ineligible to own S corporation stock. Later, Sub's owners learned that these contractual funding agreements may have caused C and D to be treated as owning equity in Sub. Additionally, Sub's owners learned the agreements could potentially create a second class of stock in Sub for purposes of § 1361(b)(1)(D).

X was formed under the laws of State 2 on Date 4. In a transaction intended to qualify as a reorganization under § 368(a)(1)(F): (1) A and B contributed all of their shares of stock in Sub to X on Date 5 thereby causing Sub to become a subsidiary of X; (2) X elected to treat Sub as a Qualified Subchapter S Subsidiary ("QSub") within the meaning of § 1361(b)(3)(B) effective Date 5; (3) on Date 6, Sub converted to a State 2 limited liability company; and (4) on Date 6, X contributed all of its membership interests in Sub to A Corp, an association taxable as a corporation. Consistent with Rev. Rul. 64-250, 1964-2 C.B. 33 and Rev. Rul. 2008-18, 2008-1 C.B. 674, X succeeded in Sub's election to be treated as an S corporation as of Date 5.

Because C and D were ineligible S corporation shareholders under § 1361(b)(1)(B) and the funding agreements may have created a second class of stock, Sub's S corporation election may have terminated pursuant to § 1362(d)(2) on Date 2, and subsequently on Date 3 to the extent its S corporation election had not already terminated on Date 2. Additionally, due to the funding agreements, Sub may have failed to meet the requirement under § 1361(b)(3)(B) that 100 percent of its stock is owned by an S corporation. Therefore, X's QSub election for Sub may have been ineffective.

X represents that the circumstances resulting in the potential termination of Sub's S corporation election and the potential ineffectiveness of X's election to treat Sub as a QSub were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that, for the period Sub requests to be treated as an S corporation, Sub and its eligible shareholders (A and B) have filed all federal tax returns consistent with Sub's status as an S corporation. C and D did not file federal tax returns as if they were shareholders of Sub. Further, X represents that all tax returns filed for the period of Date 5 to Date 6 were filed in a manner consistent with Sub being treated as a QSub effective Date 6. Finally, X, Sub, and their shareholders (including Sub's potential shareholders, C and D) have agreed to make adjustments consistent with the treatment of Sub as an S corporation and subsequently as a QSub with respect to the period specified 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(1)(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(1)(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 1361(b)(3)(A) provides that, except as provided in regulations prescribed by the Secretary, for purposes of the Code, (i) a corporation which is a QSub shall not be treated as a separate corporation, and (ii) all assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 1361(b)(3)(B) provides that the term “QSub” means any domestic corporation which is not an ineligible corporation (as defined in § 1361(b)(2)), if (i) 100 percent of the stock of such corporation is held by the S corporation, and (ii) the S corporation elects to treat such corporation as a QSub.

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 1st day of the 1st 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 that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) 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) or § 1361(b)(3)(C), (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 (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or a QSub, as the case may be, or (B) to acquire the shareholder consents, 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 or a QSub, as the case may be) 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 or a QSub, as the case may be during the period specified by the Secretary.

Section 1.1362-4(d) provides, in part, that the Commissioner may require any adjustments that are appropriate. In general, the adjustments should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that Sub's S corporation election may have terminated on Date 2, and, to the extent it had not already terminated on Date 2, may have terminated on Date 3 as a result of entering into the funding agreements with C and D. We conclude, however, that the circumstances resulting in the potential termination were inadvertent within the meaning of § 1362(f). Therefore, under § 1362(f), Sub will continue to be treated as an S corporation from Date 2 to Date 5, provided Sub's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d).

In addition, we conclude that X's election to treat Sub as a QSub effective Date 5 may have been ineffective because Sub did not meet all the requirements of § 1361(b)(3)(B) at the time the election was made and for all periods for which the election was to be effective. However, we conclude that the circumstances resulting in the potential ineffectiveness of the QSub election were inadvertent within the meaning of § 1362(f). Therefore, under the provisions of § 1362(f), Sub will be treated as a QSub from Date 5 to Date 6, provided that the QSub election was otherwise valid and was not otherwise terminated under § 1361(b)(3)(C).

This letter is subject to the following condition in accordance with § 1362(f) and § 1.1362-4(d): X, Sub, A, B, C, and D will not treat C and D as holding equity in Sub for any federal tax purposes including, but not limited to, determining the holding period of any shares of stock of A Corp under § 1202. If this condition is not met, then this ruling is null and void. Also, if this condition is not met, Sub must notify the service center with which Sub filed its S corporation election that its election terminated on Date 2 and that its QSub election on Date 5 was ineffective.

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 a valid S corporation, whether Sub was otherwise eligible to be an S corporation, whether Sub is otherwise eligible to be, or was a valid, QSub, or the validity of the reorganization under § 368(a)(1)(F) or its tax consequences.

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 ruling request, it is subject to verification on examination.

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

Sincerely,

Jennifer N. Keeney
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure:

Copy of this letter for § 6110 purposes

cc: