

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **201905002**  
Release Date: 2/1/2019

Third Party Communication: None  
Date of Communication: Not Applicable

Index Numbers: 1361.01-04, 1361.05-00,  
1362.00-00, 1362.01-00,  
1362.01-01, 1362.04-00

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B3  
PLR-117171-18  
Date:  
October 23, 2018

Legend

X =

Y =

A =

B =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Operating Agreement =

Dear \_\_\_\_\_ :

This letter responds to a letter dated May 11, 2018, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

### Facts

The information submitted states that X was organized as a limited liability company under the laws of State on Date 1. A was the sole shareholder of X on Date 1. X elected to be an S corporation effective Date 2. On Date 3, X acquired from B all the membership interests of Y, a State limited liability company that made a timely election to become a qualified subchapter S subsidiary (QSub) of X effective Date 3. However, on Date 3, X's Operating Agreement included provisions regarding partnerships. Section 2.10 of the Operating Agreement provides, in part, that the members intend that X shall be treated as a partnership for tax purposes and to file its returns consistent with such treatment. Section 9.3 provides, in part, that if X were to be liquidated, assets of X are to be distributed to its members in proportion to their respective positive capital account balances. When X's members discovered the effect of the partnership provisions they amended X's Operating Agreement effective Date 4 to remove the partnership provisions and provide identical distribution and liquidation rights to X's members.

X represents that the termination of X's S corporation election and ineffectiveness of Y's QSub election were inadvertent and not the result of retroactive tax planning. X further represents that no federal tax return of any person has been filed inconsistent with a valid S corporation election having been made for X effective Date 2 and a valid QSub election having been made for Y effective Date 3. X also represents that all distributions and allocations of income to its shareholders have been made pro rata in accordance with their interests in X. X, Y, and X's shareholders have agreed to make any adjustments required by the Service consistent with the treatment of X as an S corporation and Y as a QSub.

### 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 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 1361(b)(3)(A) provides that, except as provided in regulations prescribed by the Secretary, for purposes of this title (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, for purposes of § 1361(b)(3)(B), the term “qualified subchapter S subsidiary” 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)(1) 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) is 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 1362(f) provides that if (1) an election under § 1362(a) or § 1361(b)(3)(B)(ii) by any corporation (i) 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 (ii) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C); (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 the termination occurred is a small business corporation or a QSub, as the case may be, or to acquire the required 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), agree to make the 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 this period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

Section 1.1361-1(l)(1) of the Income Tax Regulations 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 state laws, and binding agreements relating to distribution and liquidation proceeds (collectively, governing provisions).

### Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election terminated on Date 3 and Y's QSub election was ineffective on Date 3 because X had more than one class of stock due to the provisions in the Operating Agreement. We also conclude that the termination of X's S corporation election and the ineffectiveness of Y's QSub election were inadvertent within the meaning of § 1362(f). Accordingly, under the provisions of § 1362(f), X will be treated as an S corporation from Date 3 and thereafter, provided that X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d). Furthermore, under § 1362(f), Y will be treated as a QSub from Date 3, and thereafter, provided the QSub election for Y is otherwise valid and has not terminated under § 1362(b)(3)(B).

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, including whether X was otherwise a valid S corporation and whether Y was otherwise a valid QSub.

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 for precedent.

Pursuant to a power of attorney on file, we are sending a copy of this letter to X's authorized representative.

The rulings contained in this letter are 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 rulings requested, it is subject to verification on examination.

Sincerely,

Adrienne M. Mikolashek  
Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter

Copy for §6110 purposes