

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B01  
PLR-102857-22

Date:  
August 02, 2022

Legend

X =

State =

A =

B =

Y =

Z =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

\$n =

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

This letter responds to a letter dated December 28, 2021, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

#### Facts

According to the information submitted and representations made, X was incorporated under the laws of State. X elected to be treated as an S corporation effective Date 1. At that time, X's only shareholders were individuals A and B.

On Date 2, X converted from a State corporation to a State limited partnership, and filed a Form 8832, Entity Classification Election, to be classified as an association taxable as a corporation effective Date 2. X represents that the conversion qualified as a reorganization under § 368(a)(1)(F) and X therefore continued as an S corporation. After the conversion, X's limited partners were A and B and X's general partners were Y and Z. Y and Z were both limited liability companies formed under the laws of State treated as entities disregarded from A and B, respectively, for federal tax purposes.

Effective Date 3, the partners of X entered into a new partnership agreement, Revised Partnership Agreement. This agreement contained provisions in contemplation of X being treated as a partnership for federal income tax purposes, including that capital accounts be maintained and that liquidating distributions of the partnership be made in accordance with the partners' positive capital account balances.

The conversion on Date 2 to a State limited partnership may have created a second class of stock in violation of the one class of stock requirement under § 1361(b)(1)(D), thereby possibly causing X's S corporation election to terminate. In addition, the

provisions in the Revised Partnership Agreement gave rise to a second class of stock causing X's S corporation election, if not otherwise terminated, to terminate on Date 3. However, X represents that any second class of stock was created inadvertently.

On Date 4, A gifted A's limited partnership interest in X to Trust 1, Trust 2, and Trust 3. Also on Date 4, A gifted A's interest in Y to Trust 1 and Trust 2. Because of this transfer, Y changed from being treated as a disregarded entity to being treated as a partnership. On Date 5, Trust 3 merged with and into Trust 4. As a result of this merger, Trust 3's interest in X became the property of Trust 4.

X represents that Trust 1, Trust 2, Trust 3, and Trust 4 each met the definition of an Electing Small Business Trust (ESBT) under § 1361(e)(1). However, the respective trustees failed to make timely ESBT elections for the trusts under § 1361(e)(3). As a result, X had ineligible shareholders in violation of § 1361(b)(1)(B) and X's S corporation election would have terminated on Date 4 and Date 5. However, X represents that the failure to make ESBT elections was inadvertent.

X also represents that when A's interest in Y was gifted to Trust 1 and Trust 2 on Date 4, Y converted from being treated as a disregarded entity to being treated as a partnership for federal tax purposes and therefore was an ineligible shareholder under § 1361(b)(1)(B), also causing X's S corporation election to terminate on Date 4. However, X represents that it was unaware of that consequence of the transfer and that the change to a partnership was inadvertent.

Upon discovering that it had ineligible shareholders and more than one class of stock, X took the following actions:

On Date 6, Y's general partnership interest was converted to a limited partnership interest and was distributed out to Trust 1 and Trust 2 such that Y was no longer a shareholder. Also on Date 6, Z's general partnership interest was converted to a limited partnership interest and distributed out to B such that Z was no longer a shareholder. In addition, language contained in the Revised Partnership Agreement in contemplation of X being treated as a Partnership for federal tax purposes was removed and new language contemplating X being treated as an S corporation for federal tax purposes was inserted.

On Date 7, Trust 1 purchased Trust 4's limited partnership interest in X and also purchased a portion of B's limited partnership interest in X. Also on Date 6, Trust 2 purchased a portion of B's limited partnership interest in X. After these purchases, Trust 1, Trust 2, and B were the only remaining shareholders of X.

Effective Date 8, X converted from a State limited partnership to a State limited liability company. X filed a Form 8832, Entity Classification Election, to be classified as an association taxable as a corporation effective Date 8.

X represents that there was no intent to terminate X's S corporation election and the inadvertent terminations were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have consistently treated X as an S corporation since Date 1 and agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

### 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 1361(c)(2)(A)(v) provides that, for purposes of § 1361(b)(1)(B), an ESBT may be a shareholder.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)-(5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and subsequent taxable years of such trust unless revoked with the consent of the Secretary.

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 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 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, in part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in the termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which 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) as may be required by the Secretary regarding this period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required 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 representations made and the information submitted, we conclude that if X's conversion from a State corporation to a State limited partnership on Date 2 did create a second class of stock, the consequent termination of X's S corporation election was inadvertent within the meaning of 1362(f). We further conclude that X's S corporation election, if not otherwise terminated, would have terminated on Date 3 because the partnership provisions created a second class of stock. In addition, we conclude that X's S corporation election, if not otherwise terminated, would have terminated on Date 4 because it had ineligible shareholders under § 1361(b)(1)(B)--Y became a partnership and was therefore an ineligible shareholder and the trustees of Trust 1, Trust 2, and Trust 3, failed to make ESBT elections thus the trusts were ineligible shareholders. Finally, the election also would have terminated on Date 5 when Trust 3 merged into Trust 4 because the trustee of Trust 4 failed to make an ESBT election. However, we also conclude that such terminations were inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning on and after Date 2, unless X's S corporation election is otherwise terminated under § 1362(d).

This ruling is contingent on: (1) the trustees of Trust 1, Trust 2, and Trust 3 filing within 120 days from the date of this letter ESBT elections effective Date 4 on behalf of their respective trusts with the appropriate service center; (2) the trustees of Trust 4 filing within 120 days from the date of this letter an ESBT election effective Date 5 on behalf of Trust 4 with the appropriate service center; and (3) Trust 1, Trust 2, and Trust 4 filing within 120 days from the date of this letter amended returns for all open years to properly reflect the treatment of Trust 1, Trust 2, and Trust 4 as ESBTs. A copy of this letter must be attached to any ESBT elections and income tax returns to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this

requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Furthermore, as an adjustment under § 1362(f)(4), a payment of \$n and a copy of this letter must be sent within 45 days from the date of this letter to the following address: Internal Revenue Service, Kansas City Submission Processing Campus, Attn: Manual Deposit, 333 W. Pershing Road, Stop 7777, Kansas City, MO 64108.

If the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the service center with which it filed its S corporation election that its election terminated.

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 request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation or Trust 1, Trust 2, or Trust 3's eligibility to be ESBTs.

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.

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

Sincerely,

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Caroline E. Hay  
Senior Technician Reviewer, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure (1)  
Copy for § 6110 purposes

cc: