Internal Revenue Service

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Person To Contact:
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Telephone Number:

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CC:PSI:B01
PLR-101483-24

Date:
July 17, 2024

LEGEND

X =

A =

B =

C =

Estate 1 =

Estate 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Dear :

This letter responds to a letter dated December 26, 2023, and supplemental information submitted on behalf of X by X's authorized representatives, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted represents that X was incorporated under the laws of State on Date 1 and elected S corporation status effective Date 1.

On Date 2, X converted from a State corporation to a State limited partnership and filed 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 therefore X continued as an S corporation. However, the conversion to a State limited partnership on Date 2 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.

After the conversion on Date 2, X's limited partners were individual spouses A and B and X's general partner was C, a State limited liability company. C was wholly owned by A and B as community property under the laws of State. X represents that A and B treated C as a disregarded entity from Date 2 until Date 3. However, for the tax year beginning Date 3, C filed Form 1065, U.S. Return of Partnership Income, inadvertently converting C from a disregarded entity to a partnership for federal income tax purposes effective Date 3. Therefore, C, as a partnership, became an ineligible shareholder of X under § 1361(b)(1)(B) causing X's S corporation election, if not otherwise terminated, to terminate on Date 3.

On Date 4, A died and her interest in X and C passed to her estate, Estate 1. Thus, C remained a partnership with Estate 1 and B as equal partners. On Date 5, B died and his interest in X and C passed to his estate, Estate 2.

Upon discovering that it had an ineligible shareholder and that it may have had more than two classes of stock, X took the following actions:

On Date 6, Estate 2 acquired Estate 1's interest in C causing C to become wholly owned by Estate 2 and therefore a disregarded entity.

Effective Date 7, X converted from a limited partnership to a limited liability company under the laws of State. X filed Form 8832, Entity Classification Election, to be treated as an association taxable as a corporation effective Date 7. X represents that the reorganization qualified as a reorganization under § 368(a)(1)(F) and that X intended at all times for X to remain a valid S corporation.

On Date 8, C distributed its interest in X to Estate 2. Thus, Estate 1 and Estate 2 became the sole shareholders of X effective Date 8.

X represents that there was no tax avoidance or retroactive tax planning involved, and the resulting termination of X's S corporation election was inadvertent. X and its shareholders agree to make any adjustments that the Secretary may require as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) of the Code.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code 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 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(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in

termination, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period. Then, notwithstanding the circumstances resulting in the termination, the corporation will be treated as continuing to be an S corporation during the period specified by the Secretary.

Rev. Proc. 2002-69, 2002-2 C.B. 831, provides guidance on the classification of a business entity owned by a husband and wife as community property. If the husband and wife treat a qualified entity as a disregarded entity for federal income tax purposes, the Service will respect that treatment. If the husband and wife treat a qualified entity as a partnership for federal income tax purposes and file appropriate partnership returns, the Service will respect that treatment. A change in reporting position will be treated as a conversion of the entity. A business entity is a qualified entity if (1) it is wholly owned by a husband and wife as community property under the laws of a state, a foreign country, or a possession of the United States; (2) no person other than one or both spouses would be considered an owner for federal tax purposes, and (3) the business entity is not treated as a corporation under § 301.7701-2.

CONCLUSION

Based solely on the information submitted and the representations made, 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, then 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 when C became a partnership and was therefore an ineligible shareholder of X. However, we also conclude that such termination was inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions under § 1362(f), X will be treated as continuing to be an S corporation on Date 2 and thereafter provided that X's S corporation election was valid and not otherwise terminated under § 1362(d).

The ruling contained in this letter is 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 ruling request it is subject to verification on examination.

Except as specifically ruled above, we express or imply no opinion as to the federal income tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation.

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

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

Sincerely,

_____/s/_____
Jennifer N. Keeney
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy of letter for § 6110 purposes
cc: