

Now is a Good Time to Confirm Your S Corporation Status

October 25, 2022

On October 11, 2022, the IRS published Revenue Procedure 2022-19 providing taxpayers with liberalized procedures for resolving common S corporation issues. Previously, taxpayers would have needed costly IRS letter rulings for certainty on their S corporation status. The new procedures are simpler and less expensive.

The IRS has separately assured taxpayers that LLCs that are classified as S corporations may also qualify for this liberalized relief.

Inadvertent loss of S corporation status can have significant tax consequences and can make your business a less attractive acquisition target. For example, an S corporation that reverts to a C corporation may be subject to a double layer of tax going back several years. As a result, potential acquirers of any S corporation invariably request representations on the validity of the S corporation status.

The new Revenue Procedure describes common situations that the IRS has historically treated as not affecting the validity of S corporation status or qualified S corporation Qsub status, such as:

1. One class of stock requirement in the governing provisions (including the concept that commercial contractual agreements are not treated as binding agreements unless a “principal purpose” of the agreement is to circumvent the one class of stock requirement);
2. Disproportionate distributions inadvertently creating a second class of stock;
3. Certain inadvertent errors or omissions on Form 2553 or Form 8869;
4. Missing administrative acceptance letters for S corporation or Qsub elections;
5. Federal income tax return filings inconsistent with an S election; or
6. Governing provisions that allow for non-identical treatment of shareholders, such as differing liquidation rights (allowing for retroactive corrections).

For these common situations, there are now simpler and cheaper procedures to preserve S corporation status. For example, for certain small errors such as missing officer signatures, S corporations may follow the same simplified procedures as the late election relief procedures in Revenue Ruling 2013-30. Those procedures do not require a private letter ruling request, but only the original election form with a reasonable cause statement. As another example, if the issue is non-identical governing provisions and no disproportionate distributions were made, the S corporation may simply be retroactively treated as an S Corporation if it meets certain eligibility requirements and keeps a copy of a signed statement in its files.

Shareholders of uncertain S corporations should consider taking advantage of these new relaxed and cheaper procedures for curing S corporation mistakes. Each different type of error has a different cure with specific requirements. Please contact your Miller Canfield attorney or the authors of this alert if you have any questions.