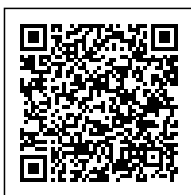


# LLCS TAXED AS S CORPORATIONS: WELCOME RELIEF FOR INADVERTENT “S” FAILURES

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## A Disaster Waiting to Happen

Picture it: The year is 2003. You are an owner of a limited liability company that has elected to be taxed as an S corporation. When you formed your LLC, you worked with an attorney to draft the operating agreement, and your CPA filed the S election. You went about your business, growing the company and ensuring a nice standard of living for yourself, your co-owner, and your employees. It is now the summer of 2022, and your co-owner has decided he wants to leave the business. You pull the operating agreement out of the drawer and, because your original attorney has since retired, you take it to your new attorney to provide advice as to the buy-out procedure.

Enter your attorney's nightmare: The operating agreement that you and your co-owner signed in 2003 did not contemplate that the LLC would be taxed as an S corporation. Rather, it contains all of the income tax allocation and distribution provisions that are standard for LLCs taxed as

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What to do? Should you live with an invalid S election? *Can* you live with an invalid S election? What potential buyer of the company would want to take on that risk?

Your new attorney would in all likelihood recommend that the company seek a Private Letter Ruling from the Internal Revenue Service to ensure that the company's S corporation election was valid since inception. Unfortunately, that Private Letter Ruling request likely will require payment of a \$38,000 filing fee, ([Rev. Proc. 2022-1, Appendix A, § A\(4\), 2022-1 I.R.B. 1; ABA Tax Section Comments requesting reduced PLR User Fees](#)) in addition to the legal fees necessary to file the request.

Fortunately, however, it is 2023 (and not late summer 2022), which means that your attorney can deliver the great news that you may be eligible to take steps to ensure you have a valid S-election without needing a PLR!

## **Revenue Procedure 2022-19 ([Rev. Proc. 2022-19, 2022-41 I.R.B. 282.](#))**

In October of 2022, the Internal Revenue Service (the "IRS") issued Revenue Procedure 2022-19, providing the means by which an S corporation may secure relief from an inadvertent election or termination without the necessity of obtaining a private letter ruling.

### ***Retroactively Correcting One or More Non-Identical Governing Provisions***

In the case of an LLC that has elected Subchapter-S Status, where the LLC's operating agreement contains distribution and liquidation provisions that otherwise could give rise to a second class of stock (such as the provisions described in the "Disaster Waiting to Happen" above), as long as the LLC/S corporation and its shareholders meet certain specified requirements and are otherwise eligible, ([Rev. Proc. 2022-19, 2022-41 I.R.B. 282, Section 3.06.](#)), then the LLC/S corporation can essentially self-correct the error, and the IRS will treat the LLC/S corporation as having a valid S-election.

Importantly, to secure retroactive correction, in addition to meeting the eligibility requirements, the S corporation must: (1) Correct the errors in the governing provisions (e.g., amend the operating agreement); (2) complete a Corporate Governing Provision Statement, which must be kept in the company's file and must be signed under penalties of perjury by an authorized person; and (3) have each shareholder sign a statement attesting to various items, including that each shareholder reported income consistent with the S election.

### ***Time to Act***

Importantly, the corrective action must be taken before any non-identical governing provision is discovered by the IRS, which means that any LLC taxed as a Subchapter S corporation should review its operating agreement and consider taking corrective action (if necessary and if eligible) sooner rather than later.

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