Internal Revenue Service

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Department of the Treasury
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
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Date:
March 23, 2009

X =

State =

D1 =

D2 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

D3 =

Dear :

This responds to a letter dated October 14, 2008, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State on D1, and X elected to be treated as an S corporation effective D2. X had subchapter C earnings and profits at the close of each of its Year 1, Year 2, and Year 3 taxable

years and had gross receipts for each of those years more than 25 percent of which were passive investment income. As a result, X's S election terminated on D3. X paid the tax under § 1375 for its Year 1, Year 2, and Year 3 taxable years. X represents that the termination of X's election to be an S corporation was inadvertent, unintended, and not the result of tax avoidance or retroactive tax planning. In Year 4, X distributed all of its subchapter C earnings and profits to its shareholders. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of three consecutive taxable years, and has gross receipts for each of such years more than 25 percent of which are passive investment income. Section 1362(d)(3)(A)(ii) provides that any termination under § 1362(d)(3) shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (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 the termination, steps were taken so that the corporation is 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1375 imposes a tax on the income of an S corporation that has accumulated earnings and profits at the close of a taxable year, and that has gross receipts more than 25 percent of which are passive investment income (within the meaning of § 1362(d)(3)).

Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated on D3 under § 1362(d)(3)(A),

because X had subchapter C earnings and profits at the close of each of three consecutive taxable years, and had gross receipts for each of those taxable years more than 25 percent of which were passive investment income.

We further conclude that the termination of X's S corporation election was an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning D3, and thereafter, provided that X's S corporation election was valid and is not otherwise terminated under § 1362(d). Based on the particular facts of this case, no adjustments are required under § 1362(f)(4). Furthermore, no amendments shall be made to X's or its shareholders Year 3 income tax returns with respect to the issues addressed in this letter. If these 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 X's S corporation election was filed that the election terminated on D3.

Expect as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the above-described facts under any other provisions of the Code. Specifically, no opinion is expressed on whether X was or is otherwise eligible to be treated as an S corporation.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the power of attorney on file, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Melissa C. Liquerman
Chief, Branch 2
(Passthroughs & Special Industries)

Enclosures (2):
Copy of this letter
Copy for § 6110 purposes

cc: