Internal Revenue Service

Number: **201519018**
Release Date: 5/8/2015

Index Number: 1362.02-03, 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-136698-14

Date:
January 28, 2015

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Dear :

This responds to a letter dated September 18, 2014, submitted on behalf of X by its authorized representatives, requesting relief under § 1362(f) of the Internal Revenue Code with respect to the termination of X's S corporation election.

FACTS

The information submitted indicates that X was incorporated in State on Date 1. X filed Form 2553, Election by a Small Business Corporation, to be effective Date 2.

At the time that X elected to be an S corporation, and for subsequent periods, including the taxable years ending on Date 3, Date 4, and Date 5, X had accumulated earnings and profits which were not distributed. X had passive investment income that exceeded 25% of its gross receipts for the taxable years ending on Date 3, Date 4, and Date 5. As a result, X's S corporation election terminated on Date 6 pursuant to § 1362(d)(3).

X represents that its tax return preparers were not aware of the passive investment income provisions under § 1362 and were not aware of the termination provision in § 1362(d)(3)(A)(i). X represents that it intended to maintain its S corporation status and that the termination of its S corporation election was inadvertent. X represents that the termination of its S corporation election was not part of a retroactive tax planning scheme or a plan to avoid federal income tax. X represents that X and its shareholders consistently treated X as an S corporation for all years since its S corporation election.

X indicates that, if the requested relief is granted, it will amend its tax return for the taxable year ended Date 7 to elect under § 1.1368-1(f)(3) to distribute all of its accumulated earnings and profits through a deemed dividend.

LAW AND ANALYSIS

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

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 section 1362(a) is in effect for such year.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. The termination is effective on and after the day of the termination.

Section 1362(d)(3)(A)(i) provides that an election under section 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 taxable years more than 25 percent of which are passive investment income. Section 1362(d)(3)(A)(ii) provides that any termination under section 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 section 1362(d)(3)(A)(i).

Section 1362(f) provides that if (1) an election under section 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (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 such termination, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder of such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated on Date 6 under § 1362(d)(3) because X had accumulated earnings and profits at the close of each of three consecutive taxable years beginning Date 2, 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). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning Date 6, and thereafter, unless X's S corporation election is otherwise terminated under the provisions of § 1362(d), provided the following conditions are met. X must distribute all of its accumulated earnings and profits. This distribution is to be accomplished with a deemed distribution pursuant to an election made pursuant to § 1.1368-1(f) reflected on an amended federal income tax return to be filed by X for the taxable year ended Date 7. X must attach a statement to such amended return which identifies the election, states that each shareholder of X consents to the election, and identifies the amount of the deemed dividend that is treated as being distributed to each shareholder. Each of X's shareholders must pay a tax liability to the IRS as if that shareholder had reported this distribution on his federal income tax return for the taxable year ended Date 7. 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 has terminated.

Except as specifically ruled above, we express or imply no opinion concerning 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 whether X is otherwise eligible to be an S corporation.

A copy of this letter should be attached to X's amended federal tax return for the taxable year ending Date 7. A copy is enclosed for that purpose.

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.

Pursuant to a power of attorney on file with this office, a copy of this letter will be sent to X's authorized representative.

Sincerely,

David R. Haglund
David R. Haglund
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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