

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

[REDACTED]

Refer Reply To:
CC:PSI:B01-GENIN-162233-02
Date:
Dec 9 2002

Dear [REDACTED]:

This letter is in response to your letter, dated October 23, 2002, on behalf of [REDACTED], seeking a reinstatement of [REDACTED] S corporation status.

Section 1361(a)(1) of the Internal Revenue Code defines a S corporation as a small business corporation for which an election under section 1362(a) is in effect. Section 1361(b)(1) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, other than a trust described in section 1361(c)(2), and other than an organization described in (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 1362(d) of the Code describes the ways to terminate a valid S corporation election. In relevant part, section 1362(d)(1) provides for termination of an S corporation election by revocation. Section 1362(d)(2) provides that a corporation may terminate its S corporation status by ceasing to be a small business corporation. Finally, section 1362(d)(3) provides that a valid S corporation election is terminated if the passive investment income of the corporation exceeds 25 percent of gross receipts for 3 consecutive taxable years and the corporation has accumulated earnings and profits.

Section 1362(f) of the Code provides that a corporation is treated as continuing to be a S corporation during the period specified by the Secretary if (1) an election under section 1362(a) by any corporation was terminated under paragraph (2) or (3) of section 1362(d) (provided in the previous paragraph), (2) the Secretary determines that the termination was inadvertent, (3) no later than a reasonable period of time after discovery of the terminating event, 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 section 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 that period.

Section 1362(g) of the Code states that if a small business corporation has made an election under subsection (a) and if such election has been terminated under subsection (d), such corporation (and any successor corporation) shall not be eligible to make an election under subsection (a) for any taxable year before its 5th taxable year which begins after the 1st taxable year for which such termination is effective, unless the Secretary consents to such election.

Section 1.1362-5(a) of the Regulations provides that absent the Commissioner's consent, an S corporation whose election has terminated (or a successor corporation) may not make a new election under section 1362(a) for five taxable years as described in section 1362(g). However, the Commissioner may permit the corporation to make a new election before the 5-year period expires. The corporation has the burden of establishing that under the relevant facts and circumstances, the Commissioner should consent to a new election. The fact that more than 50 percent of the stock in the corporation is owned by persons who did not own any stock in the corporation on the date of the termination tends to establish that consent should be granted. In the absence of this fact, consent ordinarily is denied unless the corporation shows that the event causing termination was not reasonably within the control of the corporation or shareholders having a substantial interest in the corporation and was not part of a plan on the part of the corporation or of such shareholders to terminate the election.

Section 1.1362-5(c) of the Regulations provides limited instances of automatic consent by the Commissioner for a taxpayer to file an election before the expiration of the 5-year period. It provides, in relevant part, that a corporation may, without requesting the Commissioner's consent, make a new election under section 1362(a) before the 5-year period described in section 1362(g) expires if the termination occurred because the corporation (1) revoked its election effective on the first day of the first year for which the its election was to be effective; or (2) failed to meet the definition of a small business corporation on the first day of the first taxable year for which its election was to be effective.

Unless the taxpayer qualifies under either section 1362(f) or the automatic consent provisions listed in section 1.1362-5(c) of the regulations, a taxpayer that has previously revoked their valid S corporation status and is seeking to file an S corporation election before the expiration of the 5-year period, must file a private letter ruling request seeking the Commissioner's consent. The procedure for submitting such a request is outlined in Revenue Procedure 2002-01. For your convenience, we have included a copy of the Revenue Procedure with this letter.

Please note that there is a filing fee required, if you decide to seek a private letter ruling (see Appendix A of Rev. Proc. 2002-01, which is tabbed for your convenience). Appendix B provides a sample letter ruling format which should closely be followed. It contains a complete ruling request with descriptions of what is required. Finally, Appendix C is a required checklist that should be filled out and submitted with your private letter ruling request to ensure its completeness.

We appreciate this opportunity to provide you with assistance. If you have further questions, please contact us at (202) 622-3050 (not a toll free number).

Sincerely,

/s/ Dianna K. Miosi

Dianna K. Miosi
Chief, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure (1)
Revenue Procedure 2002-01