



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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CC:PSI:B01 [REDACTED]  
GENIN-153845-02

[REDACTED]

Dear [REDACTED]:

Reference: [REDACTED]

This letter is in response to your letter, dated August 27, 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(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), (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(d) of the Code, referenced above, provides a listing of 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

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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.

As noted above, there are only two instances where a termination of an S corporation election may be ignored by the Internal Revenue Service -- either by the corporation ceasing to be a small business corporation (section 1362(d)(2)), or through the earning of excessive passive income as outlined in section 1362(d)(3) of the Code. Terminations by revocation, located in section 1362(d)(1), are not afforded relief under section 1362(f) of the Code.

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 5<sup>th</sup> taxable year which begins after the 1<sup>st</sup> taxable year for which such termination is effective, unless the Secretary consents to such election.

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,

David R. Haglund  
Senior Technician Reviewer, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)