

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-108352-10

Date:
September 02, 2010

LEGEND

X =

State =

A =

B =

C =

D =

Date =

1
Date =

2
Date =

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Date =

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8
a =

b =

Dear :

This letter responds to a letter dated February 15, 2010, and subsequent correspondence, submitted on behalf of X by X's authorized representatives, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

According to the information submitted, X was incorporated under the laws of State on Date 1. X elected to be an S corporation effective Date 2. In the consecutive taxable years ending Date 3, Date 4, and Date 5, X received passive investment income (within the meaning of § 1362(d)(3)) in excess of 25% of its gross receipts. Furthermore, X had accumulated earnings and profits (AE&P) remaining in each of these three years. To correct the error, X elected to distribute all of its AE&P in the amount of \$a to A, B, C, and D on Date 6 pursuant to § 1.1368-1(f)(3) of the Income Tax Regulations. On Date 7, X discovered that its S corporation election had inadvertently terminated on Date 8. X requested this ruling soon after discovering that its S corporation election had terminated.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X further represents that X and X's shareholders have filed tax returns consistent with X being an S corporation. 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 with respect to the period specified by § 1362(f).

LAW AND ANALYSIS

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

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 the taxable years more than 25% of which are passive investment income. The termination

is effective on and after the first date of the first tax 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 not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation, or to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to 1362(f), 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 ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) provides that for purposes of § 1.1362-4(a), the determination of whether a termination or invalid election was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election was inadvertent.

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that X's S corporation election terminated on Date 8, under § 1362(d)(3)(A), because X had AE&P at the close of each of three consecutive tax years ending on Date 5, and had gross receipts for each of those years more than 25% of which were passive investment income. We further conclude that the termination was inadvertent 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 on Date 8 and thereafter, unless X's S election is otherwise terminated under § 1362(d). X must send payment of \$b with a copy of this letter to the following address:

Internal Revenue Service

Cincinnati Service Center
201 West Rivercenter Blvd.
Covington, KY 41011
Stop 31
Terri Lackey
Manual Deposit.

X must send this payment no later than 45 days from the date of this letter. If this condition is not met, then this ruling is null and void. Furthermore, if this condition is not met, X must send notification that its S election has terminated to the service center with which X's S election was filed.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X's S corporation election was a valid election under § 1362.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for the ruling, it is subject to verification on examination.

Sincerely,

/s/

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes

cc: