Internal Revenue Service

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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:B03
PLR-142222-11
Date:
February 16, 2012

LEGEND

Company =

Shareholders =

State =

a =

b =

c =

d =

e =

f =

g =

h =

i =

Dear :

This letter responds to a letter dated October 6, 2011, as well as subsequent correspondence, submitted on behalf of Company by Company's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, Company is a State corporation that has an S corporation election in effect as of a. At the close of three consecutive taxable years ending d, Company had subchapter C accumulated earnings and profits of g. Moreover, for each taxable year ending b, c, and d, Company had passive investment income (within the meaning of § 1362(d)(3)) in excess of 25 percent of its gross receipts. As a result, Company's S corporation election terminated on e.

Company represents that the termination of its S corporation election was inadvertent, unintended, and not the result of tax avoidance or retroactive tax planning. Company and the Shareholders have consistently treated Company as an S corporation and agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary.

LAW

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 percent of which are passive investment income. The termination is effective on and after the first date of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i).

Section 1362(d)(3)(C)(i) defines the term "passive investment income" to mean, except as otherwise provided in § 1362(d)(3), gross receipts derived from royalties, rents, dividends, interest, and annuities.

Section 1362(f) provides, in part, 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 1368(c) provides rules for determining the source of distributions made by an S corporation having accumulated earnings and profits with respect to its stock. Section 1368(e)(3) and § 1.1368-1(f)(2) of the Income Tax Regulations provide that an S corporation may, with the consent of all of its affected shareholders, elect to distribute earnings and profits first.

Section 1.1368-1(f)(3) provides, in part, that an S corporation may elect to distribute all or part of its subchapter C earnings and profits through a deemed dividend. If an S corporation makes the election provided in § 1.1368-1(f)(3), the S corporation will be considered to have made the election provided in § 1.1368-1(f)(2) (relating to the election to distribute earnings and profits first).

Section 1375(a) provides that if an S corporation has accumulated earnings and profits at the close of a taxable year and gross receipts for that taxable year more than 25 percent of which are passive investment income, then there is imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in § 11(b).

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that Company's S corporation election terminated on e, under § 1362(d)(3)(A) because Company had subchapter C earnings and profits at the close of each of three consecutive taxable years beginning in year h, and had gross receipts for each of those tax years more than 25 percent of which were passive investment income. We further conclude that the termination of Company's S corporation election was an inadvertent termination within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), Company will be treated as continuing to be an S corporation beginning on e, and thereafter, provided that Company's S corporation election was valid and has not otherwise terminated under § 1362(d) and that the following conditions are met. Within 120 days from the date of this letter, Company shall file an amended income tax return for its f tax year, electing pursuant to

§ 1.1368-1(f)(3) to make a deemed dividend of g. Also, within 120 days, the Shareholders of Company must amend their income tax returns for their corresponding taxable years to reflect the changes made to Company's f tax return. No amendments shall be made to Company's income tax returns for the taxable years ending b, c, and d with respect to the tax imposed under § 1375. However, as an adjustment under § 1362(f)(4), Company must send a payment of i 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.

Company must send this payment no later than 45 days from the date of this letter. If all the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, Company must notify the Cincinnati Service Center that its S corporation election has terminated.

Except as expressly provided herein, we express or imply no opinion 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 Company is an S corporation for federal tax purposes.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code 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 ruling request, it is subject to verification on examination.

Sincerely,

/s/

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: