

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:PT&E:B01

PLR-110249-23

Date:

March 17, 2025

In Re: Private Letter Ruling Request

LEGEND

X =

\$a =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year 1 =

Year 2 =

Year 3 =

Dear _____ :

This letter responds to a letter dated May 9, 2023, submitted on behalf of X by its authorized representatives, requesting relief under § 1362(f) of the Internal Revenue Code (Code).

FACTS

According to the information submitted and representations within, X was incorporated under the laws of State on Date 1 and filed an election under § 1362(a) of the Code to be treated as an S corporation effective Date 2. X represents that it has filed its tax returns consistent with S corporation status (other than with respect to its passive investment income and the tax under § 1375) since Date 2.

X had approximately \$a of accumulated earnings and profits (AE&P) on Date 2 due to its prior C corporation years. For each of the consecutive years Year 1, Year 2, and Year 3, X had passive investment income that exceeded 25 percent of its yearly gross receipts and \$a of AE&P. Therefore, X's S election terminated on Date 3.

X represents that it was unaware that it had AE&P due to its prior C corporation years and excessive passive investment income for Year 1, Year 2, and Year 3 that could cause the termination of X's S election. Since the discovery of the termination, X took corrective action by making an election under § 1368(e)(3) and distributing its \$a of AE&P to its shareholder, thereby eliminating its AE&P as of Date 4. X and its shareholder agree to make any adjustments during the termination period (consistent with the treatment of X as an S corporation) as might be required by the Internal Revenue Service.

X represents that the circumstances resulting in the termination of its S corporation election were inadvertent and not motivated by retroactive tax planning or tax avoidance.

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 (I) has accumulated earnings and profits at the close of each of three consecutive taxable years and (II) 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 day of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i).

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C), (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 for which the termination occurred is a small business corporation, and (4) the corporation for which 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 the 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 an S corporation during the period specified by the Secretary.

Section 1368(e)(3) provides that an S corporation may, with the consent of all of its affected shareholders, elect to have § 1368(c)(1) not apply to all distributions made during the taxable year for which the election is made.

Section 1375(a) imposes a tax on the income of an S corporation if the S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts more than 25 percent of which are passive investment income.

Section 1375(d) provides that, if the S corporation establishes to the satisfaction of the Secretary that (1) it determined in good faith that it had no AE&P at the close of a taxable year, and (2) during a reasonable period of time after it was determined that it did have AE&P at the close of that tax year the AE&P were distributed, the Secretary may waive the tax imposed by § 1375(d) for that year.

Section 1.1375-1(d)(2) of the Income Tax Regulations provides that a request for waiver of the tax imposed by § 1375 shall be made in writing to the district director and shall contain all relevant facts to establish that the requirements of § 1.1375-1(d)(1) are met.

CONCLUSION

Based solely upon the representations made and the information submitted, we conclude that X's S election terminated on Date 3 because X had AE&P at the close of each of the three consecutive tax years, Year 1, Year 2, and Year 3, and had gross receipts for each of those years of which more than 25 percent was passive investment income.

We further conclude that the termination of X's S election on Date 3 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 on and after Date 3, unless X's S election is otherwise terminated under § 1362(d).

Having determined that X satisfied the requirements of § 1.1375-1(d), the Service, by letter dated Date 5, has waived the tax imposed by § 1375(a) for Year 1, Year 2, and Year 3.

Except as specifically ruled above, we express or imply no opinion concerning the federal 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.

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 upon examination.

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

In accordance with the power of attorney on file with this office, we are sending copies of this letter to X's authorized representatives.

Sincerely,

By: _____
Joy C. Spies
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

PLR-110249-23

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cc: