

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Date of Communication: Not Applicable

Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B01  
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Date:

July 5, 2022

LEGEND

A =

State =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

X =

Y =

Trust 1 =

Trust 2 =

Dear \_\_\_\_\_ :

This responds to your letter dated November 29, 2021, and subsequent correspondence, submitted on behalf of A requesting relief under § 1362(f) of the Internal Revenue Code.

### FACTS

According to the information submitted, A was incorporated in State in Year 1 and made an S election effective Year 1.

On Date 1, X, a shareholder of A, created Trust 1 for the benefit of his children and transferred shares of A to Trust 1. Also on Date 1, Y, a shareholder of A, created Trust 2 for the benefit of his children and transferred shares of A to Trust 2.

For the taxable years from Year 2 to Year 3, Trust 1 was incorrectly treated as a grantor trust with X as owner and, consequently, X reported the income of Trust 1 on his personal tax returns for the relevant years. For the taxable years from Year 2 to Year 3, Trust 2 was incorrectly treated as a grantor trust with Y as owner and, consequently, Y reported the income of Trust 2 on his personal tax returns for the relevant years.

A recently discovered that Trust 1 and Trust 2 did not qualify as grantor trusts. Within a reasonable time after the discovery of these mistakes, it is represented that X and Y caused the amendment of Trust 1 and Trust 2 so that Trust 1 and Trust 2 now qualify as grantor trusts.

It is represented that at all relevant times, A and its shareholders treated A as an S corporation and filed all tax returns consistent with the treatment of A as an S corporation.

A and its shareholders have agreed to make any adjustments consistent with the treatment of A 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 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1362(d)(2) provides that (A) an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation; and (B) any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (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 the termination, steps were taken so that the corporation is 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 under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and representations made, we conclude that A's S election terminated on Date 1 when shares of A were transferred to Trust 1 and Trust 2. We further conclude that the termination was inadvertent within the meaning of § 1362(f).

Accordingly, under § 1362(f), A will be treated as continuing to be an S corporation from Date 1, provided, that A's S election is valid and not otherwise terminated under § 1362(d).

Additionally, Trust 1 and Trust 2 will be treated as trusts described in § 1361(c)(2)(A)(i) from Year 2 until Year 3.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, we express or imply no opinion regarding whether A is otherwise eligible to be an S corporation. Additionally, no opinion is expressed on the income tax consequences of Trust 1 and Trust 2 converting from non-grantor trusts to grantor trusts.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to A's authorized representatives.

Sincerely,

---

Joy C. Spies  
Senior Technician Reviewer, Branch 1  
(Passthroughs & Special Industries)

Copy for § 6110 purposes

cc: