Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:2 - PLR-106236-99
Date:
June 7, 1999

A =

B =

C =

Year =

Trust =

Trustee =

State =

Dear :

This letter responds to a letter dated March 12, 1999, submitted on behalf of Trust, requesting a ruling that the trust is an eligible S corporation shareholder under § 1361(c)(2)(A)(i) of the Internal Revenue Code.

The information submitted states the following. Trust is an irrevocable trust created by A and B in Year. Trust has a beneficiary, C, a minor child of A and B. A is the sole shareholder of an S corporation and plans to transfer shares from the S corporation to Trust.

Article IV, Section 1(a) of the Trust provides that the trustees may distribute the net income and principal from the

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Trust to C in the Trustees' sole discretion. However, no such distribution may be made if the distribution discharges any parental or other legal obligation which either Grantor may have at any time, nor shall any distribution of income or principal be made to or for the benefit of any person other than C. Any undistributed income shall be periodically added to principal.

Article IV, Section 1(b) of the Trust provides that once C attains the age of forty (40) years, C shall have the right to withdraw one-third (1/3) of the remaining trust property held for C's use and benefit. After C attains the age of forty-five (45) years, C shall have the right to withdraw one-half (½) of the remaining trust property held for C's use and benefit and after C attains the age of fifty (50) years, C shall have the right to withdraw the entire remainder of the trust property held for her use and benefit. Notification of withdrawal shall be made in writing by C and delivered to the Trustee. The rights of withdrawal shall not lapse or be diminished by reason of the failure of C to exercise such withdrawal rights, or any part thereof, at any time.

Article IV, Section 1(c) of the Trust provides that at the death of C, the remainder of the trust, shall be distributed to such person(s) or to the estate of C, in such manner and in such amount(s), in trust or otherwise, as C may appoint either by an instrument in writing dated, witnessed and acknowledged in the same manner that deeds of real estate are required to be witnessed and acknowledged to be eligible for recording by the law in effect in State, as of the date of execution of such instrument, or in and by the Last Will and Testament of the Beneficiary. This power of appointment shall be exercisable only by specific reference to such power in such a written instrument or in the Last Will and Testament ("Will") of C, provided that in the case of conflict, the exercise of the power of appointment executed latest in time shall govern.

Article IV, Section 1(d) of the Trust provides that at the death of C the Trustee shall distribute all of the principal and undistributed income which C has not so directed and appointed to the then living issue of C by right of representation or, if there are no living issue of C, to the then living issue of Grantors by right of representation. If there are no issue of Grantors then living the Trustee shall distribute the remaining assets of the Trust outright in equal shares to each of the then living sisters of Grantors and to the then living issue of any deceased sister of Grantors by right of representation. The Trust contains additional provisions describing whether the distribution in these circumstances is outright or in trust for the benefit of the beneficiary.

Article IV, Section 6 of the Trust gives C an absolute right to withdraw transfers of property and money made to the Trust (the "Transferred Property"). The right of withdrawal extends for a thirty (30) day period after each contribution is made. The Trustee is required to notify C, or C's legal representative, of all transfers of property to the Trust. To the extent that such a withdrawal right has not been exercised by the end of such thirty (30) day period, the withdrawal right lapses.

Section 1361(a) of the Code provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under 1362(a) is in effect for the year.

Section 1361(b)(1)(B) of the Code provides that for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not 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.

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

Section 671 of the Code provides that when the grantor or another person is treated as the owner of any portion of a trust, there shall be included in the computing the taxable income and credits of the grantor or the other person those items of income, deduction, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 of the Code in computing the taxable income or credits against tax of an individual.

Sections 673 through 678 of the Code specify the circumstances under which the grantor or another person will be regarded as the owner of a portion of a trust.

Section 678(a) of the Code provides that a person other than a grantor shall be treated as the owner of any portion of a trust with respect to which (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or (2) the person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would cause a grantor to be treated as the owner of such a portion of the trust within the principles of §§ 671 to 677 inclusive.

Section 677(a) of the Code provides, in part, that the grantor will be treated as the owner of any portion of a trust whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse, or (2) held or accumulated for future distribution to the grantor or grantor's spouse.

Because transfers of property and money to the Trust will be subject to the absolute power to withdraw those transfers by C under Section 6 of the Trust, C will be treated as having a power to vest such transfers in herself within the meaning of § 678(a)(1) of the Code. If C fails to exercise the withdrawal power, C will be treated as having released the power, while retaining a right to have all trust income allocable to the portion of the transfers subject to the power to withdraw (ordinary income and income allocable to corpus), in the sole discretion of the trustee, distributed to her or accumulated for future distribution to her, for purposes of §§ 678(a)(2) and 677(a). Therefore, because C has a power to withdraw all of the transfers of property and money to the trust, C will be treated as the owner of the entire trust under § 678(a) of the Code.

Based on our conclusion that C is the owner of the entire Trust, the trust meets § 1361(c)(2)(A)(i).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code.

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.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Trustee.

Sincerely yours,

(signed) J. THOMAS HINES

J. THOMAS HINES
Senior Technician Reviewer
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of this letter
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