

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-114879-06

Date: September 19, 2006

LEGEND:

X =

A =

Spouse =

Trust =

Non-Marital
Trust =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear

This responds to a letter dated February 17, 2006, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling concerning federal income tax issues with respect to X, an S corporation, and Trust.

The information submitted states that X was incorporated under the laws of State and elected to be an S corporation effective Date 1. Trust, a trust that was treated (under subpart E of part I of subchapter J of chapter 1 of the Code ("subpart E")) as entirely owned by A, was a shareholder of X. On Date 2, A died. Upon A's death, Trust ceased to qualify as a grantor trust with respect to A. Trust continued to qualify as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) during the 2-year period beginning on the day of A's death.

Trust provided that following A's death, the Non-Marital Trust be funded with a portion of the trust assets, and a marital trust be funded with the remaining assets. Trust provided that Spouse had the power to request a distribution of all the assets from the marital portion provided she survived A's death by 15 months. The Non-Marital Trust was fully funded on Date 4 with assets other than the X stock. On Date 4, the assets within the marital portion of Trust were ascertainable and included all the X stock. Spouse survived A's death by 15 months and is still alive.

X represents that since Date 1 until Date 5, X and its shareholders have filed federal income tax returns consistent with X's S corporation election and Spouse has reported as the owner of the X stock held in Trust. On Date 5, X was acquired by an unrelated buyer and its S election terminated.

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that the term small business corporation is a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate and other than 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 all of which is treated (under subpart E) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1362(c)(2)(A)(ii) provides that a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence

after such death, but only for the 2-year period beginning on the day of the deemed owner's death may be a shareholder.

Section 678(a)(1) provides that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself.

Section 672(d) provides that a person is considered to have a power described in subpart E, even though the exercise of the power is subject to a precedent giving of notice or takes effect only after the expiration of a certain period of time.

Section 1.672(d)-1 of the Income Tax Regulations provides that a person is considered to have a power described in subpart E, even though the exercise of the power is subject to a precedent giving of notice or takes effect only after the expiration of a certain period of time. However, a grantor or third person will not be treated as the owner of a trust if the exercise of a power to affect the beneficial enjoyment of income takes place after the expiration of a period of time such that, if the power were a reversionary interest, he would not be treated as an owner under § 673. Therefore, if a grantor or third person has a power that would make him the owner, which is exercisable after 15 months, they would be taxed as the owner before the expiration of the 15 month period.

Based solely on the information submitted and the representations made, we conclude that X's S corporation election did not terminate following A's death. Trust was a permissible S shareholder under § 1361(c)(2)(A)(ii) beginning the date of A's death and ending on Date 3, the day before the Non-Marital Trust was fully funded. The power granted to Spouse to withdraw all assets not contributed to the Non-Marital Trust, including the X stock, from Trust 15 months after A's death, results in Spouse being treated as the owner of the entire Trust beginning Date 4, the date the marital portion of Trust was ascertainable, under §§ 678(a)(1) and 672(d). Accordingly, Trust is a permitted shareholder of X under § 1361(c)(2)(A)(i).

All of X's shareholders in determining their respective income tax liabilities must include their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and non-separately stated computed items of income or loss of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368.

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, including whether X was or is a small business corporation under § 1361(b).

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 the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

J. Thomas Hines
Chief, Branch 2
(Passthroughs & Special Industries)

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

cc: