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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-117305-06  
Date: March 27, 2007

Legend:

$$\underline{X} =$$
TrustA Agreement =TrustA1 =TrustA2 =TrustA3 =TrustB Agreement =TrustB1 =TrustB2 =TrustB3 =

TrustB4 =

TrustB5 =

TrustB6 =

TrustB7 =

TrustB8 =

TrustB9 =

TrustC Agreement =

TrustC1 =

TrustC2 =

TrustC3 =

TrustC4 =

TrustC5 =

TrustD Agreement =

TrustD1 =

TrustD2 =

TrustD3 =

TrustD4 =

TrustD5 =

TrustD6 =

A =

B =

C =

D =

State1 =

State2 =

Date1 =

Date2 =  
Date3 =  
Date4 =  
Date5 =  
Date6 =  
Date7 =  
Date8 =  
Date9 =

Dear :

This letter responds to your letter dated March 20, 2006, and subsequent correspondence requesting a ruling on behalf of X that, pursuant to § 1362(c)(2)(A)(i) of the Internal Revenue Code, certain trusts qualify as shareholders of an S corporation.

#### FACTS

The information submitted states that X was incorporated in State1 on Date1. X made a timely S corporation election effective Date1.

On Date4, A, a United States citizen, executed the TrustA Agreement under State2 law. The TrustA Agreement created sub-trusts TrustA1, TrustA2, and TrustA3, each with a single current beneficiary. Under the terms of Section III of the TrustA Agreement, equal shares of trust assets were apportioned as three separate and distinct trusts but physical separation of the assets was not required. A, the Grantor of the trust, authorized the Trustee to “mingle and commingle investments, but wishes it understood that Grantor is creating independent trusts for all purposes.” On Date4, A transferred X corporation stock to TrustA1, TrustA2 and TrustA3.

The TrustA Agreement provides in Section XIV that the trust is an irrevocable trust. Section IV of the TrustA Agreement provides that A retains the right and power to acquire or reacquire any trust property and substitute other property of equivalent value without incurring liability to a trust beneficiary or other party. The TrustA Agreement states that the substitution power granted to the power holder is exercisable in a non-fiduciary capacity.

Section VII of the TrustA Agreement provides each beneficiary of the respective sub-trusts the right to appoint to himself a proportionate share of additions made to the sub-trust each year. The amount appointed cannot exceed the amount excludable for gift tax purposes in any calendar year.

On Date5, B, a United States citizen, executed the TrustB Agreement under State2 law. By its terms the TrustB Agreement created sub-trusts TrustB1, TrustB2, TrustB3, TrustB4, TrustB5, TrustB6, TrustB7, and TrustB8, each with a single current beneficiary. TrustB9 was created for the benefit of Unborn Children. Under the terms of Section III of the TrustB Agreement, shares of trust assets were apportioned as separate and distinct trusts but physical separation of the assets was not required. B, the Grantor of the trust, authorized the Trustee to “mingle and commingle investments, but wishes it understood that Grantor is creating independent trusts for all purposes.” On Date6, B transferred X stock to TrustB1, TrustB2, TrustB3, TrustB4, TrustB5, TrustB6, TrustB7, and TrustB8.

Section XIV of the TrustB Agreement provides that the trust is irrevocable. Section IV of the TrustB Agreement provides that B retains the right and power to acquire or reacquire any trust property and substitute other property of equivalent value without incurring liability to a trust beneficiary or other party. The TrustB Agreement states that the substitution power granted to the power holder is exercisable in a non-fiduciary capacity.

Section VII of the TrustB Agreement provides each beneficiary of the respective sub-trusts the right to appoint to himself a proportionate share of additions made to the sub-trust each year. The amount appointed cannot exceed the amount excludable for gift tax purposes in any calendar year.

On Date2, C and D, United States citizens and husband and wife, executed the TrustC Agreement under State2 law. The TrustC Agreement created sub-trusts TrustC1, TrustC2, TrustC3, TrustC4, and TrustC5. Under the terms of Section III of the TrustC Agreement, shares of trust assets were apportioned as separate and distinct trusts but physical separation of the assets was not required. C and D, the Grantors of the trust, authorized the Trustee to “mingle and commingle investments, but wishes it understood that Grantor is creating independent trusts for all purposes.” On Date3, TrustC1, TrustC2, TrustC3, TrustC4, and TrustC5 purchased X corporation stock.

Section XIV of the TrustC Agreement provides that the trust is irrevocable. Section IV of the TrustC Agreement provides that C and D retain the right and power to acquire or reacquire any trust property and substitute other property of equivalent value without incurring liability to a trust beneficiary or other party. The TrustC Agreement states that the substitution power granted to the power holder is exercisable in a non-fiduciary capacity.

Section VII of the TrustC Agreement provides each beneficiary of the respective sub-trusts the right to appoint to himself a proportionate share of additions made to the sub-trust each year. The amount appointed cannot exceed the amount excludable for gift tax purposes in any calendar year.

On Date7, C and D executed TrustD Agreement under State2 law. The TrustD Agreement created sub-trusts TrustD1, TrustD2, TrustD3, TrustD4, TrustD5, and TrustD6. Under the terms of Section III of the TrustD Agreement, shares of trust assets were apportioned as separate and distinct trusts but physical separation of the assets was not required. C and D, the Grantors of the trust, authorized the Trustee to “mingle and commingle investments, but wishes it understood that Grantor is creating independent trusts for all purposes.” On Date7, the sub-trusts created under TrustC Agreement merged under State2 law into the sub-trusts created under TrustD Agreement. The X corporation stock held by the TrustC Agreement sub-trusts was transferred to the TrustD Agreement sub-trusts on Date7.

Section XIV of the TrustD Agreement provides that the trust is irrevocable. Section IV of the TrustD Agreement provides that C and D retain the right and power to acquire or reacquire any trust property and substitute other property of equivalent value without incurring liability to a trust beneficiary or other party. The TrustD Agreement states that the substitution power granted to the power holder is exercisable in a non-fiduciary capacity.

Section VII of the TrustD Agreement provides each beneficiary of the respective sub-trusts the right to appoint to himself a proportionate share of additions made to the sub-trust each year. The amount appointed cannot exceed the amount excludable for gift tax purposes in any calendar year.

A and B were treated on their federal income tax returns as owners of the X stock transferred by the Grantors to the respective sub-trusts created under the TrustA Agreement and TrustB Agreement from the time of the stock transfers through Date8. C and D were treated on their joint federal income tax returns as owners of the X stock transferred by the Grantors to the sub-trusts created under the TrustC Agreement and merged into the sub-trusts created under the TrustD Agreement from the time of the stock transfers through Date8. Effective one day later, on Date9, A, B, and C and D irrevocably relinquished their power to substitute trust assets with respect to the TrustA Agreement, TrustB Agreement and TrustD Agreement sub-trusts, respectively. Elections were made to treat each of the sub-trusts as electing small business trusts under § 1361(e)(1)(A), effective Date9.

The beneficiaries of the sub-trusts created under the TrustA Agreement, TrustB Agreement, TrustC Agreement, and TrustD Agreement received timely notification of their withdrawal rights and no beneficiary has exercised those rights.

## 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)(B) provides that a small business corporation may 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)(1)(A)(i) provides that for purpose of § 1361(b)(1)(A) a husband and wife shall be treated as one shareholder.

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 I) as owned by an individual who is a citizen or resident of the United States may be a shareholder in an S corporation. The deemed owner of the trust shall be treated as the shareholder under § 1361(c)(2)(B)(i).

Section 1.1361-1(e)(2) of the Income Tax Regulations provides that for purposes of § 1.1361-1(e)(1), stock owned by a husband and wife is treated as if owned by one shareholder, regardless of the form in which they own the stock. For example, if husband and wife are owners of a subpart E trust, they will be treated as one individual. Both husband and wife must be U.S. citizens or residents.

Section 675(4) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. Section 675(4)(C) provides that “power of administration” means, among other things, a power to reacquire the trust corpus by substituting other property of an equivalent value.

Section 1.675-1(a)(4)(iii) (flush language) provides, in part, that if a power is not exercisable by a person as trustee, the determination of whether the power is exercisable in a fiduciary or nonfiduciary capacity depends on all of the terms of the trust and the circumstances surrounding its creation and administration.

Section 678(a) provides that a person other than the 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 modifications retains such control as would cause a grantor to be

treated as the owner of such portion of the trust within the principles of §§ 671 to 677, inclusive.

Section 678(b) provides that § 678(a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust is otherwise treated as the owner under the provisions of subpart E other than § 678.

### CONCLUSION

Based solely on the facts and representations submitted, we conclude that the circumstances surrounding the administration of the sub-trusts created under the TrustA Agreement, TrustB Agreement, TrustC Agreement, and TrustD Agreement will determine whether the power of administration is exercisable in a fiduciary or nonfiduciary capacity. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the Internal Revenue Service office where the returns are filed. Therefore, we cannot determine at this time whether A will be treated as the owner of the sub-trusts created under the TrustA Agreement, whether B will be treated as the owner of the sub-trusts created under the TrustB Agreement, and whether C and D will be treated as the owners of the sub-trusts created under the TrustC Agreement and the TrustD Agreement under § 675(4)(C). Provided that the circumstances indicate that the power of administration is exercisable in a nonfiduciary capacity, A will be treated as the owner of the sub-trusts created under the TrustA Agreement, B will be treated as the owner of the sub-trusts created under the TrustB Agreement, and C and D will be treated as owners of the sub-trusts created under the TrustC Agreement and the TrustD Agreement, under §§ 675 and 678(b).

Accordingly, the sub-trusts created under the TrustA Agreement were permitted shareholders in X, an S corporation, under § 1361(c)(2)(A)(i), if otherwise eligible, from Date4 through Date8; the sub-trusts created under the TrustB Agreement were permitted shareholders in X, an S corporation, under § 1361(c)(2)(A)(i), if otherwise eligible, from Date6 through Date8; the sub-trusts created under the TrustC Agreement, were permitted shareholders in X, an S corporation, under § 1361(c)(2)(A)(i), if otherwise eligible, from Date3 until Date7; and, the sub-trusts created under the TrustD Agreement, were permitted shareholders in X, an S corporation, under § 1361(c)(2)(A)(i), if otherwise eligible, from Date7 through Date8.

Except as expressly provided herein, we express or imply no opinion concerning the federal 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 X is otherwise eligible to be an S corporation for federal tax purposes.



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

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.

Sincerely,

/s/

James A. Quinn  
Senior Technician Reviewer (Acting)  
Branch 2  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes