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Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
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PLR-151240-06

Date:
May 01, 2007

X =

H =

W =

Trust =

A =

B =

C =

D =

State =

D1

D2 =

D3 =

D4 =
D5 =

Dear :

This responds to a letter dated October 30, 2006, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws State and elected to be an S corporation effective D1. H and W are married and both U.S. citizens. H and W created Trust on D2. On D3, D4, and D5, H transferred X stock to Trust for the benefit of H and W's children: A, B, C and D ("the Beneficiaries").

Article 2.1(d)(2) of Trust provides that during H and W's (the grantors) lifetime, an advisory committee shall have the right, acting solely and without the approval or consent of the grantors or of any adverse party (within the meaning of § 672(a)) to add one or more tax-exempt charities as permissible beneficiaries of the income and principal of Trust in the trustee's discretion.

Article 2.4(a) of Trust provides, generally, that in any calendar year in which property is added to any segregated subaccount of Trust, the beneficiary who is the primary beneficiary of the segregated subaccount shall have the power to withdraw, from the principal of that segregated subaccount, property having a value equal to the value of the property added to that share; provided, however, that the total amount which may be withdrawn shall not exceed the maximum amount excludible from a donor's taxable gifts for such year in respect of gifts to any donee prescribed under § 2503(b) (and, with a married donor, taking into account § 2513).

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 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, 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 in computing taxable income or credits against the tax of an individual.

Section 673 through 678 specify the circumstances under which the grantor or a person other than the grantor is treated as the owner of any portion of a trust.

Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

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) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of §§ 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

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 or a transferor (to whom § 679 applies) is otherwise treated as the owner under the provisions of subpart E other than § 678.

Based solely on the information submitted and the representations made, we conclude that X's S corporation election did not terminate as a result of H's contribution of X stock to Trust. The power granted to the Beneficiaries to withdraw amounts contributed to Trust will result in the Beneficiaries being treated as the owners of their respective portions of Trust subject to their withdrawal power, unless as provided in § 678(b), the grantor is treated as the owner. Under the terms of Trust, the power to add tax-exempt charities as beneficiaries affects beneficial enjoyment. Accordingly, H and W, as grantors, are treated as the owners of Trust under § 674(a). Because Trust is a grantor trust under § 674 with respect to H and W, it is a grantor trust in its entirety with respect to H and W notwithstanding the powers of withdrawal held by the beneficiaries that would otherwise make them the owners under § 678. Accordingly, H and W are treated as the single deemed owner of Trust. Trust therefore qualifies as 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 adjustment to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. Additionally, Trust will cease to be a permitted shareholder of X under § 1361(c)(2)(A)(i) if individuals other than H and W contribute property to Trust.

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: