

Internal Revenue Service

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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
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Date: January 16, 2008

Legend

Trust =

Trustee =

Company =

Sub =

Business =

State =

a =

b =

c =

d =

e =

f =

g =

h =

Dear :

This letter responds to a letter dated July 18, 2007, submitted on behalf of Trust requesting rulings under §§ 331, 336, and 1361 of the Internal Revenue Code.

FACTS

According to the facts submitted, Trust owns all of the stock in Company, an S corporation. Trust was formerly a revocable grantor trust, but became an irrevocable trust upon the death of the grantor on a. Accordingly, Trust represents that it is an eligible S corporation shareholder pursuant to § 1361(c)(2)(A)(ii).

Company is engaged in the business of Business. Company wholly owns Sub, which holds certain real properties discussed below. Because Sub is a qualified subchapter S subsidiary pursuant to § 1361(b)(3)(A), it is disregarded as an entity separate from its owner for federal tax purposes. Thus, any references to Company include Sub and its properties.

Company's principal real property assets, held by Sub, consist of two separate commercial properties (Properties A and B) and one residential property (Property C). Company's adjusted basis in Property A is approximately \$b, and the property's value is approximately \$c. Company's adjusted basis in Property B, a business park, is approximately \$d. Property B's value, while not established, is estimated to be not less than \$e. Company has a negligible basis in Property C, which is undeveloped land that has been zoned residential. It is estimated that Company would recognize a gain of not less than \$f upon the sale of Property C.

Company intends to completely liquidate and dissolve during g, but after h. Pursuant to a formal plan of complete liquidation, Company will sell Properties A and B and then distribute its assets, including Property C, in complete liquidation to Trust. To the extent the sale of Property B has not closed prior to Company's complete liquidation, Company will make a liquidating distribution of Property B to Trust.

Trust represents that its Trustee will elect to treat all assets of Trust as qualified terminal interest property ("QTIP") pursuant to § 2056(b)(7). Further, Trust represents that any capital gains or losses recognized by Trust from the sale of QTIP property would be attributable to trust principal under State law.

LAW AND ANALYSIS

Section 331(a) provides that amounts received by a shareholder in a distribution in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. Section 331(c) provides that the amount of gain or loss recognized is determined under §1001.

Section 336(a) provides that, except as otherwise provided in § 336 or § 337, gain or loss shall be recognized to a liquidating corporation on the distribution of property in complete liquidation as if such property were sold to the distributee at its fair market value.

Section 1361(c)(2) provides, in part, that for purposes of § 1361(b)(1)(B), the following trusts may be shareholders: (i) A trust all of which is treated (under subpart E of part 1 of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States. (ii) A trust that was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1.1361-1(h)(1)(ii) of the Income Tax Regulations provides that in general, a trust is not a permitted small business corporation shareholder. However, except as provided in § 1.1361-1(h)(2), a trust that was a qualified subpart E trust immediately before the death of the deemed owner and that continues in existence after the death of the deemed owner is a permitted shareholder, but only for the two-year period beginning on the day of the deemed owner's death ("Former Qualified Subpart E Trust"). A trust is considered to continue in existence if the trust continues to hold the stock pursuant to the terms of the will or the trust agreement, or if the trust continues to hold the stock during a period reasonably necessary to wind up the affairs of the trust. See § 1.641(b)-3 for rules concerning the termination of trusts for federal income tax purposes.

Section 1.1361-1(h)(3)(i) provides, in part, that for purposes of §1.1361-1(b) (qualification as a small business corporation), and except as provided in § 1.1361-1(h)(3)(ii), for purposes of § 1366 (relating to the pass-through of items of income, loss, deduction, or credit), 1367 (relating to adjustments to the basis of shareholder's stock), and 1368 (relating to distributions), the shareholder of S corporation stock held by a trust that is a permitted shareholder under § 1.1361-1(h)(1) is as follows: (B) If stock is held by a trust defined in § 1.1361-1(h)(1)(ii), the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner's death. However, if stock is held by such a trust in a community property state, the decedent's estate is the shareholder only of the portion of the trust included in the decedent's gross estate (and the surviving spouse continues to be the shareholder of the portion of the trust owned by that spouse under the applicable state's community property law). The estate ordinarily will cease to be treated as the shareholder upon the earlier of the transfer of the stock by the trust or the expiration of the 2-year period beginning on the day of the deemed owner's death. If the trust qualifies and becomes an electing QSST,

the beneficiary and not the estate is treated as the shareholder as of the effective date of the QSST election, and the rules provided in § 1.1361-1(j)(7) apply. If the trust qualifies and becomes an ESBT, the shareholders are determined under §§ 1361-1(h)(3)(i)(F) and (h)(3)(ii) as of the effective date of the ESBT election, and the rules provided in § 1.1361-1(m) apply.

Section 1.1361-1(h)(3)(ii) provides, in part, that solely for purposes of §§ 1366, 1367, and 1368 the shareholder of S corporation stock held by a trust is determined as follows: (A) If stock is held by a trust as defined in § 1.1361-1(h)(1)(ii) (other than an electing QSST or an ESBT), the trust is treated as the shareholder. If the trust continues to own the stock after the expiration of the 2-year period, the corporation's S election will terminate unless the trust is otherwise a permitted shareholder.

CONCLUSIONS

Based on the facts submitted and representations made, and during the time Trust, as a Former Qualified Subpart E Trust, is an eligible shareholder of Company, we conclude as follows:

1. Because Trust is treated under § 1.1361-1(h)(3)(ii) as the shareholder of Company for purposes of § 1366, any gains recognized by Company on the sales of Property A and B, to the extent Property B is sold, will pass through to Trust;
2. Pursuant to §336(a), Company will recognize gain on the liquidating distribution of Property C, and any unsold portion of Property B that is distributed, as if such property were sold to Trust at its fair market value. Any gains recognized by Company on such distributions of Property A and any unsold portion of Property B will pass through to Trust;
3. Because Trust is treated under § 1.1361-1(h)(3)(ii) as the shareholder of Company for purposes of § 1367, Trust's basis in Company stock will be increased under § 1367(a)(1) by any gains in Rulings 1 and 2 above that pass through to Trust; and
4. Under §331, amounts received by Trust on the liquidating distribution of Company will be treated as in full payment in exchange for Company stock. Provided Company stock is a capital asset in the hands of Trust at the time of the liquidation, Trust will realize a capital loss on the complete liquidation of Company pursuant to § 331, to the extent that Trust's basis in Company stock exceeds the fair market value of the liquidating distribution. The loss will be treated as a long-term or short-term capital loss pursuant to the rules under § 1222.

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 regarding whether

Trust qualifies as a trust described in § 1.1361-1(h)(1)(ii) (a Former Qualified Subpart E Trust).

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

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.

Sincerely,

/s/

MARY BETH COLLINS
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes