

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:
July 22, 1999

LEGEND

Company =

State =

Settlor =

Trust =

d1 =

a =

b =

Dear

This letter responds to your letter dated March 13, 1999, written on behalf of Company, requesting a ruling that Trust will be a permissible shareholder of a subchapter S corporation under § 1361(c)(2)(A)(i) of the Internal Revenue Code.

FACTS

According to the information submitted, Company, a State limited liability company classified as a corporation for federal tax purposes, has elected under § 1362 to be taxed as an S corporation. Settlor, a Company shareholder, established Trust, an irrevocable trust, in State on d1. Settlor has gifted a shares of Class A voting and b shares of Class B nonvoting Company stock to Trust.

Section 1 of the Trust Agreement provides that the gift, which was made pursuant to State law, was conditioned on Company receiving a ruling that the Trust is an eligible S corporation shareholder under § 1361(c)(2)(A)(i).

Section 10.1 of the Trust Agreement provides that the Trustees shall have the authority to loan to the Settlor, and the Settlor shall have the authority to borrow from the Trust, all or any part of corpus and/or income of the Trust, without adequate security, in exchange for the Settlor's promissory note of equal value to the amount lent. Company and Settlor represent that it is their intention that this section allows Settlor to exercise this power unconditionally, without the approval of the trustees, or any other party.

Section 10.2 of the Trust Agreement provides that the Settlor during his lifetime shall have the right and power at any time, acting in a nonfiduciary capacity and without consent of the Trustees, to withdraw any asset of the trust if the Settlor shall simultaneously substitute therefor other property of an equivalent value. No fiduciary duty imposed on the Trustees or any other person may be asserted as a defense to the exercise of this power granted to the Settlor.

LAW AND ANALYSIS

Section 1362 provides that except as provided in § 1362(g) a small business corporation may elect to be an S corporation.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which 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 the purposes of § 1361(b)(1)(B), a trust all of which 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 may be a shareholder of an S corporation.

Section 1361(c)(2)(B)(i) provides that for the purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder of the corporation.

Subpart E of part I of subchapter J of chapter 1 of the Code includes § 671 through § 679. Section 671 provides, in part, that where it is specified in subpart E that the grantor is treated as the owner of any portion of a trust, there must then be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust to the extent that the items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 675(2) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power exercisable by the grantor or a nonadverse party, or both, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest or without adequate security except where a trustee (other than the grantor) is authorized under a general lending power to make loans to any person without regard to interest or security.

Section 675(4)(C) provides that the grantor will be treated as the owner of any portion of a trust in 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. For the purposes of § 675(4), the term "power of administration" includes the power to reacquire the trust corpus by substituting other property of an equivalent value.

Section 1.675-1(4)(iii) of the Income Tax Regulations 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 a nonfiduciary capacity depends on all of the terms of the trust and the circumstances surrounding its creation and administration.

CONCLUSION

Based on the facts submitted and the representations made, we conclude that Settlor will be treated as the owner of the entirety of Trust because Settlor retained the powers listed in § 675(2). Furthermore, Settlor may also be treated as the owner of the entirety of Trust under § 675(4). However, the circumstances surrounding the administration of Trust 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 office of the District Director where the returns are filed. Therefore, we cannot determine at this time whether Taxpayer will be treated as the owner of Trust under § 675(4) of the Code. Provided that the circumstances indicate that the power of administration is exercisable in a nonfiduciary capacity, Taxpayer will be treated as the complete owner of Trust under § 675(4). Because Trust will be treated (under subpart E of part I of subchapter J of chapter 1) as owned by Settlor, an individual who is a citizen or resident of the United States, Trust is an eligible shareholder of an S corporation under § 1361(c)(2)(A)(i).

We express no opinion of the tax consequences of the above mentioned transactions under the estate and gift sections of the Code.

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

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 yours,

William P. O'Shea
Chief, Branch 3
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes