

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:1-PLR-113069 -98

Date:

November 4, 1998

Legend

X =

Trust =

A =

B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

m =

n =

\$o =

\$p =

\$q =

This responds to a letter dated June 18, 1998, submitted on behalf of X, requesting a ruling under § 1361 of the Internal Revenue Code.

Rulings Requested

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The corporate gain or loss on a sale of assets pursuant to a plan of complete liquidation that is allocable to shares of S corporation stock held by a qualified subchapter S trust (QSST), together with any gain or loss recognized under § 331 and § 336 as a result of distributions from the corporation to the QSST, will be that of the QSST, and not the income beneficiary of the QSST.

Facts

X was incorporated on Date 1, and made an election to be treated as an S corporation which was effective on Date 2. Trust was created under the will of B, who died on Date 3. On Date 4, Trust received m shares of X's stock. On Date 5, Trust received n shares of X's stock. On Date 6, the income beneficiary of Trust, A, made an election under § 1361(d)(2) to treat Trust as a QSST.

On Date 7, the directors and shareholders of X adopted a plan of complete liquidation (the Plan) pursuant to which all of the operating assets of X would be sold and the proceeds distributed to the shareholders in complete liquidation of the corporation. On Date 8, X, pursuant to the Plan, entered into a definitive agreement with an unrelated buyer for the sale of substantially all of the operating assets of X, and effected the sale of such assets for approximately \$o. After payment of debts and other expenses, the net amount of the proceeds potentially available for distribution was \$p. On the date of sale, \$q was distributed to the shareholders of X. All remaining assets held by X (all of which are cash) will be distributed to the shareholders in liquidation of X as soon as all contingent liabilities and other amounts have been satisfied (or otherwise provided for). The taxpayer represents that the corporation will be liquidated completely on or before Date 9.

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 336(a) generally provides that 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 1366(a) provides that in determining the tax of an S corporation shareholder, there shall be taken into account the shareholder's pro rata share of the corporation's (A) items of income (including tax-exempt income), loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder, and (B) nonseparately computed income or loss.

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Section 1361(d)(1)(B) provides that for purposes of § 678(a), the beneficiary of a QSST is treated as owner of that portion of the trust which consists of stock in an S corporation with respect to which the QSST election is made.

Section 1.1361-1(j)(7) of the Income Tax Regulations provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

Section 1.1361-1(j)(8) provides that if a valid QSST election is made, the income beneficiary is treated as owner, for purposes of § 678(a), of that portion of the trust that consists of the stock of the S corporation for which the QSST election was made. However, solely for purposes of applying the preceding sentence to a QSST, an income beneficiary who is a deemed § 678(a) owner only by reason of § 1361(d)(1) will not be treated as the owner of the S corporation stock in determining and attributing the federal income tax consequences of a disposition of the stock by the QSST. For example, if the disposition is a sale, the QSST election terminates as to the stock sold and any gain or loss recognized on the sale will be that of the trust, not the income beneficiary. Similarly, if a QSST distributes its S corporation stock to the income beneficiary, the QSST election terminates as to the distributed stock and the consequences of the distribution are determined by reference to the status of the trust apart from the income beneficiary's terminating ownership status under §§ 678 and 1361(d)(1). The portions of the trust other than the portion consisting of S corporation stock are subject to subparts A through D of subchapter J of chapter 1, except as otherwise required by subpart E of the Code.

Conclusions

We hold that under the facts represented, the sale, pursuant to a plan of complete liquidation, of a corporation's assets, combined with the complete liquidation of the corporation, results in the disposition of stock by the shareholders within the meaning of § 1.1361-1(j)(8). Therefore, (1) the Trust's pro rata share of gain or loss resulting from the sale of X's assets pursuant to the Plan should be allocated to Trust, and not A, and (2) any gain or loss recognized on the liquidation of X under both § 331 and § 336 as a result of distributions from X to Trust will be that of Trust, and not A.

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. Specifically, no opinion is expressed or implied concerning whether X's S corporation election was a valid election under § 1362, whether Trust is a QSST under § 1361(d), or whether there is a complete liquidation under § 331.

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.

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Under a power of attorney on file in this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Signed/David R. Haglund
David R. Haglund
Senior Technician Reviewer, Branch 1
Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
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