

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

May 22, 2002

G =

B =

Trust =

Corp =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

D7 =

D8 =

Dear :

This is in reply to your letter, dated May 15, 2001, and subsequent correspondence, submitted on behalf of Trust requesting rulings under §§ 678 and 1361 of the Internal Revenue Code.

The information submitted states that Trust is an irrevocable trust created by G on D1. B is the sole beneficiary of Trust and is over thirty-five years old. G contributed Corp stock to Trust on D2, D3, D4, D5, D6, and D7. Corp elected to be an S corporation effective D8. Trust elected to be treated as an Electing Small Business

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Trust (ESBT) effective D8.

Article II, paragraph 2(a), of the Trust agreement provides that if an addition is made to the Trust in a calendar year, the beneficiary of the Trust shall have the power, in his sole discretion, commencing with the date of the addition and ending 60 days after notification from the trustee, to withdraw property belonging to the principal of the trust (including property constituting the addition) having a value equal at the time of the withdrawal to the value of the addition at the time of the addition.

Article II, paragraph 3(a)(i), provides that while the beneficiary is under the age of twenty-one years, the trustee may use for the beneficiary's benefit so much or all of the net income of the Trust as the trustee, in the trustee's sole and absolute discretion, determines to be required or desirable for the beneficiary's support, welfare, education and best interests, adding to principal any income not so used. After the beneficiary reaches the age of twenty-one years, the trustee shall pay all the net income of the Trust to the beneficiary in convenient installments at least quarter-annually.

Article II, paragraph 3(a)(i), also provides that after the beneficiary has reached the age of twenty-five years, the trustee shall distribute to the beneficiary such portion or all of the principal of the Trust, other than Corp stock, as the beneficiary from time to time requests in writing, not exceeding in the aggregate, however, one-third in value of such assets, other than Corp stock, before the beneficiary has reached the age of thirty years nor two-thirds in value after the beneficiary has reached the age of thirty-five years.

Article II, paragraph 3(a)(ii), provides that the trustee may pay to the beneficiary, or use for the beneficiary's benefit, so much or all of the principal of the Trust, other than Corp stock, as the trustee from time to time in the trustee's sole and absolute discretion determines to be required or desirable for the beneficiary's support, welfare, education and best interests.

Article II, paragraph 3(b), provides that if the Trust has not yet terminated, upon the death of B, the Trust as then constituted shall be distributed to such appointee or appointees, including B's own estate, upon such conditions and estates, in trust or otherwise, with such powers, in such manner and at such times as B appoints and directs by will specifically referring to the power of appointment.

Section 671 of the Code provides that when the grantor or another person is treated as the owner of any portion of a trust, there shall be included in computing the taxable income and credits of the grantor or the other person those items of income, deduction, 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 of the Code in computing the taxable income or credits against tax of an individual.

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Sections 673 through 678 specify the circumstances under which the grantor or another person will be treated as the owner of a portion of a trust.

Section 674(a) provides that the grantor is 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, a nonadverse party, or both, without the approval or consent of an adverse party.

Section 674(b)(3) provides that § 674(a) does not apply to a power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 677(a) provides that the grantor will be treated as the owner of any portion of a trust whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse, or (2) held or accumulated for future distribution to the grantor or the grantor's spouse.

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 modification retains such control as would cause a grantor to be treated as the owner of such a portion of the trust within the principles of §§ 671 to 677 inclusive.

Section 1361 (c)(2)(A)(i) provides that 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 an S corporation shareholder.

B had the right to withdraw the stock of Corp on the first day of its contribution to Trust under Article II paragraph 2(a) of the Trust if B received notice of the contribution on the day of the contribution. Assuming that B received notice of the contributions on the day of each contribution, B will be treated as having a power to vest the stock in herself within the meaning of § 678(a)(1). Because B failed to exercise the withdrawal power, while retaining a testamentary general power of appointment over all the assets held by Trust at B's death (including Corp stock and gains allocable to corpus not otherwise distributed to B), and the right to have all the income of Trust (including corpus, other than Corp stock, and gains allocable to corpus, in the discretion of the trustee) distributed to him or accumulated for future distributions to him, B will be treated as having released the withdrawal power while retaining such control as would

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cause a grantor to be treated as the owner of Trust under §§ 674 and 677. Therefore, B will be treated as the owner of Trust under § 678(a).

Because B will be considered the owner of the entire trust for purposes of § 671, Trust is a permitted S corporation shareholder as described in § 1361(c)(2)(A)(i).

Except as specifically ruled upon above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. Moreover, if the trust instrument is amended, this ruling may not remain in effect.

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 Trust.

Sincerely yours,

J. THOMAS HINES  
Chief, Branch 2  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes