

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
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Date:  
August 22, 2001

LEGEND

A =

B =

Company =

State =

d1 =

d2 =

y =

Trust =

- Trust1 =
- Trust2 =
- Trust3 =
- Trust4 =
- Trust5 =
- Trust6 =
- Trust7 =
- Trust8 =
- Trust9 =
- Trust10 =
- Trust11 =
- Trust12 =

Dear

This letter responds to a letter dated February 27, 2001, and subsequent correspondence submitted by your authorized representative on behalf of A, B, and Trust, requesting rulings under §§ 678 and 1361 of the Internal Revenue Code.

## FACTS

According to the information submitted, A and B (Donors) executed and funded Trust as an irrevocable trust on d1. Upon Trust's creation, its assets were divided into twelve separate trusts for each then living grandchild of A and B (Trust1 through Trust12). Each grandchild is a Primary Beneficiary of his or her separate trust. Moreover, it is represented that each Primary Beneficiary is a citizen of the United States. Each separate trust is administered by two non-adverse, independent trustees, and aside from the names of the beneficiaries, Trust1 through Trust12 have identical terms and are subject to the same Trust agreement.

Contemporaneously with the division, A and B contributed y shares of non-voting Company stock to each separate trust. Company is a State law corporation that elected to be treated as an S corporation effective d2. A and B request a ruling that Trust1 through Trust12 are grantor trusts under § 678, and therefore are eligible shareholders of an S corporation under § 1361(c)(2)(A)(i).

The relevant terms of each separate trust are as follows:

Paragraph 3(c)(i) of Trust provides that each grandchild of the Donors living at the time of the initial contribution and any additions, gifts, or deemed gifts made to the trust, shall have the annual noncumulative right to withdraw, with respect to each calendar year, such initial contribution, additions, gifts or deemed gifts in their entirety with respect to such calendar year divided by the number of then living grandchildren of the Donors and then deceased grandchildren of the Donors with then living issue.

Paragraph 3(c)(iii) of Trust provides that upon receipt by the Trustees of any addition or gift, or upon the occurrence of any gift deemed to be made to the trust (as determined for federal gift tax purposes), the Trustees shall promptly give notice of such addition, gift or deemed gift made to the trust to each beneficiary then having a power of withdrawal exercisable with respect to such addition, gift or deemed gift.

Paragraph 3(c)(iv) of Trust provides that any exercise of a power of withdrawal granted under subparagraph 3(c)(i) shall be effective only upon timely delivery to the Trustees of written notice thereof executed by the beneficiary. Such written notice by the beneficiary shall be deemed timely only if mailed or personally delivered to the Trustees not later than thirty days after the date the Trustees send notice as provided for in subparagraph 3(c)(iii).

Paragraph 4(b)(i) of Trust provides that the Trustees may, in their absolute discretion, distribute to or use and apply for the direct or indirect benefit of the Primary Beneficiary of such separate trust, or any one or more issue of such Primary Beneficiary, any part or all of the income and/or principal of the separate trust created for such Primary Beneficiary as the Trustees in the Trustees' absolute discretion, determine to be appropriate and in the best interest of the Primary Beneficiary and his

or her issue. To the extent that net income is not distributed for a given year, it shall be accumulated and added to principal.

### LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

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 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 (a grantor trust) may be a shareholder of an S corporation.

Section 671 provides that when the grantor or another person is 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 of the Code in computing taxable income or credits against tax of an individual.

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

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 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 677(a) provides, in part, 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 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.

### CONCLUSIONS

Because each contribution to each separate trust (Trust1 through Trust12

respectively) will be subject to the withdrawal power of the Primary Beneficiary of each separate trust, each Primary Beneficiary will be treated as having a power to vest each contribution in himself or herself within the meaning of § 678(a)(1). If the Primary Beneficiary fails to exercise the withdrawal power, he or she will be treated as having released the power, while retaining a right to have all trust income (ordinary income and income allocable to corpus), in the sole discretion of the trustees, distributed to the Primary Beneficiary or accumulated for future distribution to the Primary Beneficiary, for purposes of §§ 678(a)(2) and 677(a). Also, our examination of the Trust agreement reveals none of the circumstances that would cause the Donors to be considered the owners of Trust. Therefore, each Primary Beneficiary will be treated as the owner of his or her separate trust under § 678(a).

Because each Primary Beneficiary will be treated as the owner of his or her separate trust (Trust1 through Trust 12 respectively), for purposes of § 671, Trust1 through Trust12 will be permitted S corporation shareholders under § 1361(c)(2)(A)(i).

Except for the specific rulings above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express no opinion under any provision of the Gift, Estate, or Generation Skipping Transfer Tax chapters of the Code. Additionally, Trust contains provisions in which the trustees may: 1) elect to treat two or more of the separate trusts as a single trust; 2) convert one or more of the separate trusts from a grantor trust to a trust described in § 1361(d)(1) (a qualified subchapter S trust); or 3) convert one or more of the separate trusts to a trust described in § 1361(e) (an electing small business trust). We express no opinion on whether any of the separate trusts would continue to be eligible S corporation shareholders after any of the aforementioned elections or the tax consequences concerning the elections.

Pursuant to a power of attorney on file with this office, a copy of this letter will be sent to your authorized representative.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,  
Mary Beth Collins  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2):  
Copy of letter  
Copy for § 6110 purposes