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1361.03-00

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CC:DOM:P&SI:2 - PLR-112568-99

DEC 15 1999

X =

A =

B =

C =

Trust =

State =

Date 1 =

Dear

This is in reply to a letter dated June 23, 1999, and previous correspondence, submitted on behalf of A and Trust, by their authorized representative, requesting rulings under sections 678, 1361, 2503, and 2033 through 2046 of the Internal Revenue Code.

A intends to establish Trust for the benefit of his child, B, a United States citizen. The original trustee of Trust will be C. X is a corporation organized and operating under the laws of State. X elected to be treated as an S corporation effective Date 1.

A owns shares of X stock, and intends to make gifts of X stock to Trust for the benefit of B.

Article III of Trust provides that the trustee may receive any additional real or personal property from the settlor or from any other person or persons, by lifetime gift, under a will or trust, or from any other source. Such property will be held by the trustee subject to the terms of the trust agreement. Promptly upon receipt of any real or personal property by the trustees from the settlor or from any other person or persons (whether the initial contribution or an additional contribution), but in no event later than thirty (30) days following the receipt of such contribution or addition, the trustee shall give written notice to B that such contribution or addition has been made and of his right of withdrawal with respect thereto. Commencing on the date that any contribution or addition is made to the trust during any calendar year, B shall have a right to withdraw from the trust such contribution or addition. Such right of withdrawal shall be exercisable by written notice to the trustee not later than thirty (30) days after notice of the addition was mailed to the beneficiaries. To the extent not exercised within such thirty (30) day period, such right of withdrawal shall lapse with respect to such addition.

Article IV.A. of Trust requires the trustees to pay to any member of the group consisting of B and his sibling(s) such sums from income and principal as the trustee deems advisable for his or her health, care, support, maintenance and education. Article IV.A. also provides that any income not distributed will be added to principal.

Article IV.B. of Trust provides that when B attains the age of twenty-eight years, the trustee shall distribute one-fourth (1/4) in value of the principal and accumulated income of the trust to B. Article IV.B. of Trust further provides that when B attains the age of thirty-five (35) years, the trustee shall distribute one-third (1/3) in value of the principal and accumulated income remaining in the trust to B, and when B attains the age of forty (40) years, the trustee shall distribute all of the principal and accumulated income remaining in the trust and the trust shall terminate. Finally, Article IV.B. of Trust provides that if B should die before receiving full distribution, the trustee is directed to distribute the principal and accumulated income remaining in the trust to the appointee or appointees, including B's estate, that B designates by will or other written agreement and, in the absence of the exercise of the power of appointment, directs the trustee to distribute the principal and accumulated income remaining in the trust to B's descendants, if any, or if none, per stirpes to B's sibling(s).

Article IV.C. of Trust provides that, if in the event of B's death before the age of forty, any share of the trust becomes distributable to any beneficiary who has not attained the age of twenty-one (21) years, the trustee shall pay the net income to each such beneficiary in convenient installments no less frequently than annually, as directed by such beneficiary. Article IV.C. of Trust also provides that in addition to the net income, the trustee shall pay to such beneficiary such sums from the principal as the trustee deems advisable for his or her health, care, support, maintenance, and education. In addition, Article IV.C. provides that if a beneficiary should die before attaining the age of twenty-one (21) years, the balance of his or her share shall be

distributed upon his or her death per stirpes to his or her descendants, if any, or if none, per stirpes to the descendants of A.

Ruling Request No. 1

Section 1361(a) of the Code provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under section 1362(a) is in effect for the year.

Section 1361(b)(1)(B) of the Code provides that for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have as a shareholder a person (other than an estate and other than a trust described in section 1362(c)(2)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of section 1361(b)(1)(B), a trust may be a shareholder of an S corporation if the entire trust 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.

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 the tax of an individual.

Sections 673 through 678 of the Code 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) of the Code 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 portion of the trust within the principles of sections 671 to 677, inclusive.

Section 678(b) of the Code provides that section 678(a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor ( to whom section 679 applies) is otherwise treated as the owner under the provisions of subpart E other than section 678.

Section 677(a) of the Code 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 section 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.

Because each contribution to Trust will be subject to the withdrawal power of B, B will be treated as having a power to vest each contribution in himself within the meaning of section 678(a)(1) of the Code. If B fails to exercise the withdrawal power, B 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 trustee, distributed to B, or accumulated for future distribution to B, for purposes of sections 678(a)(2) and 677(a). Also, our examination of the Trust agreement reveals none of the circumstances that would cause the grantor to be treated as an owner of Trust under the provisions of subpart E. Therefore, B will be treated as the owner of the entire Trust under section 678(a) of the Code.

Because B, a United States citizen, will be treated as the owner of the entirety of Trust, for purposes of section 671 of the Code, Trust will be a permitted S corporation shareholder as described in section 1361(c)(2)(A)(i).

Ruling Request No. 2

Section 1361(d)(3) of the Code defines a qualified subchapter S trust as a trust all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States. In addition, the terms of the trust must require that during the life of the current income beneficiary there shall be only one income beneficiary of the trust; any corpus distributed during the life of the current income beneficiary may be distributed only to that beneficiary; the income interest of the current income beneficiary in the trust shall terminate on the earlier of that beneficiary's death or the termination of the trust; and upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary. A substantially separate and independent share of a trust within the meaning of section 663(c) shall be treated as a separate trust for purposes of section 1361(d) and section 1361(c).

The separate shares provided for, should B die before the age of 40, under Article IV.C. of Trust, for the benefit of beneficiaries who have not attained the age of twenty-one, meet the requirements of section 1361(d)(3) of the Code as it currently reads. Accordingly, should these trusts come into existence, and provided that the elections under section 1361(d)(2) are properly made, each of these trusts will be a permitted shareholder of an S corporation under section 1361(c)(2)(A)(i).

Ruling Request No. 3

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident. Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 2503(b) provides that, in the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first $10,000 of such gifts to such person shall not be included in the total amount of gifts made during such year. The annual exclusion is only available for gifts of present interests in property.

Section 25.2503-3(a) of the Gift Tax Regulations provides that the term "future interest" includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time.

If a trust beneficiary is given the power to demand immediate possession and enjoyment of corpus or income, he or she may have a present interest. Crummey v. Commissioner, 397 F. 2d 82 (9th Cir. 1968). See also, Rev. Rul. 73-405, 1973-2 C.B. 321. It is necessary, however, to consider not only the terms of the trust but also circumstances in which the gift was made in order to determine whether the gift is a present interest or future interest. When the delivery of property to a trust is accompanied by limitations upon the donor's present enjoyment of the property in the form of conditions, contingencies or the will of another, either under the terms of the trust or other circumstances, the interest is a future interest, even if enjoyment is deferred only for a short time. Disston v. Commissioner, 325 U.S. 442 (1945); Fondren v. Commissioner, 324 U.S. 18 (1945); Ryerson v. United States, 312 U.S. 405 (1941); Roderick v. Commissioner, 57 T.C. 108 (1971).

In the present case, the trustee of Trust is required to provide B with written notice of a contribution to Trust within thirty days of the date of the contribution. B is granted thirty days following notice in which to exercise B's right of withdrawal. Upon exercising his withdrawal right, B will have the immediate and unrestricted right to the contribution. Accordingly, assuming the thirty day notice of a contribution is given to B, and assuming there is no implied or express understanding that B would not exercise the power of withdrawal, the transfers to Trust will be eligible for the annual exclusion provided in section 2503(b).

Ruling Request No. 4

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of the decedent's death.

Section 2036 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate consideration in money or money's worth), by trust or otherwise, under which he has retained for life or for any period which does not in fact end before his death– (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom. Section 20.2036-1(b)(2) provides that possession, right to income or other enjoyment of the transferred property includes a retained right to have the enjoyment or income applied to discharge a legal obligation of the decedent, or otherwise for his pecuniary benefit. The term legal obligation includes a legal obligation to support a dependent during the decedent's lifetime.

Section 2038 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Under the terms of Article VII of Trust, the trust agreements are irrevocable and A will have no power to amend or modify the provisions of the trust agreement, within the meaning of section 2038(a)(1). Article IV. E. of Trust provides that no interest in the principal or income of the trust assets shall remain in or revert to the respective settlor or his estate, within the meaning of section 2037.

Article IX of Trust provides that by mutual agreement, the trustee, A and his wife will have the power at any time to designate a bank, trust company, or any individual (except A and his spouses) to be a successor trustee. The retained power to remove the trustee and appoint a successor will not cause inclusion of Trust property in A's estate, since the powers of the trustee is limited by an ascertainable standard as described above. See, Rev. Rul. 73-143, 1973-1 C.B. 407.

In addition, under Article VII.K., the trustee is prohibited from making discretionary distributions of income and/or principal to any beneficiary or to make loans to any beneficiary, if such disbursements would satisfy support obligations of A. Accordingly, A will not be

considered to have retained any right to have the use, possession, right to income, or enjoyment of the property applied towards the discharge of any legal obligation of A, or otherwise for A's pecuniary benefit.

In conclusion, Trust property will not be includible in the gross estate of A, under the Code provisions discussed above.

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.

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are forwarding a copy of this letter to your authorized representative.

Sincerely yours,

(signed) J. THOMAS HINES

J. THOMAS HINES
Acting Branch Chief
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and Special
Industries)

Enclosures: 2
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