

**INTERNAL REVENUE SERVICE**

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October 20, 2000

Trust =  
A =  
B =  
Date 1 =  
X =  
State =  
Dear :

This responds to your letter dated May 16, 2000, submitted on behalf of Trust, requesting a ruling under §1361(e) of the Internal Revenue Code.

The information submitted states that Trust was established on Date 1, by A ("Grantor") for the benefit of the living children of the Grantor's child, B, or, failing such living children, for the living children of Grantor's other children.

Trust currently holds stock in X, a State corporation, which intends to elect to be an S corporation.

Trust represents that: (1) Trust has not made an election to be a qualified subchapter S trust, (2) Trust is not exempt from tax under subtitle A of the Code and (3) each Trust beneficiary is an individual.

Article One of Trust provides that the trustees shall hold, manage, invest, and reinvest the trust property, shall collect the income therefrom and shall pay the net income in convenient installments, in such proportions and with such exclusions as the trustees shall deem advisable, among the living children of B, or, failing such living children at any time of payment, among the living children of Grantor's other children, or

the trustees shall have the right to and are authorized to accumulate any or all of such net income, as they shall deem advisable, and add the same to the principal of the trust property. Any payments of net income may be made by the trustees either directly to, or indirectly in trust or otherwise for the benefit of, the beneficiary concerned.

Article One of Trust further provides that in the event that any payment of income authorized under Article One to any individual beneficiary shall be insufficient in the opinion of the trustees to defray the expenses of any illness, accident or other emergency, or to provide for the proper maintenance, support and education of such beneficiary, the trustees are authorized to use from time to time so much of the principal of the trust property as the trustees may deem advisable therefor.

Article Two of Trust provides that Trust shall continue in effect, unless sooner terminated until twenty-one years after the death of the last to die of the four children of Grantor and the grandchildren of Grantor living at the date of the trust agreement.

Article Two of Trust further provides that in the event of the death of B without children living, any undistributed portion of the trust property shall be divided equally among and added to the other three trusts established by Grantor on the same day Trust was established. Failing all such takers, the said undistributed portion shall be transferred, delivered and paid over to such charitable organization or organizations as the trustees shall select.

Section 1361(a) of the Code 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.

Section 1362(b)(1) of the Code provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) 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), (C) have a nonresident alien as a shareholder, and (D) more than one class of stock.

Under §1361(c)(2)(A)(v) of the Code an electing small business trust is an eligible shareholder of an S corporation. Section 1361(e) defines electing small business trust.

Section 1361(e)(1)(A) of the Code provides that, except as provided in §1361(e)(1)(B), the term "electing small business trust" means any trust if – (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, or (III) an organization described in paragraph (2), (3), (4), or (5) of §170(c), (ii) no interest in such trust was acquired by purchase, and (iii) an election under §1361(e) applies to such trust.

Section 1361(e)(1)(B) of the Code provides that the term “electing small business trust” shall not include – (i) any qualified subchapter S trust (as defined in §1361(d)(3)) if an election under §1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A of chapter 1, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in §664(d)).

Section 1361(e)(2) of the Code provides that for purposes of §1361(c), the term “potential current beneficiary” means, with respect to any period, any person who at any time during such period is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust.

Notice 97-49, 1997-2 C.B. 304, provides that for purposes of §1361(e)(1)(A)(i), the term beneficiary does not include a distributee trust, but does include those persons who have a beneficial interest in the property held by the distributee trust. Furthermore, the Notice provides that for purposes of §1361(e)(2) if a distributee trust becomes entitled to, or at the discretion of any person may receive, a distribution from principal or income of the ESBT, then the trust will become a potential current beneficiary and the S corporation election will terminate unless the distributee trust is a trust described in §1361(c)(2)(A).

Accordingly, based on the representations made and the information provided and the assumption that the interest of any contingent charitable beneficiary of Trust described in §170(c)(1) is so remote as to be negligible and that such contingent charitable beneficiaries are therefore not beneficiaries of Trust as described in §1361(e)(1)(A)(i), we conclude that for purposes of §1361(e)(1)(A)(i) the beneficiaries of Trust are individuals and are qualified beneficiaries.

With respect to the power given to the trustees under Article One to make certain distributions either directly to or indirectly in trust or otherwise for the benefit of the beneficiary concerned, this is a power to make a distribution for purposes of §1361(e)(2). However, since there are currently no distributee trusts identified or currently in existence, the power to distribute to these trusts will be disregarded for purposes of §1361(e)(2). Thus, there is no distributee trust that is a potential current beneficiary. If a distributee trust is identified or otherwise comes into existence in any period, then the distributee trust will become a potential current beneficiary and the S corporation election will terminate unless the distributee trust is a trust described in §1361(c)(2)(A). Furthermore, the beneficiary of any such new trust must satisfy the shareholder restrictions of §1361(b)(1).

Accordingly, upon Trust making a valid and timely election under §1361(e)(3), Trust will satisfy the requirements of §1361(e)(1).

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.

This ruling is directed only to the taxpayer who requested 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 of file with this office, we are forwarding a copy of this letter to Trust.

Sincerely yours,  
J. THOMAS HINES  
Acting Branch Chief Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

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