

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Date:

October 15, 2003

**LEGEND**

Company 1 =

Company 2 =

X =

State =

Cite =

Dear :

This letter responds to a letter written on behalf of Company 1 and Company 2, dated March 25, 2003, requesting a ruling regarding whether a life tenant who holds stock under a life estate qualifies as an eligible shareholder for S corporation purposes under § 1361 of the Internal Revenue Code.

**FACTS**

X, who is a U.S. citizen and resides in State, holds stock in Company 1 and Company 2 as a life tenant. X has transferred his life estate in the shares of Company 1 and Company 2 stock to a revocable grantor trust so that his rights as a life tenant may be exercised by the trustee if he becomes incompetent. Upon X's death, various remaindermen will own the stock outright.

It is represented that, X, as the life tenant, has the right to all income during his lifetime from the stock subject to the life estate. X also has the right to sell the shares of stock of which he is a life tenant, reinvest the proceeds, and use the income derived therefrom for his lifetime. It is also represented that under State law, a life tenant is treated as a fiduciary with respect to his or her remaindermen. In this regard, the life tenant has a duty to prevent waste, to refrain from manipulating title to property so as to defeat the remainderman's interest, and to not transfer property for inadequate consideration. Cite.

It is represented that, under the law of State, X's life estate in the shares of stock is deemed to give rise to a trust relationship between X and the remaindermen, and that the deemed trust satisfies the requirements for treatment as a qualified subchapter S trust (QSST) under § 1361(d) (3).

Company 1 and Company 2 are planning to elect to be treated as S corporations under § 1362. Accordingly, Company 1 and Company 2 request a ruling as to whether X is a permissible shareholder of an S corporation.

## **LAW**

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 the year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, 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(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(3) provides that, for purposes of § 1361(d), a QSST means a trust (A) the terms of which require that (i) during the life of the current income beneficiary there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of

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the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

### CONCLUSION

Based on the facts represented and the information submitted, and provided that X makes a timely election to treat the arrangement created by the life estate with respect to the stock as a QSST, we conclude that the QSST may be a permitted shareholder of an S corporation. This ruling is based upon the information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination.

Except for the specific ruling above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provisions of the Code. Specifically, we express or imply no opinion on whether Company 1 or Company 2 is otherwise eligible to be an S corporation.

Under a power of attorney on file with this office, we are sending a copy of this letter to Company 1 and Company 2's authorized representative.

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

Sincerely,

/s/

Christine Ellison  
Branch Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

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

cc: