

CHECKLISTS FOR DETERMINING WHETHER A TRUST IS A VALID S SHAREHOLDER

I. QSST Determination (Sec. 1361(d))

Name of S corporation _____

<i>Questions</i>	<i>Yes/No</i>	<i>Date Completed</i>
1. Is the trust a domestic trust? ■ If no, the trust does not qualify; see Sec. 701(a)(31)(B) and (a)(30)(E) for the definitions of foreign and domestic trusts.	_____	_____
2. Do the trust terms permit more than one income beneficiary during the current income beneficiary's life? ■ If yes, the trust does not qualify as a QSST unless the separate share rules apply (see Question #3).	_____	_____
<i>Note:</i> For a QSST, a husband and wife are treated as one current income beneficiary if they file a joint income tax return and each is a U.S. citizen or resident.		

Questions

Yes/No

Date Completed

3. If there is more than one current income beneficiary, is the trust set up in such a way so that each such beneficiary has a separate share under Sec. 663(c)?

■ If no, the trust does not qualify as a QSST.



4. Is the current income beneficiary a U.S. citizen or resident?

■ If no, the trust does not qualify as an S shareholder.



5. Do the trust terms allow corpus distributions only to the current income beneficiary during his or her life?

■ If no, the trust does not qualify as a QSST.



6. Do the trust terms provide that the current income beneficiary's income interest in the trust terminates on the earlier of the death of the current income beneficiary or the termination of the trust?

■ If no, the trust does not qualify as a QSST.



7. Do the trust terms provide that if the trust terminates during the current income beneficiary's life, all trust assets must be distributed to that current income beneficiary?

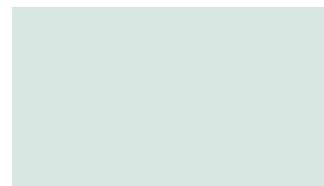
■ If no, the trust does not qualify as a QSST.



8. Do the trust terms require all trust accounting income to be distributed at least annually?

■ If no, such income must actually be distributed to the current income beneficiary at least annually for the trust to qualify as a QSST.

■ Trust accounting income is generally determined by applicable local law and trust provisions. Trust accounting income generally includes distributions to the trust from the S corporation and is frequently different from the trust's pro-rata share of the S corporation's items of income, loss, deductions or credits.



9. Under the trust instrument or under applicable state law, can anyone besides the current income beneficiary receive any benefit from the trust while the current income beneficiary is alive?

■ If yes, the trust does not qualify as a QSST.



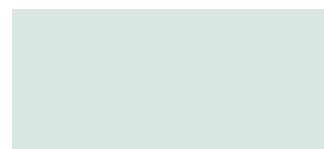
10. Can payments be made from the trust that will discharge someone else's obligation to support the current income beneficiary? For instance, some state laws may require a parent to provide a child's school tuition.

■ If yes, the trust does not qualify as a QSST.



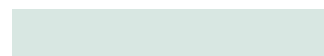
11. Did the current income beneficiary make a QSST election with respect to this S corporation?

■ If no, the trust does not qualify as a QSST, unless the current income beneficiary is a successor beneficiary that does not affirmatively refuse to consent as to this S corporation (see Question #20 for possible late election relief). But it may be a QSST with respect to another S corporation for which the current income beneficiary has made a valid QSST election.



12. Is the current income beneficiary a successor to a previous current income beneficiary?

■ If yes, and he or she filed an affirmative refusal to consent to the QSST election, the trust no longer qualifies as a QSST.



Questions	Yes/No	Date Completed
<p>13. If the trust held stock before the corporation made an S election, did the then-current income beneficiary sign the consent of shareholders for the S election?</p> <ul style="list-style-type: none"> ■ If no, remedial action needs to be taken for the S election to be effective; see Sec. 1362(f) and Regs. Sec. 1.1362-6(b)(3)(iii). ■ If the spouse of a shareholder in a community property state, who is a shareholder solely pursuant to state community property law, fails to consent to the S election, Rev. Proc. 2004-35, IRB 2004-23, 1029, provides relief procedures. 	_____	_____
<p>14. Was the QSST election either mailed certified, return receipt requested, or filed by hand with a copy stamped by the IRS?</p> <ul style="list-style-type: none"> ■ Under Prop. Regs. Sec. 301.7502-1(e)(1), direct proof of actual delivery and registered or certified mail are the exclusive means to establish prima facie evidence of delivery of the election. When finalized, this rule will apply to all documents mailed after Sept. 21, 2004. 	_____	_____
<p>15. Does the QSST election contain all of the information required by Regs. Sec. 1.1361-1(j)(6)(ii)?</p>	_____	_____
<p>16. Was the QSST election filed with the same Internal Revenue Service Center where the S corporation files its return?</p>	_____	_____
<p>17. Did the IRS accept the QSST election?</p> <ul style="list-style-type: none"> ■ A copy of the QSST election should be kept in the files. 	_____	_____
<p>18. If the trust held the corporate stock before the S election was made, was the QSST election filed within two months and 15 days after the earlier of the date on which the S election was (1) filed or (2) effective?</p> <ul style="list-style-type: none"> ■ If not, remedial action needs to be taken for the S election to be effective. 	_____	_____
<p>19. If the S election was effective before the stock was transferred to the trust, was the QSST election filed no later than two months and 15 days after the transfer date?</p> <ul style="list-style-type: none"> ■ A QSST election may not be made before the trust's acquisition of the S stock. 	_____	_____
<p>20. If the QSST election was not filed on time, was the late filing due to inadvertence? See Rev. Proc. 2003-43 for relief.</p>	_____	_____
<p>21. If the trust currently is an ESBT, does it wish to convert to a QSST?</p> <ul style="list-style-type: none"> ■ If yes, the IRS must consent to the revocation of the ESBT election, generally via a letter ruling request; but see Regs. Sec. 1.1361-1(m)(7) for circumstances under which such consent is automatically granted. 	_____	_____
<p>22. Does the current income beneficiary understand that he or she must report all of the S corporation tax items attributable to the S stock owned by the QSST on his or her personal income tax return?</p> <ul style="list-style-type: none"> ■ This attribution to the current income beneficiary does not apply to the tax consequences of the trust's disposition of the S stock. ■ For example, if the trust sells S stock, gain or loss is recognized by the trust, not the current income beneficiary. However, a disposition of S stock by the trust after 2004 is considered made by the current income beneficiary for purposes of applying the Sec. 465 at-risk rules and the Sec. 469 passive activity loss rules to the beneficiary. 	_____	_____

23. When the current income beneficiary is added to the number of other shareholders, will the total exceed the allowable limit?

- If yes, although the trust may qualify as a QSST, the S election will terminate.

II. ESBT Determination (Sec. 1361(e))

1. Does the trust have only individuals, estates or qualified exempt organizations as beneficiaries?

- Generally, a beneficiary, as used in this question, is broader than, but includes, the term “potential current beneficiary” and includes a person who has a present, remainder or reversionary interest in the trust; compare Regs. Sec. 1.1361-1(m)(1)(ii) with Regs. Sec. 1.1361-1(m)(4) (as modified by Sec. 1361(e)(2)).
- A person in whose favor a power of appointment could be exercised is not an ESBT beneficiary or potential current beneficiary (due to such power), unless the power is actually exercised in favor of that person.
- A beneficiary who is not an eligible shareholder who later becomes a potential current beneficiary will terminate the S election, if not cured as provided in Sec. 1361(e)(2).
- A qualified exempt organization is defined in Sec. 170(c)(2)–(5), or in 170(c)(1) to the extent it holds a contingent interest and is not a potential current beneficiary.

2. When the potential current beneficiaries are added to the number of other shareholders, will the total number exceed the allowable shareholder limit?

- If yes, the S election is terminated.
- Every potential current beneficiary counts as a shareholder with respect to the allowable shareholder limit.
- A potential current beneficiary is a person or organization that is entitled to or may currently receive distributions from the trust’s principal or income.

3. Is each potential current beneficiary an eligible shareholder?

- If no, the S election is terminated; see Sec. 1361(b)(1).

4. If the trust currently is a QSST, does it wish to convert to an ESBT?

- If yes, the IRS must consent to the revocation of the QSST election, generally via a letter ruling request; but see Regs. Sec. 1.1361-1(j)(12) for circumstances under which such consent is granted automatically.

5. Is the trust a charitable remainder trust (CRT)?

- A CRT cannot qualify as an ESBT.

6. Is the trust exempt from income tax?

- If yes, the trust is not an ESBT.

7. Has any person acquired an interest in the trust by purchase?

- If yes, the trust does not qualify as an ESBT.
- A purchase includes any transaction for which the basis of acquired property is cost.

8. Does the ESBT election include all information as required by Regs. Sec. 1.1361-1(m)(2)?

Questions	Yes/No	Date Completed
9. Did the trustee sign the ESBT election?	_____	_____
10. Was the ESBT election timely filed?	_____	_____
11. If the ESBT election was not filed on time, was the late filing due to inadvertence? See Rev. Proc. 2003-43 for relief.	_____	_____
12. Was the ESBT election either mailed certified return receipt, or filed by hand with a copy stamped by the IRS?	_____	_____
<ul style="list-style-type: none"> ■ Under Prop. Regs. Sec. 301.7502-1(e)(1), direct proof of actual delivery and registered or certified mail are the exclusive means to establish prima facie evidence of delivery of the election. When finalized, this rule will apply to all documents mailed after Sept. 21, 2004. 		
13. Was the ESBT election filed with the same Internal Revenue Service Center where the S corporation files its return?	_____	_____
14. If the ESBT initially owns stock in more than one S corporation, and the S corporations file returns in multiple service centers, was the ESBT election filed in all relevant Internal Revenue Service Centers where the S corporations file returns?	_____	_____
<i>Note:</i> Unlike a QSST election (which must be made separately for each S corporation whose stock the QSST owns), an ESBT election generally needs to be filed only once, unless the multiple Internal Revenue Service Center situation above applies.		
15. Did the IRS accept the ESBT election?	_____	_____
<ul style="list-style-type: none"> ■ Retain proof of mailing. 		
16. If the trust held the stock before the S election was made, was the ESBT election filed within two months and 15 days after the earlier of the date on which the S election was (1) filed or (2) effective?	_____	_____
<ul style="list-style-type: none"> ■ If not, remedial action needs to be taken for the S election to be effective. 		
17. If the S election was effective before the stock was transferred to the trust, was the ESBT election filed no later than two months and 15 days after the date of the transfer?	_____	_____
<ul style="list-style-type: none"> ■ If not, remedial action needs to be taken for the S election to remain effective. 		
III. Inter Vivos Trust Determination		
1. Is a U.S. citizen or resident treated as the deemed owner of the entire trust?; see Secs. 671-678.	_____	_____
<ul style="list-style-type: none"> ■ If no, go to Question #2. ■ If yes, the trust qualifies as an S shareholder while the deemed owner is alive. ■ It appears that grantors who are husband and wife (both of whom are U.S. citizens or residents) are treated as one deemed owner for this purpose; see Regs. Sec. 1.1361-1(e)(2) and -1(k)(1), <i>Example (1)</i>. A substantially separate and independent share of a trust (within the meaning of Sec. 663(c)) is treated as a separate trust for this purpose; see Regs. Sec. 1.1361-1(j)(3). 		

Questions

Yes/No

Date Completed

2. Is the trust a voting trust under Sec. 1361(c)(2)(A)(iv)?

- If no, go to Question #3.
- If yes, and if the trust meets the requirements under Regs. Sec. 1.1361-1(h)(1)(v), the trust qualifies as an S shareholder and the beneficiaries are deemed the owners of the trust's stock.

3. Is the trust a QSST or an ESBT under Part I or II above?

- If no, and Questions #1 and #2 above are both answered negatively, the trust does not qualify as an S shareholder unless it is an exempt trust described in Sec. 401(a) or 501(c)(3). In addition, an IRA (including a Roth IRA) is a permitted shareholder of an S corporation bank or a depository institution holding company, but only to the extent of the bank or holding company stock held by the IRA on Oct. 22, 2004.

4. When the deemed owners are added to the other shareholders, does the total number of shareholders exceed the allowable limit?

- If yes, the S election terminates.

IV. Subpart E Trust after The Grantor's (or Other Deemed Owner's) Death and Testamentary Trust Determination

1. Was the trust a qualified subpart E trust (i.e., all of which is treated as owned by an individual who was a U.S. citizen or resident) immediately before the deemed owner's death, that continues in existence after the decedent's death?

- If so, the trust remains a permitted S shareholder until the day preceding the second anniversary of the deemed owner's death.
- After the two-year period, the former subpart E trust will not be a permitted S shareholder, unless it otherwise qualifies as a qualified subpart E trust, a QSST or an ESBT.
- For income tax purposes, if the trust was a qualified revocable trust under Sec. 645 immediately before the decedent's death and a proper Sec. 645 election was made, the trust is treated during the Sec. 645 election period not as a separate trust but, rather, as the estate or part of the estate.
- If the trust includes withdrawal powers, it may or may not be a Sec. 678 trust, all of which is treated as owned by one individual. If not, an ESBT election should be considered.

2. Was the trust created under a will (a testamentary trust)?

- If so, the trust is a permitted S shareholder, generally for the two-year period beginning on the day the stock is transferred to the trust.
- For this purpose, a testamentary trust also includes: (1) a trust to which S stock is transferred during the Sec. 645 election period pursuant to the terms of a qualified revocable trust for which a valid Sec. 645 election has been made; and (2) the deemed new trust to which S stock is deemed distributed at the close of the last day of the Sec. 645 election period of a qualified revocable trust for which a valid Sec. 645 election has been made; see Regs. Secs. 1.1361-1(h)(1)(iv)(B) and 1.645-1(h)(1).
- After the two-year period, the testamentary trust will not be a permitted S shareholder, unless it otherwise qualifies.