

# Only certain trusts can own S corporation stock

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S corporations must comply with several strict requirements or risk losing their tax-advantaged status. Among other things, they can have no more than 100 shareholders, can have no more than one class of stock and are permitted to have only certain types of shareholders.

In an estate planning context, it's critical that any trusts that will receive S corporation stock through operation of your estate plan be eligible shareholders.

## Which trusts are eligible?

Eligible trusts include:

**Grantor trusts.** A grantor trust is eligible provided that it has one "deemed owner" who's a U.S. citizen or resident and meets certain other requirements. Also, when the grantor dies, the trust remains an eligible shareholder for two years, after which it must distribute the stock to an eligible shareholder or qualify as a qualified subchapter S trust ("QSST") or an electing small business trust ("ESBT").

**Testamentary trusts.** These trusts, which are established by your will, are eligible S corporation shareholders for up to two years after the transfer and then must either distribute the stock to an eligible shareholder or qualify as a QSST or ESBT.

**QSSTs.** These trusts must meet several requirements, including distributing all current income to a single beneficiary who's a U.S. citizen or resident and filing an election with the IRS. They cannot be used to benefit multiple beneficiaries or to accumulate income, although in effect there can be multiple beneficiaries if they're treated as each owning a separate share of the trust. A QSST's income is taxed at the beneficiary's tax rate.

**ESBTs.** A trust qualifies as an ESBT if (1) all of its beneficiaries or “potential current beneficiaries” would be eligible shareholders if they held the stock directly; (2) no beneficiary purchases its interest; and (3) the trustee files an election with the IRS.

If you have any S corporation stock that will be distributed to a trust, be sure to review its terms carefully to ensure it couldn’t inadvertently disqualify the S corporation. Please contact us with further questions.

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