

Only specific trusts are eligible to hold 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, no more than one class of stock and only certain types of shareholders.

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

4 eligible trust types

Trusts that are eligible to own S corporation stock include:

Grantor trusts. An important caveat is that these trusts must have one “deemed owner” who’s a U.S. citizen or resident and meet certain other requirements. Not all grantor trusts are eligible, including some that contain common tax-planning features. In addition, when the grantor dies, the trust remains eligible for two years, after which it must either 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. This trust type is established by your will. It’s an eligible S corporation shareholder 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.

Review your portfolio and estate plan

If you have any S corporation stock held in a trust, be sure to review its terms carefully to avoid inadvertently disqualifying the S corporation. We can help you determine if you’ve properly accounted for S corporation stock in your estate plan.

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