

power of S corporation stock transferred to it. To qualify as a voting trust for purposes of this section (a qualified voting trust), the beneficial owners must be treated as the owners of their respective portions of the trust under subpart E and the trust must have been created pursuant to a written trust agreement entered into by the shareholders, that—

(A) Delegates to one or more trustees the right to vote;

(B) Requires all distributions with respect to the stock of the corporation held by the trust to be paid to, or on behalf of, the beneficial owners of that stock;

(C) Requires title and possession of that stock to be delivered to those beneficial owners upon termination of the trust; and

(D) Terminates, under its terms or by state law, on or before a specific date or event.

(2) *Foreign trust.* For purposes of paragraph (h)(1) of this section, in any case where stock is held by a foreign trust as defined in section 7701(a)(31), the trust is considered to be the shareholder and is an ineligible shareholder. Thus, even if a foreign trust qualifies as a subpart E trust (e.g., a qualified voting trust), any corporation in which the trust holds stock does not qualify as a small business corporation.

(3) *Determination of shareholders—(i) General rule.* For purposes of paragraph (b) of this section (qualification as a small business corporation), and, except as provided in paragraph (h)(3)(ii) of this section, for purposes of sections 1366 (relating to the pass-through of items of income, loss, deduction, or credit), 1367 (relating to adjustments to basis of shareholder's stock), and 1368 (relating to distributions), the shareholder of S corporation stock held by a trust that is a permitted shareholder under paragraph (h)(1) of this section is determined as follows:

(A) If stock is held by a qualified subpart E trust, the deemed owner of the trust is treated as the shareholder.

(B) If stock is held by a trust defined in paragraph (h)(1)(ii) of this section, the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner's death. However, if stock is held by such a trust in a community property state, the decedent's estate is the shareholder only of the portion of the trust included in the decedent's gross estate (and the surviving spouse continues to be the shareholder of the portion of the trust owned by that spouse under the applicable state's community property law).

The estate ordinarily will cease to be treated as the shareholder upon the earlier of the transfer of the stock by the trust or the expiration of the 60-day period (or, if applicable, the 2-year period) beginning on the day of the deemed owner's death. If the trust qualifies and becomes an electing QSST, the beneficiary and not the estate is treated as the shareholder as of the effective date of the QSST election, and the rules provided in paragraph (j)(7) of this section apply.

(C) If stock is held by an electing QSST, see paragraph (j)(7) of this section for the rules on who is treated as the shareholder.

(D) If stock is transferred to a testamentary trust (other than a qualified subpart E trust or an electing QSST), the estate of the testator is treated as the shareholder until the earlier of the transfer of that stock by the trust or the expiration of the 60-day period beginning on the day that the stock is transferred to the trust.

(E) If stock is held by a qualified voting trust, each beneficial owner of the stock, as determined under subpart E, is treated as a shareholder with respect to the owner's proportionate share of the stock held by the trust.

(ii) *Exceptions.* Solely for purposes of section 1366, 1367, and 1368 the shareholder of S corporation stock held by a trust is determined as follows—

(A) If stock is held by a trust (as defined in paragraph (h)(1)(ii) of this section) that does not qualify as a QSST, the trust is treated as the shareholder. If the trust continues to own the stock after the expiration of the 60-day period (or, if applicable, the 2-year period), the corporation's S election will terminate unless the trust is otherwise a permitted shareholder. If the trust is a QSST described in section 1361(d) and the income beneficiary of the trust makes a timely QSST election, the beneficiary and not the trust is treated as the shareholder from the effective date of the QSST election; and

(B) If stock is transferred to a testamentary trust described in paragraph (h)(1)(iii) of this section (other than a qualified subpart E trust or a trust that has a QSST election in effect), the trust is treated as the shareholder. If the trust continues to own the stock after the expiration of the 60-day period, the corporation's S election will terminate unless the trust otherwise qualifies as a permitted shareholder.

(i) [Reserved]

(j) *Qualified subchapter S trust—(1) Definition.* A qualified subchapter S trust (QSST) is a trust (whether intervivos or testamentary), other than a

foreign trust described in section 7701(a)(31), that satisfies the following requirements:

(i) All of the income (within the meaning of § 1.643(b)–1) of the trust is distributed (or is required to be distributed) currently to one individual who is a citizen or resident of the United States. For purposes of the preceding sentence, unless otherwise provided under local law (including pertinent provisions of the governing instrument that are effective under local law), income of the trust includes distributions to the trust from the S corporation for the taxable year in question, but does not include the trust's pro rata share of the S corporation's items of income, loss, deduction, or credit determined under section 1366. See §§ 1.651(a)–2(a) and 1.663(b)–1(a) for rules relating to the determination of whether all of the income of a trust is distributed (or is required to be distributed) currently. If under the terms of the trust income is not required to be distributed currently, the trustee may elect under section 663(b) to consider a distribution made in the first 65 days of a taxable year as made on the last day of the preceding taxable year. See section 663(b) and § 1.663(b)–2 for rules on the time and manner for making the election. The income distribution requirement must be satisfied for the taxable year of the trust or for that part of the trust's taxable year during which it holds S corporation stock.

(ii) The terms of the trust must require that—

(A) During the life of the current income beneficiary, there will be only one income beneficiary of the trust;

(B) Any corpus distributed during the life of the current income beneficiary may be distributed only to that income beneficiary;

(C) The current income beneficiary's income interest in the trust will terminate on the earlier of that income beneficiary's death or the termination of the trust; and

(D) Upon termination of the trust during the life of the current income beneficiary, the trust will distribute all of its assets to that income beneficiary.

(iii) The terms of the trust must satisfy the requirements of paragraph (j)(1)(ii) of this section from the date the QSST election is made or from the effective date of the QSST election, whichever is earlier, throughout the entire period that the current income beneficiary and any successor income beneficiary is the income beneficiary of the trust. If the terms of the trust do not preclude the possibility that any of the requirements stated in paragraph (j)(1)(ii) of this