

**Internal Revenue Service**

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PA:APJP:1-PLR-117523-99  
Date:  
September 11, 2000

Re: Letter Ruling Request Regarding the Exclusion of Gain from the Sale of a Residence

LEGEND:

- Taxpayer =
- Decedent =
- Residence =
- Trust =
- Trust A =
- Trust B =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =

Dear . :

This responds to your letter of Date 4 requesting a ruling on whether gain from the sale of your client’s principal residence would be excluded under section 121 of the Internal Revenue Code (“Code”).

FACTS

Taxpayer and his wife, Decedent, established the Trust on Date 1. The Residence was transferred to the Trust shortly after it was established. The Residence

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was used by Taxpayer and Decedent as their principal residence from the time it was purchased until the death of Decedent on Date 2. Taxpayer continued to use the Residence as his principal residence from Date 2 until Date 3, having lived at the Residence for greater than thirty years, when it became necessary for him to move out of the Residence and into an assisted living facility. Taxpayer can no longer maintain the Residence and therefore intends to sell the property.

The Trust was revocable by Taxpayer and Decedent from the time that it was established until the death of Decedent, at which time the Trust was divided into two Trusts, Trust A and Trust B, each for the benefit of Taxpayer. Trust A, which remains revocable by Taxpayer, was allocated all of Taxpayer's interest in the community estate plus a portion of Decedent's interest in the community estate in order to satisfy the maximum Marital Deduction formula provided for in the Trust. The balance of the community estate was allocated to Trust B, which is irrevocable, including one hundred percent of the Residence.

Section 3.2.2 of Trust B provides that the Trustor shall have the power to withdraw from the principal of Trust B in each calendar year such amount as shall not exceed Five Thousand Dollars (\$5,000.00) or five percent (5%) of the then aggregate market value of all property included in the principal of Trust B, whichever is greater. The surviving Trustor shall exercise such power in each year by serving written notice of the amount to be so withdrawn on the Trustee. Such power shall be non-cumulative so that any amount which the surviving Trustor was entitled to but did not withdraw in any one calendar year may not be withdrawn in any succeeding calendar year. This type of power in a trust is commonly referred to as a "five or five" power.

Section 3.2.3 of Trust B provides that the Trustee shall pay to or apply for the benefit of the beneficiary, during his or her lifetime, in monthly or other convenient installments, but no less often than annually, all of the net income of Trust.

Section 5.12 of Trust B provides that the beneficiary shall have the right to occupy all real property in the trust estate that was being used for residential purposes. The beneficiary, in his or her discretion, may direct the Trustee to sell any such property and replace it with or rent or lease another residence selected by the beneficiary of comparable or lower value.

#### OWNERSHIP REQUIREMENT FOR SECTION 121 PURPOSES

Section 121(a) of the Code provides that a taxpayer's gross income will not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more.

Section 121(b)(1) of the Code provides that the amount of gain excluded from

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gross income under section 121(a) with respect to any sale or exchange will not exceed \$250,000 (\$500,000 for certain joint returns, see section 121(b)(2)).

Rev. Rul. 66-159, 1966-1 C.B. 162, considers whether the gain realized from the sale of trust property used by the grantor as the grantor's principal residence qualifies for the deferment and rollover of gain into a replacement residence under section 1034 of the Code. The ruling holds that because the grantor is treated as the owner of the entire trust under sections 676 and 671 of the Code, the sale by the trust will be treated for federal income tax purposes as if made by the grantor.

Rev. Rul. 85-45, 1985-1 C.B. 183, considers whether gain realized from the sale of trust property used by a beneficiary of a trust as the beneficiary's residence qualifies for the one-time exclusion of gain from the sale of a residence under section 121 of the Code. The ruling holds that because the beneficiary is treated as the owner of the entire trust under sections 678 and 671 of the Code, the sale by the trust will be treated for federal income tax purposes as if made by the beneficiary.

#### OWNERSHIP OF TRUST PROPERTY FOR INCOME TAX PURPOSES

Section 678 provides that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which (1) such person has a power exercisable solely by himself to vest corpus or the income therefrom in himself, or (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677 inclusive, subject a grantor of a trust to treatment as the owner thereof.

Section 677 provides that the grantor of a trust shall be treated as the owner of any portion of the trust whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor.

In Rev. Rul. 67-241, 1967-2 C.B. 225, the beneficiary of a trust held a noncumulative power, exercisable solely by the beneficiary, to withdraw certain amounts of corpus annually from the trust. Rev. Rul. 67-241 concludes that, for each year that this demand power is held, section 678(a)(1) treats the beneficiary as the owner of that portion of the trust which is subject to this demand power, whether or not it is exercised.

#### RULING

We conclude that Taxpayer's five or five power is a power to vest in Taxpayer a portion of the corpus of Trust B. Until the power is exercised, released, or allowed to lapse, Taxpayer will be treated as the owner for each year of that portion of Trust B that is subject to the power to withdraw under section 678(a)(1). To the extent that Taxpayer exercises the five or five power during a calendar year, such withdrawal shall

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be deemed to have been made from Taxpayer's pro rata share of each asset of Trust B corpus that he is treated as owning.

For each year that Taxpayer fails to exercise the five or five power, he will be deemed to have partially released the power to withdraw the portion of the trust corpus subject to that power under section 678(a)(2). After each succeeding year in which Taxpayer fails to exercise his power, he will be treated as the owner of an increasing portion of the corpus of the trust. The annual increase of the portion of the corpus of Trust B of which Taxpayer will be treated as the owner is the product of the amount which he could withdraw multiplied by a fraction, the numerator of which is the portion of the trust corpus that he is not already treated as owning, and the denominator of which is the total trust corpus from which the withdrawal could be made.

Section 671 provides that where a grantor or other person is treated as the owner of any portion of a trust, the income, deductions, and credits against tax of the trust attributable to such portion of the trust shall be included by the grantor or other person in computing his taxable income and credits.

Section 1.671-3(a) of the Income Tax Regulations provides that a deemed owner of corpus must include his or her share of the capital gains realized by the trust if allocable to the portion of corpus which that person is deemed to own.

Section 1.671-3(a)(3) provides that if a person is treated as owning an undivided fractional share of trust corpus or an interest represented by a dollar amount, then a pro rata share of each such item of capital gain shall be allocated to that person.

Therefore, Taxpayer must include, in computing his tax liability, items of income, deductions, and credits that are attributable to that portion of the corpus of Trust B which Taxpayer is treated as owning. Also, as the owner of an undivided fractional share of the corpus of Trust B, Taxpayer shall be allocated a pro rata share of each item of any capital gain realized by Trust B.

Taxpayer has also asked whether he is treated as an owner of an additional portion of Trust B as a result of section 5.12 of Trust B. Under section 5.12 of Trust B, Taxpayer has the right to occupy all real property in the trust estate that was being used for residential purposes. Pursuant to section 5.12 of Trust B, Taxpayer, in his discretion, may also direct the Trustee to sell any such property and replace it with, or rent or lease another residence selected by Taxpayer, of comparable or lower value. However, this right is not a power to vest corpus in Taxpayer and thus, does not result in his being treated as an owner of any additional portion of the corpus of Trust B under section 678(a)(1). Furthermore, Taxpayer's right to occupy the residence is limited to his lifetime under the terms of section 5.12 of Trust B. The sale by the trust of any assets subject to that right does not result in a disposition of any interest represented by that right. Therefore, Taxpayer continues to have the same rights regarding property used for residential purposes held by Trust B.

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Based on the facts as represented and the relevant law as set forth above, we conclude that if Trust B sells the Residence, the gain on the Residence would be taxable to Trust B, as the owner of the corpus, not Taxpayer, except to the extent Taxpayer is deemed the owner of a portion of the property pursuant to his 5 or 5 power. As Taxpayer would be taxed on the gain from the sale of the Residence, only to the extent of his ownership pursuant to his 5 or 5 power in the Residence, section 121 shall only apply to the portion of the Residence attributable to the 5 or 5 power.

Except as specifically ruled upon above, no opinion is expressed or implied regarding the income tax consequences of the Trust, any transaction, or any item discussed or referenced in this letter.

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

Sincerely,  
Pamela W. Fuller  
Acting Assistant to the Branch Chief, Branch 1  
Administrative Provisions and Judicial Practice  
Division

Enclosures (2):

Copy of this letter  
Copy for Section 6110 purposes