

**Internal Revenue Service**

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

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February 25, 2020

Legend

Trust 1:

Subtrust:

Grantors:

Shares:

LLC:

Trust 2:

A:

Date 1:

Date 2:

Date 3:

Date 4:

Date 5:

\$a:

\$b:

Dear \_\_\_\_\_ :

This letter responds to a letter dated April 16, 2019, submitted on behalf of Trust 1, requesting a ruling as to whether gain is recognized on the sale of a partnership interest by Subtrust to Trust 2.

#### FACTS

According to the representations submitted, Grantors created Trust 1, an irrevocable trust for the benefit of Grantors' children and grandchildren. Grantors transferred Shares to Trust 1. Pursuant to the Trust 1 indenture dated Date 1, Trust 1 was divided into separate trusts for each of Grantors' children and grandchildren.

The Trust 1 indenture prohibits a distribution of the Shares, but allows for distribution of the proceeds from the sale of the Shares. On Date 2, Trust 1 contributed all of its Shares to LLC, a newly formed entity classified as a partnership for federal tax purposes, in exchange for membership interests in LLC. Trust 1 represents that the same restriction placed on the distribution of Shares also restricts the distribution of the LLC interests. Effective Date 3, Trust 1 transferred a portion of its LLC interests to Subtrust. LLC's assets include cash and the Shares. A is the sole beneficiary of Subtrust.

Trust 1 represents that A has the authority to withdraw all of Subtrust's assets when A reaches age 40 except the LLC interests. Pursuant to her withdrawal right, on Date 4, A withdrew all of Subtrust's assets except the LLC interests.

On Date 5, the trustees of Subtrust agreed to sell a portion of the LLC interests held in Subtrust to Trust 2 in exchange for \$a cash and a \$b promissory note. Trust 1 represents that Trust 2 is a grantor trust with respect to A under subpart E of part I of subchapter J of the Code. Trust 1 further represents that A has the authority to withdraw the cash and promissory note from Subtrust after the proposed sale.

LAW

Section 671 of the Code provides that where it is specified in subpart E of part I of subchapter J (sections 673 through 679 of the Code) that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 678(a) of the Code 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 the 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 §§ 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

In Rev. Rul. 85-13, 1985-1 C.B. 184, A created T, an irrevocable trust, and funded it with Corporation Z shares. W, A's spouse was trustee of T. Neither A nor any other person had a power over, or an interest, in T that would cause A to be treated as the owner of T under subpart E of part I of subchapter J. When the fair market value of the shares had increased, W, as trustee, transferred the Corporation Z shares to A. In exchange, A gave W A's unsecured promissory note with a face amount equal to the fair market of the shares bearing an adequate annual rate of interest. Principal payments on the note were scheduled to be paid in 10 equal annual installments, the first installment due three years following the date the shares were transferred to A. Less than three years later, A sold the shares to an unrelated party. Corporation Z did not make any distributions with respect to the shares exchanged for A's promissory note at any time before the sale of the shares to the unrelated party.

The Service held that the owner of a grantor trust is not merely taxable on a trust's income, but is treated as the owner of the trust's assets for federal income tax purposes, citing Ringwalt v. United States, 549 F.2d 89 (8th Cir. 1977), cert. denied, 432 U.S. 906 (1977); Estate of O'Connor v. Commissioner, 69 T.C. 165 (1977); Treas. Reg. § 1.1001-2(c), Example 5; Rev. Rul. 81-98, 1981-1 C.B. 40; Rev. Rul. 78-175, 1978-1 C.B. 144; Rev. Rul. 77-402, 1977-2 C.B. 222; Rev. Rul. 74-613, 1974-2 C.B. 153; Rev. Rul. 72-471, 1972-2 C.B. 201; Rev. Rul. 70-376, 1970-2 C.B. 164; and Rev. Rul. 66-159, 1966-1 C.B. 162; but cf. Rev. Rul. 74-243, 1974-1 C.B. 107.

Rev. Rul. 85-13 states that although A did not engage in a direct borrowing of the Corporation Z shares, A's acquisition of the T corpus in exchange for the unsecured note was, in substance, the economic equivalent of borrowing trust corpus. Accordingly, under § 675(3), A was treated as owner of the portion of T represented by A's

promissory note. Further, because the promissory note was T's only asset, A was treated as owner of the entire trust. Moreover, because A was considered owner of the promissory note held by the trust, the transfer of the Corporation Z shares by T to A was not recognized as a sale for federal income tax purposes because A was both the maker and owner of the promissory note. Citing Dobson v. Commissioner, 1 B.T.A. 1082 (1925), the ruling states that a transaction cannot be recognized as a sale for federal income tax purposes if the same person is treated as owning the purported consideration both before and after the transaction.

### CONCLUSION

Based solely on the facts submitted and representations made, we conclude that because A has a power exercisable by herself to vest the proceeds from the sale of Subtrust's LLC interests in herself and that those proceeds are Subtrust's only asset, A will be treated as the owner of Subtrust under § 678. Consequently, the transfer of the LLC interests to Trust 2 is not recognized as a sale for federal income tax purposes because Trust 2 and Subtrust are both wholly owned by A.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the transaction described above under any other provision of the Code. Specifically, this ruling is conditioned upon Trust 2 being a grantor trust as to A and A having the authority to withdraw the promissory note from Subtrust. If these facts are not as represented by Trust 1, then this ruling is null and void.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

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

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Adrienne M. Mikolashek  
Branch Chief, Branch 3  
(Passthroughs & Special Industries)

Enclosure (2):

Copy of this letter  
Copy of this letter for § 6110 purposes

cc: