

**Internal Revenue Service**

Department of the Treasury

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Washington, D.C. 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:IT&A:1

Date:

December 23, 1998

Number: **199912026**  
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Re: Letter Ruling Request Regarding the Exclusion of Gain from the Sale of a Residence by a Grantor Trust

LEGEND:

Taxpayer =

Residence =

Trust =

Spouse =

Date 1 =

Date 2 =

Date 3 =

Dear :

This responds to a letter dated August 10, 1998, requesting rulings on whether Taxpayer will be treated as the owner of the Residence for federal income tax purposes under sections 676 and 671 of the Internal Revenue Code ("the Code") and whether Taxpayer will be considered the owner of the Residence for purposes of excluding from gross income gain from the sale of a principal residence under section 121 of the Code.

## FACTS

On Date 1, Taxpayer, as Settlor, created the Trust. The Trust instrument contains the following relevant provisions:

Article I, paragraph 1.10, provides that the Trust may be amended, altered, revoked or terminated by the Settlor.

Article II, paragraph 2.10, provides that the Trust is created subject to the express condition and reservation by the Settlor that the trust indenture, or any provision or provisions thereof, may be amended, altered, revoked or terminated by the Settlor at any time or times, in whole or in part.

The Trust presently holds fee simple title to the Residence. Taxpayer and Spouse have lived in the Residence since Date 2. Taxpayer, as trustee, plans to sell the Residence on or before Date 3.

## OWNERSHIP OF TRUST PROPERTY FOR INCOME TAX PURPOSES

Section 671 of the Code provides the general rule that when the grantor or another person is treated as the owner of any portion of a trust, there will 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 in computing taxable income or credits against the tax of an individual.

Sections 673 through 677 of the Code specify the circumstances under which the grantor is treated as the owner of any portion of a trust.

Section 1.671-3(a) of the Income Tax Regulations provides that when a grantor or another person is treated under subpart E (section 671 and following) as the owner of any portion of a trust, there are included in computing the taxpayer's income tax liability those items of income, deduction, and credit against tax attributable to or included in that portion. For example, if a grantor or another person is treated as the owner of an entire trust (corpus as well as ordinary income), that taxpayer takes into account in computing the taxpayer's income tax liability all items of income, deduction, and credit (including capital gains and losses) to which the taxpayer would have been entitled had the trust not been in existence during the period the taxpayer is treated as the owner.

Section 676(a) of the Code provides that the grantor will be treated as the owner of any portion of a trust, whether or not the grantor is treated as such owner under any other provision of subpart E, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

Under the terms of the Trust, Taxpayer has retained the power to revest in Taxpayer title to the corpus of the Trust. Accordingly, Taxpayer will be considered the owner of the entire Trust (including the Residence) under sections 676(a) and 671 of the Code.

#### 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 gross income under section 121(a) with respect to any sale or exchange will not exceed \$250,000.

Section 121(b)(2)(A) of the Code provides that in the case of a husband and wife who make a joint return for the taxable year of the sale or exchange of property, the exclusion amount in section 121(b)(1) is increased to \$500,000 if-- (1) either spouse meets the ownership requirements of section 121(a) with respect to such property, (2) both spouses meet the use requirements of section 121(a) with respect to such property, and (3) neither spouse is ineligible for the benefits of section 121(a) with respect to such property by reason of section 121(b)(3).

Section 121(b)(3) provides the general rule that section 121(a) will not apply to any sale or exchange by the taxpayer if, during the 2-year period ending on the date of such sale or exchange, there was any other sale or exchange by the taxpayer to which subsection 121(a) applied.

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 deferral 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.

The reasoning of Rev. Rul. 85-45 is still valid even though section 121 has been substantially amended. In the present case, because Taxpayer will be considered the owner of the entire Trust (including the Residence) under sections 676(a) and 671, Taxpayer will be treated as the owner of the Residence for purposes of satisfying the ownership requirements of section 121 of the Code.

Based on the facts as represented and the relevant law and regulations as set forth above, we conclude as follows:

1. Taxpayer will be considered the owner of the entire Trust under sections 676(a) and 671 of the Code.
2. Taxpayer will be treated as the owner of the Residence for purposes of satisfying the ownership requirements of section 121 of the Code.

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. In addition, no opinion is expressed or implied as to whether Taxpayer and Spouse have used the Residence as their principal residence.

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. The rulings contained in this letter are 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 request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, the original of this letter is being sent to your representative.

Sincerely,

DAVID B. AUCLAIR  
Assistant to the Chief, Branch 1  
Office of Assistant Chief Counsel  
(Income Tax & Accounting)

Enclosures (2):

Copy of this letter

Copy of section 6110 purposes