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Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: December 27, 1991
September 27, 1991

Section 897 -- Disposition of Investment in United States Real Property

897.00-00

897.05-00

CC:INTL:Br4-196-91

LEGEND:

Trust = * * *

Corp X = * * *

Corp Y = * * *

A = * * *

B = * * *

Country M = * * *

Dear * * *

This is in response to a letter dated February 13, 1991, that you submitted on behalf of the Trust and that requested certain rulings pursuant to section 897(e) of the Internal Revenue Code and section 1.897-6T(b) of the Temporary Income Tax Regulations. Additional information was received in letters dated April 15, May 10, and July 3, 1991.

The ruling contained in this letter is predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of this request for a ruling. Verification of the factual information, representations and other data may be required as a part of the audit process.

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The Trust was created in the United States by A, a parent of B, in 1939. A was not a U.S. citizen or resident at the time of the creation of the Trust, and A has not become a U.S. citizen or resident in the interim. The original Trust corpus consisted of shares of Corp X, a U.S. corporation, and portfolio holdings of publicly traded U.S. and Canadian companies. The Trust has had no other contributions of property since its creation; however, other assets have been acquired by the Trust.

In 1955, as permitted by the Trust document, the situs of the Trust was transferred to Canada. Control continued to be exercised by a U.S. Advisor until 1978, at which time the control was transferred to a Canadian Advisor. The Trust Advisor has sole discretionary authority to distribute the income and the corpus of the Trust during the life of B and any of B's descendants, as well as to appoint the Trustee. The annual income of the Trust consists primarily of U.S. source interest and dividend income that is subject to U.S. withholding tax and Canadian income tax.

The Trust will terminate 21 years after the death of the survivor of A and B, both of whom are still living. A is a citizen and resident of Country M. All of the beneficiaries (Beneficiaries) of the Trust, including B, are Canadian citizens and residents. None of the Beneficiaries of the Trust are resident aliens or citizens of the United States for U.S. tax purposes.

It is represented that the Trust is not a grantor trust within the meaning of section 671 of the Code and that it is a foreign trust as defined by section 7701(a)(31).

The Trust owns approximately 69 percent of the common stock of Corp X. The remaining shares of Corp X are owned, directly or indirectly, by other family members of A and B.

Corp X was incorporated in 1931. Its primary business objective has been to maximize earnings through a variety of investments including publicly traded corporations, bonds, other securities, real estate partnerships, oil and gas partnerships and other business ventures. The shares of Corp X held by the Trust are not subject to any liabilities.

Corp Y was incorporated in Canada by the Beneficiaries in 1987.

It is proposed that the Trust distribute to the Beneficiaries, in equal portions, all of the shares of Corp X owned by the Trust. Such distribution would be made with no consideration to be received from the Beneficiaries by the Trust, and there will be no assumption of any debt by any of the Beneficiaries. The Beneficiaries will all remain beneficiaries of the Trust which will remain in existence subsequent to the proposed distribution and will continue to conduct its remaining investment activities.

Immediately after the distribution of Corp X shares by the Trust, each Beneficiary proposes to transfer all of the shares of Corp X received from the Trust to Corp Y solely in exchange for shares of Corp Y.

It is represented that there is a valid business purpose for the proposed

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transaction.

It is represented that:

(a) The Trust will not elect to recognize any gain or loss as a result of the distribution under section 643(e)(3).

(b) No gain would otherwise be required to be recognized by the Trust on the distribution of Corp X shares under section 661 and section 1.661(a)-2(f) because the distribution would not be in satisfaction of any Beneficiary's right to receive a distribution in a specific dollar amount or specific property other than that distributed.

(c) The distributable net income (DNI) of the Trust would be computed pursuant to the provisions of section 643(a) in order to determine the Beneficiaries' income inclusion and the Trust's income deduction for the purposes of sections 662(a)(2) and 661(a)(2). As a result of section 662(b), the Beneficiaries will not be required to include any amounts in income with respect to such distribution since the DNI of the Trust consists of U.S. source dividend or interest income (which has already been subject to U.S. withholding tax at the source) or foreign source income not subject to U.S. tax.

(d) The adjusted basis of the Corp X shares in the hands of Beneficiaries immediately after the distribution from the Trust will, in the aggregate, be equal to the adjusted basis of the Corp X shares in the hands the Trust immediately before the distribution. Section 643(e)(1) of the Code.

(e) Each Beneficiary will receive an equal number of Corp X shares.

The Trust has represented that it will not make the election under section 643(e) of the Code. Thus, the Trust's distribution of Corp X stock to the Beneficiaries will not cause the Trust to realize gain or loss under section 1.661(a)-2(f)(1) of the regulations, provided that the distribution is not in satisfaction of a right to receive a distribution in a specific dollar amount or in specific property other than that distributed.

Under section 643(e)(2) of the code, the amount taken into account for purposes of section 662 is the lesser of the basis of such property in the hands of the beneficiary or the fair market value of the property. In this case, the amount taken into account under section 662 for each beneficiary will be the basis of the stock distributed. The amount included in gross income of each beneficiary will be limited to the beneficiary's share of the Trust's DNI. Under section 662(b), the Trust income retains the same character in the hands of the beneficiaries as it had in the Trust. The Trust has represented that the Trust's gross income taken into account for purposes of computing DNI consists of: (1) foreign source income and (2) U.S. source interest and dividend income described under section 871(a)(1) that is subject to withholding under section 1441. Therefore, the amount included in each beneficiary's gross income will be treated as consisting of the same proportion of foreign source income or United States source interest or dividend income as the total of each class bears to the Trust's total DNI. The Beneficiaries will not be liable for tax on the amount treated as foreign source income. In addition, each beneficiary will receive the benefit of withholding on that portion treated as United States source interest and dividend income. Section 1462 of the Code.

Pursuant to section 643(e)(1) of the Code, the basis of the shares of Corp X Stock in the hands of the Beneficiaries will be the adjusted basis of the property

in the hands of the Trust immediately before the distribution.

The Trust instrument authorizes the Trust Adviser to make non-pro rata distributions of the Trust corpus. The only property to be distributed in kind from the Trust in this transaction is shares of Corp X stock. The distribution of the shares of Corp X stock is pro rata to the Beneficiaries. None of these beneficiaries are relinquishing an interest in the Trust in exchange for the distribution. Rev. Rul. 69-486 does not apply on these facts. None of the Beneficiaries has income or gain due to a relinquishment of an interest in the Trust on the stock distributed.

Section 897(a) of the Code provides, in part, that gain or loss of a nonresident alien individual (including a foreign trust) or a foreign corporation from the disposition of a United States real property interest (USRPI) shall be taken into account as if the taxpayer were engaged in a trade or business within the United States during the taxable year and as if such gain or loss were effectively connected with such trade or business. Also see section 1.897-9T(c) of the temporary regulations.

Since it has not been established that Corp X was not a U.S. real property holding Company (USRPHC) within the meaning of section 897(c)(2) of the code within the five year period preceding the distribution, Corp X will be treated as a USRPHC pursuant to section 897(c)(1)(A)(ii) and section 1.897-1(c)(1) of the regulations. Accordingly, the stock in Corp X owned by the Trust is considered to be a USRPI.

Section 897(e)(1) of the Code provides that except to the extent otherwise provided in sections 897(d) and 897(e)(2), any nonrecognition provision shall apply for purposes of this section to a transaction only in the case of an exchange of a USRPI for an interest the sale of which would be subject to taxation under this Chapter. Section 1.897-6T(a)(1) of the temporary regulations provides, in part, that, for purposes of section 897(e), any nonrecognition provision shall apply to a transfer by a foreign person of a USRPI only to the extent a USRPI is received in the exchange. The distribution of the stock of Corp X by the Trust is subject to the provisions of section 897(e)(1).

Section 897(e)(2) provides that the Secretary shall prescribe regulations providing the extent to which distributions from a partnership, trust or estate shall be treated as sale of property at fair market value. Regulations have not been issued under section 897(e)(2)(B) concerning when the distribution of USRPI by a foreign trust may be made without the recognition of gain. However, in Announcement 89-124, the Service stated that it would consider, on a case by case basis, requests for private letter rulings dealing with the extent to which nonrecognition provisions will apply under section 897(e) to a foreign trust and to foreign beneficiaries of a foreign trust on a distribution of a USRPI by the trust.

Accordingly, based solely on the representations made and the facts submitted, and provided that the taxpayers comply with the filing requirements of section 1.897-5T(d)(1)(ii), as clarified by Notice 89-57, and further provided that there is no currently outstanding obligation of the Trust to distribute shares of Corp X to A, it is held that:

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(1) The Trust and the Beneficiaries will not recognize any gain under section 897(e)(1) on the distribution of the Corp X shares to the Beneficiaries (Announcement 89-124); and

(2) Provided that the basis of the Corp X stock in the hands of the Beneficiaries is the same as the basis of the Corp X stock in the hands of the Trust, the Beneficiaries are entitled to claim the benefits of Article 13(9) of the U.S.-Canada Income Tax Treaty with respect to a disposition of the Corp X stock (Announcement 89-124).

No opinion is expressed about the tax treatment of the exchange by the Beneficiaries of the Corp X shares received from the Trust for shares of Corp Y. This exchange may be the subject of a separate letter from the Service. In addition, no opinion is expressed regarding the tax treatment of the proposed transaction under other sections of the code or regulations that may be applicable, or the tax treatment of any items existing as the time of, or resulting from, the proposed transaction that are not specifically covered by the above ruling.

This letter is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to any federal income tax return to which it is relevant.

Sincerely yours,

Charles P. Besecky

Senior Technical Reviewer Branch 4

Office of the Associate Chief Counsel (International)

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

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