SIG # 402.07-00

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

199919039

Contact Person:
xxxxx
Telephone Number:
xxxxx
In Reference to:
OP:E:EP:T:2/xxxxx
Date:
FEB 16 1999

xxxxx
xxxxx
xxxxx

Legend:

Corporation A = xxxxx
Corporation B = xxxxx

Plan X = xxxxx

Plan Y = xxxxx

Spouse = xxxxx

Dear xxxxx:

This letter is in response to a request dated April 17, 1998, as supplemented by correspondence dated October 20 and 23, and December 1, 1998, made on your behalf by your authorized representative, for rulings regarding the Federal income tax consequences of several transactions proposed with regard to certain pension benefits.

Your request for rulings is based upon the following facts and representations:

On xxxxx, 1997, in a tax-free merger under section 368 of the Internal Revenue Code, Corporation A merged into Corporation B. Before the merger, you were the President and Chief Executive Officer (CEO) of Corporation A. You also were a member of the Board of Directors of Corporation A. Since the merger, you are simultaneously the Vice-Chairman of Corporation B and the CEO of certain Corporation A businesses which, as a result of the merger, are administered as a division of Corporation B. You also are a member of the Board of Directors of Corporation B.

You intend to separate from the service of Corporation B on or before December 31, 1998. Your date of birth is October 9, 1942, thus, you have attained age 55 but will not have attained age 59 1/2 by December 31, 1998.

You intend to remain a member of the Board of Directors of Corporation B in calendar year 1999. Subsequent to your separation from the service of Corporation B, you will perform the duties of Board member as an independent contractor.

On January 1, 1989, Corporation B established Plan Y for the benefit of its employees. Plan Y is a profit-sharing plan with a cash or deferred arrangement described in section 401(k)(2) of the Code (CODA). Plan Y is a qualified plan under section 401(a) of the Code and its trust is tax-exempt under section 501(a) of the Code. You are a participant in Plan Y and intend to receive a distribution from Plan Y upon your retirement from Corporation B. Corporation B made a profit-sharing contribution to your account for the 1997 plan year and will make a profit-sharing contribution to your account for the 1998 plan year, however, payment of such contribution will not be made until the 1999 calendar year.

While an employee of Corporation A you participated in Plan X for 5 or more taxable years. On January 1, 1997, Corporation A amended and restated Plan X to merge its employee stock ownership plan (within the meaning of section 4975(e)) with the profit-sharing plan and CODA. On January 2, 1998, Plan X was merged into Plan Y. At the time of the plan merger, Plan X was a qualified plan under section 401(a) of the Code and its trust was tax-exempt under section 501(a) of the Code.

At the time of the corporate merger, Corporation A and Corporation B each had one class of stock in its authorized capital. One hundred percent of the outstanding stock of Corporation A was exchanged for Corporation B stock. The exchange ratio was xxx share of Corporation B stock (Stock B) for xxx share of Corporation A stock (Stock A). Stock B is listed on the NASDAQ system and is traded "over-the-counter".

On the date of the plan merger, one hundred percent of your account balance in Plan X was in the form of Stock A at $xxx a share. Your account balance in Plan X was exchanged for xxx shares of Stock B at the ratio in effect for the corporate merger. The value of Stock A as to cost basis with such basis representing both employer and employee contributions and with such basis being calculated according to the moving average method set forth in section 1.401(a)-1(b)(2)(ii) of the Income Tax Regulations and the value of Stock A as to fair market value on the date of the plan merger was calculated. The fair market value of your

account balance in Plan X on the date of the plan merger was determined to equal $xxx.

Plan Y does not permit in-kind distributions. Pursuant to subparagraph (d) of section 5.8 and Appendix A of Plan Y, Plan Y participants who are former Plan X participants may withdraw Stock B from the merger conversion. Plan Y allows such withdrawal of stock from the merger conversion as a protected benefit under section 411(d)(6) of the Code.

You intend to have a trustee-to-trustee transfer from Plan Y to an individual retirement arrangement (IRA) of a portion of your balance in Plan Y.

As to the portion of your account balance in Plan Y that is not rolled over into an IRA, he proposes to contribute some part of it to a charitable remainder unitrust (CRUT) as described herein. The contribution of stock to the CRUT will not exceed 10 percent in value of all the outstanding stock in Corporation B and the CRUT will comply with section 664 of the Code. Funds from the CRUT will be paid to you and your Spouse for your joint lives and then to the survivor. On the death of the last to die of you and your Spouse, the CRUT corpus will be paid to a charity. The initial trustee of the CRUT will be an individual who is unrelated to you or your Spouse. If section 170(e)(5) of the Code, or a similar provision which allows a charitable deduction for a contribution of appreciated property to a private foundation based upon the full fair market value of the contributed property, is in effect at the time of the creation of the CRUT, the remainder beneficiary of the CRUT will be a foundation established in the names of both you and your Spouse, or a qualified charitable organization designated at the time of death of the last to die of you and your Spouse. If section 170(e)(5) is not in effect at the date of the creation of the CRUT, the charitable beneficiary will be a public charity defined in section 501(c)(3) of the Code.

Based on the above facts and representations, you have requested the following rulings:

With respect to the qualified plans:

1. Any portion of Stock B and cash distribution that are rolled over, as described, to an IRA on your behalf will qualify as a tax-free rollover under sections 402(c)(1) and 401(a)(31) of the Code and no income tax withholding will be required for such trustee-to-trustee transfer.

2. The distribution in 1998 of your entire Plan Y account balance will meet the requirement of a distribution, within one year, of the receipt of the balance to the credit of your Plan Y account within the meaning of section 402(e)(4)(D)(i) of the Code, despite the profit-sharing contribution payable to you in 1999 for the 1998 plan year. (Note: Section 402(e)(4)(D)(i) of the Code, as cited in ruling request one, is effective for tax years beginning after 12/31/99.)

3. Net unrealized appreciation (NUA) within the meaning of section 402(e)(4) of the Code is the difference between the cost basis and the fair market value on the plan distribution date of non-rolled over stock, thus, you will not recognize ordinary income under section 402(e)(4)(B) of the Code on that portion of non-rolled over stock representing NUA.

4. For purposes of calculating NUA on the Plan Y distribution, Stock B allocated to your account in Plan Y at the time of the plan merger has a cost basis that is equal to the total cost basis of Stock A allocated to your account in Plan X immediately prior to the plan merger.

Please note that we are unable to rule on ruling request 4 because the request involves a finding of fact. Section 8.01 of Revenue Procedure 99-4, 1999-1 I.R.B. 115 provides that the Service will not issue letter rulings that constitute finding of fact.

5. (a) Any taxable gain on the subsequent sale of the non-rolled over stock will be treated as capital gain income on the sale of a capital asset held in excess of 18 months, to the extent of the original NUA, regardless of the time period between the sale date.

(b) Post-distribution gain in excess of the NUA amount will be taxed at the applicable capital gain rate based on the holding period of the stock from the distribution date to the sale date.

6. No portion of the Plan Y distribution will be subject to the 10 percent early distribution penalty under section 72(t)(1) of the Code because it will meet the exception under section 72(t)(2)(A)(v) for distributions made to an individual after separation from service after attaining age 55.

With respect to the CRUT:

7. You will not recognize any immediate taxable income, gain or loss from the act of contributing stock received from the qualified plan to the CRUT.

8. You will receive an income and gift tax charitable deduction for the contribution of the non-rollover shares to the CRUT equal to the fair market value of the stock at the time of transfer less the present value of your and your Spouse's retained unitrust interest.

9. The stock transferred to the CRUT will retain your cost basis and holding period for purposes of any subsequent sale by the CRUT.

10. The retained interest paid to you and your Spouse by the CRUT will be characterized under section 664 of the Code in the following order:

1) Income (other than gains from sale of capital assets) includable in gross income for the particular year and previously undistributed from prior years, to the extent of any, then;

2) Short-term capital gain for the particular year and previously undistributed from prior years, to the extent of any, then;

3) Mid-term capital gain (capital assets held between 12 and 18 months) for the particular year and previously undistributed from prior years, to the extent of any, then;

4) Long-term capital gain for the particular year and previously undistributed from prior years, to the extent of any, then;

5) Other income for the particular year and previously undistributed from prior years, to the extent of any, then;

6) distribution of trust corpus.

11. The gain from any subsequent sale by the CRUT of the non-rollover stock will be exempt from immediate direct taxation to either the CRUT (assuming the CRUT does not have unrelated trade or business income in the year of the sale) or to you or your Spouse. The amount of any gain to the extent of the NUA, from the sale of the non-rollover shares will be characterized as capital gain income from the sale of a capital asset held in excess of 18 months for purposes of the distribution characterization rules described in

ruling request 10. Gain in excess of the NUA will be characterized according to the holding period of the stock from the distribution date to the sale date.

As to the rollover to an IRA, section 402(c)(1) of the Code states that if--

(A) any portion of the balance to the credit of an employee in a qualified trust is paid to the employee in an eligible rollover distribution,

(B) the distributee transfers any portion of the property received in such distribution to an eligible retirement plan, and

(C) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

Section 402(c)(8)(A) of the Code defines the term "qualified trust" as an employees' trust described in section 401(a) of the Code which is exempt from tax under section 501(a). Section 402(c)(8)(B) of the Code provides that an individual retirement account described in section 408(a) is an "eligible retirement plan".

Section 401(a)(31)(A) of the Code provides that, in general, a trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution elects to have such distribution paid directly to an eligible retirement plan, and specifies the eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe), such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

For purposes of sections 402(c) and 401(a)(31) of the Code, section 402(c)(4) provides that the term "eligible rollover distribution" means any distribution (with the exceptions of certain equal periodic payments and distributions required under section 401(a)(9) of the Code) to an employee of all or any portion of the balance to the credit of the employee in a qualified trust.

Section 1.401(a)(31)-1 Q&A-5 of the Regulations provides that an eligible rollover distribution that is paid to an eligible retirement plan in a direct rollover is not currently includible in the distributee's gross income under section 402(c) of the Code and is exempt from the 20-percent withholding imposed under section 3405(c)(2) of the Code. However, when any portion of the eligible rollover distribution is subsequently distributed from the eligible retirement plan, that portion will be includible in gross income to the extent required under section 402, 403 or 408 of the Code.

Accordingly with respect to ruling request 1, we conclude that any portion of Stock B and cash distribution that is rolled over, as described herein, to an IRA will qualify as a tax-free rollover under sections 402(c)(1) and 401(a)(31) of the Code and no income tax withholding will be required for such trustee-to-trustee transfer to the IRA.

As to the 1998 distribution from Plan Y, section 402(a) of the Code states that any amount actually distributed to any distributee by an employees' trust described in section 401(a) of the Code which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

Section 402(d)(1) of the Code sets forth an exception to the general rule of section 402(a) of the Code by imposing a separate tax on "lump sum distributions". Sections 402(d)(1)(A) and (B) of the Code provide that there is a tax on a "lump sum distribution" as defined in section 402(d)(4)(A), the amount of which is equal to 5 times the tax which would be imposed by subsection (c) of section 1 if the recipient were an individual referred to in such subsection and the taxable income were an amount equal to 1/5 of the excess of the total taxable amount of the lump sum distribution for the taxable year, over the minimum distribution allowance.

Section 402(d)(4)(A) of the Code defines a "lump sum distribution" as the distribution or payment within 1 taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient--

(i) on account of the employee's death,

(ii) after the employee attains age 59 1/2,

(iii) on account of the employee's separation from service, or

(iv) after the employee has become disabled (within the meaning of section 72(m)(7) of the Code,

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a) of the Code.

Section 1.402(a)-(1)(a)(6)(ii) of the Regulations provides, in part, that a distribution on account of separation from service will not receive capital gains treatment unless the distribution constitutes the total amount in the employee's account at the time of the separation from service. If the total amount in an employee's account at the time of his death, other separation from service or death after separation from service is paid or includible in the gross income of the distributee within one taxable year of the distributee, such amount is entitled to capital gains treatment notwithstanding that in a later taxable year an additional amount, attributable to the last year of service, is credited to the account of the employee and distributed.

Section 402(d)(4)(F) of the Code provides that no amount distributed to an employee from or under a plan may be treated as a lump sum distribution under subparagraph (A) unless the employee has been a participant in the plan for 5 or more taxable years before the taxable year in which such amounts are distributed.

Section 402(e)(4)(B) of the Code expands on section 402(d)(1) to provide that, for purposes of sections 402(a) and 72, in the case of a lump sum distribution which includes securities of the employer corporation, there shall be excluded from gross income the NUA attributable to that part of the distribution which consists of securities of the employer corporation.

Accordingly, with respect to ruling request 2, assuming that you satisfy the Code requirements for separation from the service of Corporation B for purposes of a lump sum distribution, we conclude that the distribution in 1998 of your entire account balance in Plan Y will meet the requirements of a distribution, within one taxable year of the recipient, of the balance to the credit of your account in Plan Y within the meaning of sections 402(d)(4)(A) and 402(e)(4)(D) of the Code, despite the profit-sharing contribution from Plan Y that is payable to you in 1999 for the 1998 plan year.

With respect to NUA, section 1.402(a)-1(b)(2)(i) of the Regulations provides that the amount of NUA in securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust. Thus, if a distribution consists in part of securities which have appreciated in value and in part of securities which have depreciated in value, the NUA shall be considered to consist of the net increase in value of all of the securities included in the distribution.

Section 402(e)(4)(C) of the Code provides that, for purposes of subparagraph (B), NUA and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Treasury Secretary.

Accordingly, with respect to ruling request 3, we conclude that NUA within the meaning of section 402(e)(4) of the Code is the difference between the cost basis and the fair market value on the plan distribution date of non-rolled over stock, thus, you will not recognize ordinary income under section 402(e)(4)(B) of the Code on that portion of non-rolled over stock representing NUA.

Please refer to page 4 regarding ruling request 4.

As to ruling request 5, section 402(e)(4)(B) of the Code provides that where a lump sum distribution includes securities of the employer corporation, the NUA attributable to such distributed securities shall be excluded from gross income.

Notice 98-24, 1998-17 I.R.B. 5 provides that the amount of NUA which is not included in the basis of the securities in the hands of the distributee at the time of distribution is considered a gain from the sale or exchange of a capital asset held for more than 18 months to the extent that such appreciation is realized in a subsequent taxable transaction. The actual period that an employer security was held by a qualified plan need not be calculated in order to determine whether, with respect to the NUA, the disposition qualifies for the rate for capital assets held for more than 18 months. However, with respect to any further appreciation in the employer securities after distribution from the plan, the actual holding period in the hands of the distributee determines the capital gains rate that applies.

Accordingly, with respect to ruling request 5, we conclude that any taxable gain on the subsequent sale of the non-rolled over stock distributed, as described, from Plan Y

will be treated as capital gain income on the sale of a capital asset held in excess of 18 months, to the extent of the original NUA, regardless of the time period between the date of distribution from Plan Y and the date of sale provided that the current law is in effect at the time of such sale. We conclude further that any post-distribution gain in excess of the NUA amount will be taxed at the applicable capital gain rate based on the actual holding period of the stock from the date of distribution from Plan Y and the date of sale provided that the current law is in effect at the time of such sale.

Section 72(t)(1) of the Code provides that if any taxpayer receives any amount from a qualified retirement plan as defined in section 4974(c) of the Code, including a plan qualified under section 401(a) of the Code, the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

Section 72(t)(2) of the Code sets forth several distribution situations that are excepted from the tax imposed by section 72(t)(1). Section 72(t)(2) provides in subparagraph (v) that, in general, distributions which are made to an employee after separation from service after attainment of age 55 are excepted from the tax imposed by section 72(t)(1).

You represent that you meet the age requirement set forth in section 72(t)(2)(A)(v) of the Code. Accordingly, with respect to ruling request 6, assuming you satisfy the requirements for separation from the service of Corporation B, we conclude that the requirements under section 72(t)(2)(A)(v) of the Code have been met and that no portion of the Plan Y distribution, as described, will be subject to the 10 percent early distribution penalty under section 72(t)(1) of the Code.

With respect to ruling request 7, a donor, generally, will not recognize gain or loss as a result of a charitable gift. The case of Palmer v. Comm'r. 62 T.C. 684 (1974), provides an example of the fact that a donor does not normally recognize gain on the contribution of appreciated property to charity. See also, Rev. Rul. 78-197, 1978-1 C.B. 83.

Accordingly, assuming that the trust qualifies as a CRUT under section 664 of the Code, we conclude with respect to ruling request 7, that you will not recognize gain or loss as a result of the transfer of stock to the CRUT.

With respect to the gift tax issue of ruling request 8, section 2501 of the Code imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual. Section 2511(a) of the Code provides that the Federal gift tax shall apply whether a transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2522(a) of the Code provides that, in computing an individual's taxable gifts for the calendar year, a deduction shall be allowed for the amount of all gifts to or for the use of certain governmental entities, certain corporations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, and certain other fraternal and veterans organizations.

Section 2522(c)(2)(A) of the Code provides that, where a transfer is made to both a charitable and a noncharitable person or entity, no deduction shall be allowed for the interest passing to charity unless in the case of a remainder interest such interest is in a trust which is a charitable remainder annuity trust or a CRUT described in section 664 of the Code.

Section 664(d)(2) of the Code, as amended by the Tax Reform Act of 1986, defines a CRUT, generally, as a trust--

> (A) from which a fixed percentage (which is not less than 5 percent or more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) of the Code and, in the case of individuals, only to an individual who is living at the time of creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,
>
> (B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 170,
>
> (C) following the termination of the payments described in subparagraph (A) the remainder interest in the

trust is to be transferred to, or for the use of, an organization described in section 170(c) of the Code or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4), all or part of such securities are to be transferred to an ESOP (as defined in section 4975(e)(7) of the Code) in a qualified gratuitous transfer (as defined by subsection (g))

(D) with respect to each contribution of property to the trust, the value (determined under section 7520 of the Code) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Under section 7520(a) of the Code, for estate, gift and income tax purposes, the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest shall be determined (1) under tables prescribed by the Secretary, and (2) by using an interest rate rounded to the nearest 2/10ths of 1 percent equal to 120 percent of the Federal midterm rate in effect under section 1274(d)(1) for the month in which the valuation date fails.

Accordingly, with respect to the gift tax issue of ruling request 8, we conclude that if the CRUT satisfies the requirements of section 664 of the Code and the applicable regulations, then a gift tax charitable deduction will be allowed for the present value of the remainder interest passing to charity, determined in accordance with section 25.2522(c)-3(d)(2)(ii) of the Regulations. No ruling is issued as to whether or not the proposed CRUT satisfies the requirements of section 664.

With respect to the income tax issue of ruling request 8, section 170 of the Code permits a deduction for any charitable contribution payment which is made within the taxable year. Section 1.170A-1(c)(1) of the Regulations provides that, if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, reduced as provided in section 170(e)(1) of the Code and section 1.170A-4(a) of the Regulations.

Section 170(f)(2) of the Code provides that no deduction is allowed under section 170 for the value of a remainder interest unless the trust is a charitable remainder annuity trust or CRUT described in section 664 of

the Code. In the present case, because we are assuming that the CRUT meets the requirements of section 664, your contribution of a remainder interest to the CRUT will qualify for a charitable contribution deduction under section 170.

Under Revenue Ruling 79-368, 1979-2 C.B. 109, the deduction allowed for the value of the remainder interest in property transferred to a CRUT is subject to the percentage limitations set forth in section 170(b)(1)(B) of the Code where the grantor or a recipient of the CRUT amount has the power to designate a remainder beneficiary that must be a charitable organization described in section 170(c) but need not be an organization described in section 170(b)(1)(A). In the present case, because the remainder beneficiary may be a private foundation other than a private foundation described in section 170(b)(1)(E), the deduction will also be subject to the limitation in section 170(e)(1)(B)(ii).

Section 170(e)(1(B)(ii) of the Code provides that in the case of a charitable contribution to or for the use of a private foundation (defined in section 509(a)) other than a private foundation described in section 170(b)(1)0(E), the amount of the charitable contribution of property otherwise taken into account under section 170 is reduced by the amount of gain that would have been long-term capital gain if the property had been sold at its fair market value (determined at the time of the contribution).

Section 170(e)(5) of the Code provides an exception to this rule in the case of the contribution of "qualified appreciated stock," which is defined in subparagraph (B) as stock--

(i) for which (as of the date of the contribution) market quotations are readily available on an established securities market, and

(ii) which is capital gain property (as defined in section 170(b)(1)(C)(iv)).

We address the latter requirement first. "Capital gain property" is defined in section 170(b)(1)(C)(iv) of the Code as any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain that would have been long-term capital gain. Section 1221 of the Code defines a capital asset as property held by the taxpayer, excluding stock in trade, property held primarily for sale to customers in the ordinary course of the trade or business, and certain other items not relevant here. You represent that the shares to be contributed to

the CRUT are not stock in trade, or held primarily for sale, and that they will have been held for more than one year at the time of the contribution. Further, you represent that the fair market value of the shares at the time of the contribution will exceed the basis. Therefore, the shares constitute capital gain property within the meaning of section 170(b)(1(C)(iv) of the Code and meet the requirement of section 170(e)(5)(B)(ii).

To meet the requirements of section 170(e)(5)(B)(i) of the Code, a stock must have market quotations readily available on an established securities market. In the present case, you represent that the stock is quoted on the NASDAQ system and is publicly traded. Thus, the stock at issue meets the requirements of section 170(e)(5)(B)(i). Therefore, we conclude that the stock is "qualified appreciated stock" for purposes of section 170(e)(5).

In addition, section 170(e)(5)(C)(i) of the Code provides that the "qualified appreciated stock" exception shall not apply if the stock contributed (including the aggregate amount of all prior contributions by the donor of stock in the same corporation) exceeds 10 percent in value of all of the outstanding stock in the corporation. You represent that the stock to be contributed to the CRUT will not exceed the 10 percent limitation. You also represent that you have not made any prior contributions of any shares to the CRUT. Therefore, the limitation of section 170(e)(5)(C)(i) of the Code does not apply. Thus, we conclude that your deduction will not be subject to the provisions of section 170(e)(1)(B)(ii) because of the exception provided in section 170(e)(5) for contributions of qualified appreciated stock.

Accordingly, with respect to the income tax issue of ruling request 8, we conclude that you will receive an income tax charitable deduction, subject to the limitations set forth in section 170(b)(1)(B) and section 170(b)(1)(D), for the contribution of stock to the CRUT equal to the fair market value of the stock at the time of the transfer less the value of your remainder unitrust interest.

With respect to ruling request 9, section 1223(2) of the Code provides that in determining the period for which a taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under Chapter 1 of the Income Tax Code, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his or her hands as it would have in the hands of such other person.

Section 1015 of the Code provides that the basis in property acquired by a transfer in trust shall be the same as it would be in the hands of the grantor, with adjustments for gain or loss recognized. Pursuant to the favorable ruling in this case concerning the application of section 1015, section 1223(2) of the Code will apply.

Accordingly, with respect to ruling request 9, we conclude that under section 1223(2) of the Code the stock transferred to the CRUT will retain your holding period for purposes of any subsequent sale by the CRUT.

As to ruling request 10, section 664(b) of the Code gives guidance on how payments from a CRUT are characterized in the hands of the recipient.

Under section 664(b) of the Code, amounts distributed by a CRUT are considered as having the following characteristics in the hands of the CRUT recipient:

(1) as ordinary income to the extent of the trust's ordinary income for the trust's taxable year and its undistributed ordinary income for prior years,

(2) as capital gain to the extent of the trust's taxable year and its undistributed capital gain for prior years,

(3) as other income to the extent of the trust's other income for the trust's taxable year and its undistributed other income for prior years, and

(4) as a distribution of trust corpus.

Section 1.664-1(d)(1) of the Regulations provides that if, in any taxable year of the trust, the trust has both undistributed short-term capital gain and undistributed long-term capital gain, the short-term capital gain is deemed distributed prior to any long-term capital gain.

The general principle of section 664(b) of the Code is that income subject to the highest federal income tax rate is deemed distributed prior to income subject to progressively lower (or no) Federal income tax rate. Thus, for example, if a CRT has net long-term capital gain in more than one group of long-term capital gain, income from the group of long-term capital gain that is subject to the highest Federal income tax rate is deemed distributed before income from the group of long-term capital gain that is subject to a lower Federal income tax rate.

Accordingly with respect to ruling request 10, we conclude that the retained interest paid to you and your spouse by the CRUT will be characterized under section 664 in the following order:

1) Income (other than gains from sale of capital assets) includable in gross income for the particular year and previously undistributed from prior years, to the extent of any, then;

2) Short-term capital gain for the particular year and previously undistributed from prior years, to the extent of any, then;

3) Mid-term capital gain (capital assets held between 12 and 18 months) for the particular year and previously undistributed from prior years, to the extent of any, then;

4) Long-term capital gain for the particular year and previously undistributed from prior years, to the extent of any, then;

5) Other income for the particular year and previously undistributed from prior years, to the extent of any, then;

6) distribution of trust corpus.

As to ruling request 11, section 664(c) of the Code provides that a CRUT, for any taxable year, is not subject to any tax imposed by Subtitle A, unless the trust, for the year, has unrelated business taxable income (within the meaning of section 512 of the Code, determined as if part III of subchapter F applied to the trust).

Accordingly, with respect to ruling request 11, we conclude that, assuming the CRUT qualifies under section 664 of the Code, the gain from the CRUT's sale of non-rollover stock will not be subject to tax under section 664(c) of the Code if the CRUT does not have any unrelated business income in the year of the sale.

We have made the following assumptions for one or more of rulings 1-11:

1) Plan X and Plan Y each have met the requirements of sections 401(a) and 501(a) of the Code at all times relevant to the rulings requested and will remain so qualified at the time of the transactions described.

2) The merger of Plan X into Plan Y meets the transfer of assets/liabilities requirements of section 414(l) of the Code.

3) You will have separated from service for purposes of section 402(d)(4) of the Code prior to the proposed distribution.

4) The CRUT qualifies as a CRUT under section 664 of the Code; no opinion is expressed as to whether the CRUT actually meets the requirements of such section.

A copy of this letter is being sent to your authorized representative pursuant to a power of attorney on file in this office.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd
Chief, Employee Plans
Technical Branch 2

Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose

cc:
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xxxxx

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xxxxx
xxxxx
xxxxx

District Director
xxxxx Key District Office
Chief, Employee Plans Division