

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:EEE:EB:QP3
PLR-111319-21

Date:
November 12, 2021

Legend:

Taxpayer =
Company A =
Trust T =

Dear Mr. Reynolds:

This letter responds to your letter dated _____, as amended by correspondences dated _____, and _____, which were all submitted on your behalf by your authorized representative concerning whether the transfer of qualified replacement property (QRP), as defined in section 1042(c)(4) of the Internal Revenue Code (Code), to and from a grantor trust would result in a disposition of the QRP under section 1042(e).

The following facts and representations have been submitted under penalties of perjury in support of your request:

Trust T was created on _____, and was amended and restated _____, with Taxpayer having sole ownership and control as trustee with the power to amend or revoke the trust agreement at any time.

Taxpayer has, since the inception of Trust T, held a reversionary interest of _____ % in the value of any assets placed in Trust T. Moreover, Taxpayer reserves the right to withdraw assets, whether income or principal, from Trust T.

As stated in Trust T's terms, Taxpayer has the power to direct any act of administration, even if contrary to the terms of Trust T. Also, Taxpayer has the right to direct the trustees to make distributions during Taxpayer's lifetime to any persons named by Taxpayer.

Taxpayer represents that Trust T is a grantor trust within the meaning of sections 671 to 677, that Taxpayer has no intention of relinquishing any powers during the term of Trust T that would cause Trust T to be disqualified as a grantor trust, and that Trust T will continue to qualify as a grantor trust until Taxpayer's death.

Taxpayer sold shares of Company A to an Employee Stock Ownership Plan (ESOP) (within the meaning of section 4975(e)(7)), maintained by Company A, on _____, and reinvested the proceeds from the sale into QRP within the replacement period of section 1042(c)(3). Taxpayer properly elected nonrecognition of this gain under section 1042(a) on Taxpayer's 2018 Federal income tax return.

Taxpayer intends to transfer the QRP, currently owned by Taxpayer personally, to Trust T.

Rulings Requested

You have requested the following rulings:

- (1) That the transfer of QRP from Taxpayer to Trust T would not constitute a disposition under section 1042(e); and
- (2) That transfers of QRP that occur pursuant to the terms of Trust T after Taxpayer's death, will not constitute a disposition of the QRP under section 1042(e).

For purposes of these requested rulings, we assume that the property purchased by Taxpayer constitutes QRP, as defined in section 1042(c)(4), and that section 1042(e) applies to the property. Additionally, we assume that Company A's ESOP qualifies under section 401(a) and satisfies the requirements of section 4975(e)(7). Further, we assume for the purposes of these requested rulings, that Taxpayer is the owner of Trust T under sections 671 through 677, and therefore, that Trust T is a grantor trust within the meaning of sections 671 through 677.

Applicable Law

Under section 1042(a), a taxpayer or executor may elect in certain cases not to recognize long-term capital gain on the sale of "qualified securities" to an ESOP (as defined in section 4975(e)(7)) or eligible worker owned cooperative if the taxpayer purchases "qualified replacement property" (as defined in section 1042(c)(4)) within the replacement period of section 1042(c)(3) and the requirements of section 1042(b) and Temp. Reg. §1.1042-1T are satisfied.

Section 1042(e)(1) provides that if a taxpayer disposes of any QRP, then, notwithstanding any other provision of the Code, any gain shall be recognized to the

extent of the gain which was not recognized under section 1042(a) by reason of the acquisition by such taxpayer of QRP. Gain realized from the disposition of any QRP by a taxpayer who made an election under section 1042 must be recognized at the time of the disposition regardless of any other nonrecognition provisions of the Code that may otherwise have applied.

The legislative history of section 1042(e) indicates that it was added to the Code as part of the Tax Reform Act of 1986 to coordinate the requirement that deferred gain be recognized on the disposition of any QRP with other nonrecognition provisions of the Code. "Effective for dispositions made after the date of enactment, the Act overrides all other provisions permitting nonrecognition and requires that gain realized upon the disposition of qualified replacement property be recognized at that time." S. Rep. 99-313, 99th Cong., 2nd Sess., 1032 (1986), 1986-3 C.B. v. 3, 1032. Limited exceptions to this rule are provided in section 1042(e)(3).

Section 1042(e)(3) provides that the recapture rules of section 1042(e)(1) shall not apply to any transfer of QRP that occurs: (1) in any reorganization (within the meaning of section 368) unless the person making the election under section 1042(a)(1) owns stock representing control of the acquiring or acquired corporation and such property is substituted basis property in the hands of the transferee; (2) by reason of the death of the person making the election; (3) by gift; or (4) in any transaction to which section 1042(a) applies.

Sections 671 through 677 contain rules under which the grantor of a trust will be treated as the owner of all or any portion of a trust.

Section 671 provides that where it is specified in subpart E of Part I of subchapter J 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 673 provides that the grantor shall be treated as the owner of any portion of a trust that the grantor has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds five percent of the value of such portion.

Section 674(a) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, without the approval or consent of any adverse party.

Section 675(4) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. Under section 675(4)(C), the term "power of administration" includes a power to reacquire the trust corpus by substituting other property of an equivalent value.

Section 676(a) provides that the grantor shall be treated as the owner of any portion of a trust 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.

Section 677 provides that the grantor shall be treated as the owner of any portion of a trust whose income, without the approval or consent of any adverse party, is or may be distributed to the grantor or held or accumulated for future distribution to the grantor.

Rev. Rul. 85-13, 1985-1 C.B. 184, holds that if a grantor is treated as the owner of any portion of an entire trust, the grantor is the owner of the trust's assets for federal income tax purposes.

Analysis

For the recapture rules of section 1042(e)(1) to apply, there must be a disposition of the QRP. Because Taxpayer is treated as the owner of Trust T within the meaning of sections 671 through 677, Trust T is treated as a grantor trust within the meaning of sections 671 through 677 for purposes of the requested rulings. Accordingly, Taxpayer is treated as the owner of Trust T's assets for federal income tax purposes. See Rev. Rul. 85-13. As a result, transfers of QRP between Taxpayer and Trust T would not constitute a disposition of the QRP under section 1042(e).

Provided Trust T is a grantor trust at Taxpayer's death, transfers of QRP pursuant to Trust T's terms at that time would fall under the exception of section 1042(e)(3) for a transfer upon the death of the person making the section 1042(a) election and, therefore, would not be treated as a disposition of the QRP under section 1042(e).

Therefore, based on the facts presented and representations made, we conclude the following:

- (1) Provided that Taxpayer is treated as the owner of Trust T under sections 671 through 677, the transfer of QRP to Trust T will not constitute a disposition of the QRP under section 1042(e), and;
- (2) Provided that Taxpayer is treated as the owner of the QRP held in Trust T under sections 671 through 677 at the time of Taxpayer's death, transfers of QRP that occur pursuant to the terms of Trust T after Taxpayer's death, will not constitute a disposition of the QRP under section 1042(e).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are directed only to the taxpayer requesting them. Section 6110(k)(3) provides that a ruling may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in section 7.01(16)(b) of Rev. Proc. 2021-1. 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. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the transaction. See section 11.05 of Rev. Proc. 2021-1.

A copy of this letter has been sent to your authorized representatives in accordance with a power of attorney on file in this office.

Sincerely,

John T. Ricotta
Branch Chief, Qualified Plans Branch 3
(Employee Benefits, Exempt Organizations, and
Employment Taxes)

cc: