

Internal Revenue Service

Department of the Treasury

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10-28-99

Re: Letter Ruling Request Regarding Excluding Gain from the Sale of a Residence

LEGEND:

Taxpayers

Residence

Trust

Partnership

Year 1

Date 1

Date 2

Dear :

This responds to your letter dated June 11, 1999, and your supplemental letter dated September 27, 1999, requesting a ruling on whether Taxpayers will be considered the owners of Residence for purposes of section 121(a) of the Internal Revenue Code during the period of time that the residence was owned by Partnership.

FACTS

Taxpayers lived in Residence since before Year 1 to Date 1. Taxpayers intend to sell Residence.

In Year 1, Taxpayers transferred title in Residence to Partnership. The transfer occurred in two steps. Taxpayers first deeded 98% of Residence to Trust, then Taxpayers and Trust deeded Residence to Partnership. Trust is a grantor trust formed by Taxpayers, and Taxpayers have represented that they are treated as the owners of Trust under the grantor trust rules under sections 671 through 677 of the Code. Taxpayers each own a 1% interest in Partnership as general partners. Trust owns the remaining 98% interest of Partnership as a limited partner. Taxpayers also transferred several small rental properties to Partnership in Year 1. On Date 2, Partnership distributed title to Residence to its partners (Taxpayers and Trust) in accordance with their partnership interests.

SECTION 121 REQUIREMENTS

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) of the Code 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 deferment 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

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 be included in computing the taxable income and credits of the grantor or 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.

Taxpayers have represented that they are treated as the owners of Trust under the grantor trust rules under sections 671 through 677.

OWNERSHIP OF PARTNERSHIP PROPERTY FOR SECTION 121 PURPOSES

In order for a federal tax law partnership to exist, the parties must, in good faith and with a business purpose, intend to join together in the present conduct of an enterprise and share in the profits or losses of the enterprise. This determination requires weighing all of the facts and circumstances of a particular case. Culbertson v. Commissioner, 337 U.S. 733 (1949). Because the existence of a partnership is based on federal tax principles, an arrangement that constitutes a partnership under state law may not be a partnership under federal tax law. Commissioner v. Tower, 327 U.S. 280 (1946). In the present case, Residence was not used in the conduct of an enterprise. Partnership held title to Residence, but Residence did not yield any income to Partnership or Taxpayers, and Residence served no business purpose of Partnership or Taxpayers. Furthermore, Taxpayers (individually or as the grantors of Trust) owned 100% of Residence during the period that Partnership held title to Residence, and have taken no business deductions (such as depreciation deductions) with respect to Residence.

Based on the facts as represented and the relevant law as set forth above, we rule that for purposes of section 121(a) Taxpayers will be treated as the owners of Residence throughout the period that Partnership held title to Residence.

Except as specifically ruled upon above, no opinion is expressed or implied regarding the income tax consequences of Partnership, Trust, any transaction, or any item discussed or referenced in this letter. In addition, no opinion is expressed or implied as to whether Taxpayers are treated as the owners of Trust under the grantor trust rules of sections 671 through 677 of the Code or whether Taxpayers have used Residence as their principal residence.

This ruling is directed only to the taxpayers 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.

Sincerely,

/c/ David B. Auclair
DAVID B. AUCLAIR
Senior Technician Reviewer
Office of Assistant Chief Counsel
(Income Tax and Accounting)

Enclosures (2):

Copy of this letter

Copy of section 6110 purposes