

Internal Revenue Service

Department of the Treasury

Index Number: 7701.00-00

Washington, DC 20224

Number: **199950022**
Release Date: 12/17/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:FI&P:Br.3-PLR-107409-99
Date:
September 16, 1999

Legend:

Sponsor =

Initial Trust =

Investment Strategy =

State A =

a =

b =

c =

d =

:

This letter replies to a letter dated April 13, 1999 and other correspondence submitted on behalf of Sponsor by its authorized representatives. In general, Sponsor asks for certain rulings relating to a program in which investors in Initial Trust are given

PLR-107409-99

an opportunity, on termination of Initial Trust to contribute their share of Initial Trust's assets to one or more subsequent trusts (collectively, the Subsequent Trusts and each a Subsequent Trust).

FACTS

Sponsor proposes to create a series of trusts (the Trusts). Each Trust will hold a fixed portfolio of common stock selected according to a designated investment strategy and will issue a single class of units (Units) representing undivided beneficial interests in its assets. During the life of the Trust, Sponsor may receive additional Units by contributing to the Trust additional common stock. The common stock contributed will be identical with respect to issuer, class of stock, and number of shares per issuer to the shares represented by that number of Units prior to such contribution except to the extent that Sponsor cannot contribute fractional shares to the Trust. Dividends, if any, received by the Trustee with respect to common stock held by the Trust will be periodically distributed as cash to Unitholders. Unitholders may elect to use these cash proceeds to purchase additional Units of the Trust.

Each Trust will be organized as a domestic trust under the laws of State A, will be created by a separate indenture, and will qualify as a unit investment trust under section 4 of the Investment Company Act of 1940, 15 U.S.C. § 80a-4 (1994). A separate registration statement for each Trust will be filed with the Securities and Exchange Commission (SEC) and a separate prospectus will be used to offer its Units. The trustee (the Trustee) of each Trust will be a financial institution that is a bank within the meaning of section 2(a)(5) of the Investment Company Act and meets the requirements of section 26 of the Investment Company Act.

Initial Trust and the Subsequent Trusts are among the Trusts created or to be created by Sponsor.

Initial Trust will hold a fixed portfolio of common stocks selected according to Investment Strategy and will terminate approximately a months after creation. Prior to termination, a Unitholder may redeem Units at any time by tendering them to the Trustee. How the pre-termination redemption (Redemption) is accomplished will depend on whether the Sponsor maintains a secondary market for Units.

If the Sponsor maintains a secondary market for Units, tendered Units may be sold to the Sponsor for their net asset value and the proceeds distributed to the Unitholder. If the Sponsor does not maintain a secondary market for Units or if the Unitholder so elects, the Unitholder may tender its Units to the Trustee who will make a payment to the redeeming Unitholder equal to the net asset value of the Units tendered. However, if the Unitholder holds b or more Units (which will have an initial market value of approximately \$c or more), the redeeming Unitholder may choose to receive its pro rata share of Initial Trust securities in-kind and cash in lieu of fractional shares.

PLR-107409-99

Sponsor believes, on the basis of historical experience with other unit investment trusts, that it will be the only Unitholder eligible to receive in-kind distributions upon a Redemption.

Upon termination of Initial Trust, its securities will be distributed or sold. A Unitholder can elect (1) to receive in-kind its pro rata share of the securities and cash in lieu of fractional shares, or (2) to receive the cash proceeds from the sale of its pro rata share of the securities.

Instead of redeeming units or holding units until termination, a Unitholder in Initial Trust may elect to invest in the Units of one or more Subsequent Trusts by making an in-kind contribution (Rollover Contribution) to the applicable Subsequent Trusts. Although the Sponsor has no obligation to create any Subsequent Trusts, the Sponsor intends to create several Subsequent Trusts on a day no more than 30 days before the termination of Initial Trust. The effective date of the registration statement filed with the SEC for a Subsequent Trust will be no more than 30 days before the termination of Initial Trust.

If a Unitholder elects to make a Rollover Contribution, securities representing the Unitholder's pro rata share of the securities held by the Initial Trust will be transferred to a financial institution (the Distribution Agent) on the Rollover Date. The "Rollover Date" will be no more than 30 days before the termination of the Initial Trust. The Distribution Agent will make an in-kind contribution to the applicable Subsequent Trusts on behalf of the Unitholder within five business day following the Rollover Date.

Any securities contributed in-kind to a Subsequent Trust on behalf of a reinvesting Unitholder will have to match in number and type the securities represented by the Units of the Subsequent Trust. For example, if a Unit in a Subsequent Trust represents an interest in one share each of the common stock of Company V, Company W, Company X, Company Y and Company Z, then an in-kind contribution made to acquire five Units of the Subsequent Trust will have to consist of five shares of the common stock of each of Company V, Company W, Company X, Company Y and Company Z.

Like Initial Trust, each Subsequent Trust will hold a fixed portfolio of securities that will be selected according to an investment strategy which may not be the same as the Investment Strategy of Initial Trust. However, even if a Subsequent Trust employs the Investment Strategy of Initial Trust, the portfolio of stocks selected for that Subsequent Trust will be affected by recent market history. The portfolio of stocks to be held by any Subsequent Trust, therefore, is expected to differ somewhat from the stocks distributed to the Distribution Agent on termination of Initial Trust. For this reason, if the Distribution Agent is to make an in-kind contribution to a Subsequent Trust, the Distribution Agent will have to adjust the portfolio of securities held for the benefit of that Unitholder before making such contribution. This will require the sale of

PLR-107409-99

some stocks and the purchase of others.

Units in a Subsequent Trust will also be offered to persons who were not Unitholders in Initial Trust (Non-prior Participants). No limit will be imposed upon the number of Non-prior Participants that may be admitted to a Subsequent Trust. Non-prior Participants will be permitted to acquire Units in a Subsequent Trust by purchase or by in-kind contribution. Any shares a Non-prior Participant contributes in-kind to the Subsequent Trust will have to match in number and in type the shares represented by the Units of the Subsequent Trust. Notwithstanding the foregoing, securities received in-kind by Sponsor on the termination of a Trust cannot be contributed to another Trust. Similarly, securities received in-kind by any party through a Redemption cannot be contributed to another Trust.

Each decision by a Unitholder to invest in a Subsequent Trust will be made separately. Sponsor will not (a) formally or informally solicit a Unitholder to invest in two or more Trusts or (b) accept any formal or informal direction to do so. A decision to invest in a Subsequent Trust will be solicited by representatives of the Sponsor only during the 30 days prior to the Rollover Notification Date (which will occur no earlier than 31 business days before the termination of the Initial Trust and no later than the Rollover Date) and a Unitholder will not receive an incentive to make a decision to reinvest before the final date for such decisions. Thus, for example, no Unitholder will receive a discount for an early decision and no investor will be charged a penalty for making a later but still timely decision. No election to reinvest may be made prior to 30 days before the Rollover Notification Date and such election will be revocable at any time prior to the Rollover Date.

In general, there will be no difference between the fees (including administrative charges), commissions, or other charges payable by reinvesting Unitholders and those payable by Non-prior Participants. However, reinvesting Unitholders may receive a commission discount compared to Non-prior Participants. The commission discount for reinvesting Unitholders will not exceed d% of the public offering price per Unit when compared to the commissions paid by Non-prior participants.

Commissions and fees charged to Non-prior Participants will not exceed customary commissions and fees charged with respect to units of similar trusts offered by the Sponsor. The commissions charged upon the acquisition of Units in a Trust and any deferred commissions charged over the life of a Trust will be based upon the full fair market value of the Units.

Sponsor represents that the assets of one Trust will not be commingled with the assets of another Trust nor will the expenses of one Trust be charged against another. Unitholders of a Trust can look only to the assets of that Trust for distributions upon redemption, liquidation or termination. Creditors of a Trust are limited to the assets of that Trust for recovery of expenses, charges and liabilities. Matters that affect a Trust

PLR-107409-99

and are subject to a vote by Unitholders can only be voted on by the Unitholders of that Trust. Sponsor further represents that apart from the reinvestment arrangement described above, the Initial Trust will be classified as a grantor trust for federal income tax purposes.

LAW AND ANALYSIS

Section 301.7701-4(c)(1) of the Procedural and Administrative Regulations states that an investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets of the trust, will be classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders.

In Rev. Rul. 81-238, 1981-2 C.B. 248, a fixed investment trust adopted an automatic reinvestment plan. Under the plan, shortly before each semiannual distribution date, the sponsor of the trust created a new fixed investment trust in which the certificate holders in the existing trusts could invest their distributions of income and principal. Participation by the certificate holders in the automatic reinvestment plan was voluntary and could be terminated at the option of the certificate holder. Rev. Rul. 81-238 concludes that this arrangement did not involve reinvestment in the original trust but rather investment of trust proceeds in a new trust. Since there was no change in the investment in the original trust, this arrangement did not result in a power to vary the investment within the meaning of section 301.7701-4(c) of the regulations.

Rev. Rul. 81-238 indicates that the power to reinvest distributions from a trust does not change the classification of that trust if the power to reinvest distributions is not a power to vary the investment of that trust. The power of the Unitholders to invest distributions from Initial Trust in a Subsequent Trust is a power to vary the investment of Initial Trust if a Subsequent Trust is considered a mere continuation of Initial Trust. Initial Trust and a Subsequent Trust may be viewed as the same entity for a variety of reasons. For example, Initial Trust and a Subsequent Trust may be viewed as the same entity if the Subsequent Trust lacks independent economic substance. Cf. Rev. Rul. 90-106, 1990-2 C.B. 162. Similarly, Initial Trust and the Subsequent Trust may be treated as the same entity if creation of Initial Trust involves a binding commitment to create the Subsequent Trust. Cf. Buhl v. Kavanagh, 118 F.2d 315 (6th Cir. 1941). For the reasons stated below, we believe that the Subsequent Trusts are not a mere continuation of Initial Trust.

In the instant case, a Subsequent Trust has independent economic substance. It will be created under a separate indenture and its Units will be offered pursuant to a separately registered prospectus. Other than those who choose to reinvest, the Unitholders of Initial Trust will have no rights to the assets of a Subsequent Trust, nor will the creditors of Initial Trust have any claim to the assets of a Subsequent Trust.

PLR-107409-99

Further, creation of Initial Trust does not involve either a legal commitment or a de facto commitment to create or invest in a Subsequent Trust. Sponsor is not obligated to create any Subsequent Trusts and the Unitholders of Initial Trust are not obligated to make in-kind contributions to any Subsequent Trust. The decision by an Initial Trust Unitholder to invest in a Subsequent Trust is only one of the many choices available. Besides investing in a Subsequent Trust, the Unitholder may liquidate its investment for cash, acquire its share of securities in-kind and hold them, or acquire its share of securities in-kind and make whatever adjustments it feels are necessary in pursuit of its own investment strategy. In addition, investing in Initial Trust is not a condition to investing in a Subsequent Trust; Non-Prior Participants are free to invest in a Subsequent Trust by making in-kind contributions or through cash purchases. A Unitholder of Initial Trust who invests in a Subsequent Trust does enjoy a reduced sales charge compared to Non-Prior Participants. This discount, however, is not sufficient to compel the Initial Trust Unitholder to invest in a Subsequent Trust, nor is it sufficient to entice the Initial Trust Unitholder to chose a Subsequent Trust over other investment strategies.

Investors that hold certificates of beneficial interest in an investment trust that has a single class of ownership interests representing undivided beneficial interests in the assets of the trust and that is classified as a trust for the purposes of § 301.7701-4(c) are treated as owners of undivided interests in the entire trust. Rev. Rul. 84-10, 1984-1 C.B. 155. An investor that exchanges certificates of beneficial interest in such an investment trust for its aliquot share of the assets of the trust has not materially altered its ownership position. Rev Rul. 90-7, 1990-1 C.B. 153.

Revenue Ruling 90-7 considered an investor in such an investment trust who exchanged certificates of beneficial interest in return for its aliquot share of the trust's assets (a portfolio of common stock) with cash being received in lieu of fractional shares. The Revenue Ruling concluded that the investor could recognize neither gain nor loss for the purposes of § 1001 of the Internal Revenue Code with respect to the whole shares received since the investor had not materially altered its ownership position in those shares. However, to the extent that the investor receives cash in exchange for fractional shares, the investor had realized and must recognize gain or loss measured by the difference between the amount of cash received and the adjusted basis in the fractional shares as determined under § 1011.

Revenue Ruling 90-7 did not specifically consider the effect of the reverse transaction: an investor exchanging a pool of securities that match in number and type the securities represented by a certain number of certificates of beneficial interest in an investment trust for that number of certificates of the investment trust. However, since an investor exchanging certificates for securities is considered to have not materially altered its ownership position in the securities, an investor exchanging securities for certificates should also be considered to have not materially altered its ownership position in the securities. Therefore, such an investor should be considered to

PLR-107409-99

recognize neither gain nor loss with respect to the securities for the purposes of § 1001 of the Code as a result of such exchange.

CONCLUSION

Based on all the facts and circumstances presented and the representations made, we conclude that:

1. Initial Trust will not be classified as a business entity under § 301.7701-2 of the Regulations solely because on termination of Initial Trust the Unitholders can direct the Distribution Agent to invest in the Units of Subsequent Trusts by making in-kind contributions (after adjustments) to Subsequent Trusts.

2. A Unitholder that receives shares of common stock due to its election to receive an in-kind distribution of its pro rata portion of Initial Trust assets upon a Redemption or the termination of Initial Trust will recognize neither gain nor loss as a result of such distribution with respect to the shares for the purposes of § 1001 of the Code.

3. A Unitholder that receives cash in lieu of fractional shares of common stock due to its election to receive an in-kind distribution of its pro rata portion of Initial Trust assets upon a Redemption or the termination of Initial Trust will recognize gain or loss as a result of such distribution measured by the difference between the amount of cash received and the adjusted basis in the fractional shares as determined under § 1011 of the Code.

4. A Unitholder that contributes a pool of securities to Initial Trust that match in number and type the securities represented by a certain number of Units of Initial Trust in exchange for that number of Units of Initial Trust will recognize neither gain nor loss as a result of such contribution for the purposes of § 1001 of the Code.

The rulings contained in this letter are based upon information and representations submitted by the Sponsor 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.

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.

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

PLR-107409-99

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.

Sincerely,

Assistant Chief Counsel
(Financial Institutions and
Products)

By: _____
MARSHALL D. FEIRING
Senior Technician Reviewer
Branch 2

Enclosures: Copy of this letter
Copy for section 6110 purposes