

**Internal Revenue Service**

**Department of the Treasury**

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Date:  
March 3, 2000

G =

B =

Trust 1 =

Trust 2 =

D1 =

D2 =

Year 1 =

Dear :

This is in reply to your letter, dated August 13, 1999, and subsequent correspondence, submitted on behalf of Trust 2 requesting various rulings concerning whether and to what extent B will be treated as the owner of Trust 2 under § 678 of the Internal Revenue Code.

On D1 G created a revocable trust, Trust 1. Following G's death on D2, a marital trust and residual trust, Trust 2, were created pursuant to the provisions of Trust 1. Under the provisions of Trust 2, B, as the income beneficiary, has a lifetime power to appoint all or any part of the Trust 2 income. In addition, B has the noncumulative power to withdraw annually from the corpus of Trust 2 an amount not exceeding five thousand dollars or five percent of the market value of the net principal of Trust 2. This type of power in a trust is commonly referred to as a "five or five" power. With the exception of a partial withdrawal in Year 1, B has not exercised this five or five power.

Section 678(a) provides that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which (1) such person has a power exercisable solely

by himself to vest corpus or the income therefrom in himself, or (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of §§ 671 to 677 of the Code inclusive, subject a grantor of a trust to treatment as the owner thereof.

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

In Rev. Rul. 67-241, 1967-2 C.B. 225, the beneficiary of a trust held a noncumulative power, exercisable solely by the beneficiary, to withdraw certain amounts of corpus annually from the trust. Rev. Rul. 67-241 concludes that, for each year that this demand power is held, under § 678(a)(1) of the Code the beneficiary is the owner of that portion of the trust which is subject to this demand power, whether or not it is exercised.

We conclude that B's five or five power is a power to vest in B part of the corpus of Trust 2. Therefore, until the power is exercised, released or allowed to lapse, B will be treated as the owner for each year of that portion of Trust 2 that is subject to the power to withdraw under § 678(a)(1).

For each year that B fails to exercise the five or five power, B will be deemed to have partially released a power to withdraw a portion of the trust corpus. B has also retained a power over the income of Trust 2 that would subject a grantor of a trust to treatment as the owner under § 677. Therefore, B will also be treated as an owner of a portion of Trust 2 corpus under § 678(a)(2).

After each succeeding year in which B fails to exercise the five or five power, B will be treated as the owner of an increasing portion of the corpus of Trust 2. The annual increase of the portion of the corpus of Trust 2 of which B is treated as the owner is the product of the amount which B could withdraw multiplied by a fraction the numerator of which is the portion of trust corpus which B is not already treated as owning and the denominator of which is the total of trust corpus from which the withdrawal could be made.

We further conclude that to the extent that B exercises the five or five power during a calendar year, such distribution shall be deemed to have been made from B's pro rata share of each asset of Trust 2 corpus that B is treated as owning.

Section 671 provides that where a grantor or other person is treated as the owner of any portion of a trust, the income,

deductions, and credits against tax of the trust attributable to such portion of the trust shall be included by the grantor or other person in computing his taxable income and credits.

Section 1.671-3(a) of the Income Tax Regulations provides that a deemed owner of corpus must include his or her share of the capital gains realized by the trust if allocable to the portion of corpus which that person is deemed to own.

Section 1.671-3(a)(3) provides that if a person is treated as owning an undivided fractional share of trust corpus or an interest represented by a dollar amount, then a pro rata share of each such item of capital gain shall be allocated to that person.

We conclude that B must include, in computing B's tax liability, items of income, deductions, and credits that are attributable to that portion of the corpus of Trust 2 which B is treated as owning. Also, as the owner of an undivided fractional share of the corpus of Trust 2, B shall be allocated a pro rata share of each item of any capital gain realized by Trust 2.

Except as specifically ruled upon above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. Moreover, if the trust instrument is amended, this ruling may not remain in effect.

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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Trust.

Sincerely yours,  
J. THOMAS HINES  
Acting Branch Chief, Branch 2  
Office of the Assistant Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes