

# Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
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Date:  
May 7, 2001

Bank =

Target Bank =

Parent =

A =

Fund A =

Fund B =

Fund C =

Fund D =

City 1 =

City 2 =

State X =

Plan 1 =

Plan 2 =

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Dear \_\_\_\_\_ :

This is in reply to a letter dated December 21, 2000, and subsequent correspondence, written on behalf of Bank by Bank's authorized representative, requesting rulings regarding the proposed mergers of certain common trust funds under section 584 of the Internal Revenue Code.

Bank is a state chartered financial institution providing banking, trust and investment services to the general public. Bank has facilities in City 1, and 30 other communities throughout State. Services provided by Bank include checking accounts, savings accounts, IRA accounts, commercial, personal and residential lending, fiduciary trust services and investment accounts.

On October 1, 1998, Bank merged with Target Bank of City 2. The merger was effected through the exchange of Parent's common stock for all of Target Bank's outstanding common stock.

Prior to the merger, Bank maintained four common trust funds, including Fund A and Fund C, and Target Bank maintained five common trust funds. On September 23, 1999, two of the common trust funds originally maintained by the Target Bank were renamed Fund B and Fund D.

Fund A and Fund B are governed by Plan 1. Participation in Fund A and Fund B is limited to estates, trusts, and other funds administered by Bank or an affiliated bank in a fiduciary capacity (including with that term the office of trustee, guardian, executor or administrator or custodian under the Uniform Gifts to Minors Act).

Fund C and Fund D are governed by Plan 2. Participation in Fund C and Fund D is limited to retirement, pension, profit sharing, stock bonus or other trusts which are exempt from federal income taxation by reason of being described in § 401.

Pursuant to substantially identical written plans of merger and subject to receipt of a favorable ruling, Fund B will be merged into Fund A, and Fund D will be merged into Fund C. After the mergers, Bank will be trustee of Fund A and Fund C (Resulting Funds).

To effect the merger of Fund B into Fund A, each participating trust in the merging Fund B shall be assigned units of participation in Fund A equal in value to the participant's interest in the merging Fund B based upon the unit value of Fund A on the effective date in exchange for such participating trust's units of participation in the merging Fund B. Upon such assignment the units of participation in the merging Fund B shall be cancelled. If under this calculation a participant of Fund B would be issued a

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fractional unit, the participant will be paid the fair market value of the fractional unit in cash in lieu of being distributed the fractional unit which will be treated as a withdrawal by the participating trust to the extent of the cash received. Each participant in Fund A shall continue to own such number of units of participation of Fund A as the participant owned immediately prior to the merger.

To effect the merger of Fund D into Fund C, each participating trust in the merging Fund D shall be assigned units of participation in Fund C equal in value to the participant's interest in the merging Fund D based upon the unit value of Fund C on the effective date in exchange for such participating trust's units of participation in the merging Fund D. Upon such assignment the units of participation in the merging Fund D shall be cancelled. If under this calculation a participant of Fund D would be issued a fractional unit, the participant will be paid the fair market value of the fractional unit in cash in lieu of being distributed the fractional unit which will be treated as a withdrawal by the participating trust to the extent of the cash received. Each participant in Fund C shall continue to own such number of units of participation of Fund C as the participant owned immediately prior to the merger.

A, as the president of Bank, represents as to Funds A through D before the mergers and Resulting Funds A and C after the mergers as follows:

1. Bank is a bank under § 581.
2. Bank currently maintains Funds A through D in conformity with § 584 and the rules and regulations of the Comptroller of the Currency pertaining to the collective investment of trust funds.
3. Subsequent to the merger, Fund A and Fund C will be maintained in conformity with § 584 and the rules and regulations of the Comptroller of the Currency pertaining to the collective investment of trust funds.
4. Not more than 25 percent of the value of each Fund's total assets is invested in stock and securities of any one issuer, and not more than 50 percent of each Fund's total assets is invested in the stock or securities of five or fewer issuers. For purposes of this representation, in determining total assets, cash, and cash items (including receivables), Federal Government securities and assets acquired for the purposes of meeting § 368(a)(2)(F)(ii) have been excluded.
5. For purposes of applying the diversification tests of § 368(a)(2)(F)(ii):
  - a. All members of a controlled group of corporations as defined in § 1563(a) have been treated as one issuer;

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b. Cash and cash items (including receivables) and United States Government securities have been excluded in determining a Fund's total assets; and

c. Any fund holding stock in a regulated investment company or real estate investment trust has been deemed to hold a proportionate share of the assets of the investment company or trust.

6. None of the assets of any Fund have been acquired specifically for the purpose of meeting or avoiding the requirements of § 368(a)(2)(F)(ii).

Section 584(a) provides that the term "common trust fund" means a fund maintained by a bank (1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian, or as a custodian of accounts under a state law substantially similar to the Uniform Gifts to Minors Act, and (2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks. Also, for purposes of § 584(a), two or more banks that are members of the same affiliated group (within the meaning of § 1504) shall be treated as one bank for the period of the affiliation with respect to any fund of which any of the member banks is trustee or two or more of the member banks are co-trustees.

Section 584(b) provides that a common trust fund shall not be subject to taxation under chapter 1 of subtitle A of the Code and for purposes of that chapter shall not be considered a corporation.

Section 584(e) provides that no gain or loss shall be realized by a common trust fund upon the admission of a participant. The admission of a participant shall be treated, with respect to the participant, as the purchase of, or an exchange for, the participating interest. The withdrawal of any participating interest by a participant shall be treated as a sale or exchange of the interest by the participant.

Section 1.584-4(a) of the Income Tax Regulations provides, in pertinent part, that when a participating interest is transferred by a bank, or two or more banks that are members of the same affiliated group (within the meaning of § 1504), as a result of the combination of two or more common trust funds, the transfer to the surviving common trust fund is not considered to be an admission or withdrawal if the combining and resulting common trust funds have diversified portfolios within the meaning of § 368(a)(2)(F)(ii) and the regulations thereunder.

In order to meet the diversification requirements of § 368(a)(2)(F)(ii), the statute specifies that a fund cannot have (a) more than 25 percent of the value of its total assets invested in the stock and securities of any one issuer, and (b) more than 50

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percent of the value of its total assets invested in the stock and securities of five or fewer issuers. The statute further provides that in making these determinations, all members of a controlled group of corporations (within the meaning of § 1563(a)) shall be treated as one issuer, and that in determining the percentages certain items are to be disregarded and not included in any part of the computations. These excluded items are cash, cash items (including receivables), Government securities, and, as prescribed by regulations, assets acquired either for the purpose of meeting the percentage requirements as to diversification or for the purpose of attempting to cease being an investment company.

Based upon the facts submitted and the above representations, and a review of the portfolios of Funds A through D, we conclude that:

1. Prior to the mergers, each of Funds A through D has a diversified portfolio within the meaning of § 368(a)(2)(F)(ii).
2. After the mergers, each Resulting Fund will have a diversified portfolio within the meaning of § 368(a)(2)(F)(ii).
3. The merger of Fund B into Fund A and of Fund D into Fund C will not result in the recognition of gain or loss to any of the merging or Resulting Funds pursuant to § 584(e) and § 1.584-4(a).
4. The merger of Fund B into Fund A and of Fund D into Fund C will not adversely affect the qualification of the Resulting Funds as common trust funds under § 584(a).
5. Any distribution of cash to participants in lieu of units will be treated under § 584(e) as the proceeds from the sale or exchange of such fractional units.
6. The gain or loss of a participant receiving cash to eliminate fractional units of participation held by the participant will be determined in accordance with § 1.584-4.
7. The adjusted bases of the assets received by each Resulting Fund as a result of the mergers will be the same as the respective adjusted bases of such assets in the merging funds immediately before the merger.
8. The holding periods of the assets held by each Resulting Fund immediately after the merger will include the holding period applicable to such assets when held by the merging funds immediately prior to the merger. Section 1223(2).
9. The adjusted basis of each participant's units of participation held in each Resulting Fund immediately after the merger will be the same as its respective adjusted basis in the corresponding units of the merging funds immediately prior to the merger,

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reduced by the amount of each participant's adjusted basis attributable to any fractional unit of the Resulting Fund which is redeemed for cash.

10. The holding period for each participant's units of participation in the Resulting Funds immediately after the merger will include the holding period applicable to the corresponding units of participation held in the merging funds. Section 1223(1).

No opinion is expressed or implied about the federal income tax treatment of the above transactions under any other provision of the Code or regulations. The above rulings are based on the condition that all the funds involved do in fact qualify as common trust funds under § 584 at the time of the proposed mergers.

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

Enclosures: 2  
Copy of this letter  
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