

INTERNAL REVENUE SERVICE

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November 15, 1999

In Re:

Legend:

Sponsor =

Initial Trust =

Subsequent Trust =

Trustee =

State =

Agency =

Fund =

Board =

b =

c =

d =

e =

Dear

This is in reply to a letter dated April 8, 1999, and other correspondence requesting a private letter ruling on whether an arrangement will be treated as a business entity under section 301.7701-2 of the Procedural and Administrative Regulations. The facts submitted for consideration are summarized below.

#### FACTS

Sponsor proposes to create a series of trusts (the Trusts). Each Trust will hold a fixed portfolio of common stocks selected according to an investment strategy and will issue a single class of units (Units) representing undivided beneficial interests in its assets.

Each Trust will be organized as a domestic trust under the laws of State, 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 of each Trust will be Trustee, a financial institution subject to supervision by Agency, Fund, and Board.

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

Initial Trust will terminate more than one year after creation. Prior to termination, a holder (Holder) of Units 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 will be sold to the Sponsor for their net asset value and the proceeds distributed to the Holder. If the Sponsor does not maintain a secondary market for Units, Redemption will be accomplished by a sale of a pro rata share of the securities in the Initial Trust and a cash payment to the redeeming Holder equal to the net asset value of the Units tendered. However, if the Holder's Units have a value of \$b or more, the Holder may choose to receive its pro rata share of Initial Trust securities in-kind. Sponsor believes, on the basis of historical experience with other unit investment trusts, that it will be the only

Holder eligible to receive in-kind distributions upon a Redemption that would choose to receive in-kind distributions.

On termination of Initial Trust, its securities will be distributed or sold. Before termination, a Holder can elect (1) to receive in-kind its pro rata share of the securities, or (2) to receive the cash proceeds from the sale of its pro rata share of the securities.

A Holder in Initial Trust may also elect to invest in the Units of Subsequent Trust by making an in-kind contribution (Rollover Contribution) to Subsequent Trust. Although the Sponsor has no obligation to create Subsequent Trust, the Sponsor intends to create Subsequent Trust on a date at least c days before the termination of Initial Trust. Sponsor will set a date (Rollover Notification Date) on which Holders in Initial Trust must notify Sponsor of their decision to request a distribution in-kind for making a Rollover Contribution into Subsequent Trust. The Rollover Notification Date will not be more than c days before the Rollover Date (the date on which Rollover Contributions are made to Subsequent Trust), and the Rollover Date will not be more than d days before the termination of Initial Trust. The Rollover Notification Date will be established to give Holders time to decide whether to receive a distribution in cash or in-kind and whether to roll an in-kind distribution over, and to allow Sponsor to arrange for an orderly liquidation or distribution of Initial Trust's portfolio. Fractional shares will not be distributed.

A Holder must elect a Rollover Contribution on or before the Rollover Notification Date. The election will be revocable until the later of the Rollover Notification Date or the effective date of the registration statement for Subsequent Trust.

If a Holder elects to make a Rollover Contribution, securities representing the Holder'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 at least c days before the termination of the Initial Trust. The Distribution Agent will make an in-kind contribution to the Subsequent Trust on behalf of the Holder within e business days following the Rollover Date.

Any securities contributed in-kind to the Subsequent Trust on behalf of a reinvesting Holder will have to match in number and type the securities represented by the Units of the Subsequent Trust. For example, if a Unit in 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 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, Subsequent Trust will hold a fixed portfolio of common stocks that will be selected according to an investment strategy. However, the portfolio of stocks selected for Subsequent Trust using the investment strategy will be affected by market conditions. The portfolio of stocks to be held by 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 Subsequent Trust, the Distribution Agent will have to adjust the portfolio of securities held for the benefit of that Holder before making such contribution. This will require the sale of some stocks and the purchase of others.

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

Each decision by a Holder to invest in Subsequent Trust will be made separately from the Holder's decision to invest in Initial Trust. Sponsor will not formally or informally solicit a Holder to invest in two or more Trusts or accept any formal or informal direction to do so. A decision to invest in the Subsequent Trust will be solicited by representatives of the Sponsor only during the c days prior to the Rollover Notification Date, and a Holder will not receive an incentive to make a decision to reinvest before the final date for such decisions. Thus, for example, no Holder 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 c days before the Rollover Notification Date and such election will be revocable at any time prior to the Rollover Notification Date.

In general, there will be no difference between the fees (including administrative charges), commissions, or other charges payable by reinvesting Holders and those payable by New

Participants. However, reinvesting Holders may receive a reduced sales charge compared to New Participants.

Commissions and fees charged to New 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 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 and the expenses of one Trust will not be charged against another. Holders 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 and are subject to a vote by Holders can only be voted on by the Holders 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 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, and not as a business entity under section 301.7701-2, 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 was not reinvestment in the original trust, but rather investment 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 is not a power to vary the investment of that trust. The power of the Holders to invest distributions

from Initial Trust in Subsequent Trust is a power to vary the investment of Initial Trust if Subsequent Trust is considered a continuation of Initial Trust. Initial Trust and Subsequent Trust may be viewed as the same entity for a variety of reasons. For example, Initial Trust and Subsequent Trust may be viewed as the same entity if Subsequent Trust lacks independent economic substance. Cf. Rev. Rul. 90-106, 1990-2 C.B. 162. Similarly, Initial Trust and Subsequent Trust may be treated as the same entity if creation of Initial Trust involves a binding commitment to create Subsequent Trust. Cf. Buhl v. Kavanagh, 118 F.2d 315 (6th Cir. 1941). For the reasons stated below, Subsequent Trust is not a continuation of Initial Trust.

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 Holders of Initial Trust will have no rights to the assets of Subsequent Trust, nor will the creditors of Initial Trust have any claim to the assets of Subsequent Trust.

Further, creation of Initial Trust does not involve either a legal commitment or a de facto commitment to create or invest in Subsequent Trust. Sponsor is not obligated to create Subsequent Trust and the Holders of Initial Trust are not obligated to make in-kind contributions to Subsequent Trust. The decision by an Initial Trust Holder to invest in Subsequent Trust is only one of the many choices available. Besides investing in Subsequent Trust, the Holder 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 Subsequent Trust; New Participants are free to invest in Subsequent Trust by making in-kind contributions or through cash purchases. A Holder of Initial Trust who invests in Subsequent Trust does enjoy a reduced sales charge compared to New Participants. This discount, however, is not sufficient to compel the Initial Trust Holder to invest in Subsequent Trust, nor is it sufficient to entice the Initial Trust Holder to chose Subsequent Trust over other investment strategies.

#### CONCLUSION

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

Initial Trust will not be classified as a business entity under section 301.7701 of the regulations solely because on termination of Initial Trust the Holders can direct the Distribution Agent to invest in the Units of Subsequent Trust by

making in-kind contributions (after adjustments) to Subsequent Trust.

The ruling contained in this letter is 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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.

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 & Products)

By: \_\_\_\_\_  
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