

MEMO# 1744

March 1, 1990

REVENUE RULING ON GAIN NONRECOGNITION WHEN TRUST CERTIFICATE EXCHANGED FOR SHARE OF TRUST ASSETS

March 1, 1990 TO: TAX MEMBERS NO. 11-90 UNIT INVESTMENT TRUST MEMBERS NO. 16-90
RE: REVENUE RULING ON GAIN NONRECOGNITION WHEN TRUST CERTIFICATE EXCHANGED
FOR SHARE OF TRUST ASSETS _____ In
Revenue Ruling 90-7 (attached), the Internal Revenue Service holds that a certificate holder
in an investment trust with a single class of ownership interests and a fixed portfolio of
stocks, who exchanges certificates for a proportionate share of each of the trust's assets,
will not recognize gain or loss on that exchange. The trust instrument involved in the Ruling
permits certificate holders to exchange trust certificates for a proportionate amount of each
of the trust's assets. The certificate holder at issue pays \$200 for 100 certificates, exercises
the exchange right when the value of the 100 certificates is \$300 and receives a
proportionate amount of each of the 15 stocks held by the trust (with a value of \$295), plus
\$1 of cash as his proportionate share of a reserve for administrative expenses and \$4 of
cash in lieu of fractional shares of stock (which is funded from the other certificate holders'
shares of the reserve for administrative expenses). In the Ruling, the IRS holds that the
certificate holder is the owner of an undivided interest in all of the trust's assets for Federal
income tax purposes. Thus, when the certificates are exchanged for the trust's underlying
securities, the certificate holder went from being a co-owner of all of the trust's stock to
being the sole owner of a proportionate share of the trust's stock. Consequently, no gain or
loss is recognized on the exchange of the certificates for the stock. For similar reasons, the
certificate holder's receipt of \$1 for his share of the reserve for administrative expenses
results in no gain or loss. The receipt of \$4 of cash in lieu of fractional shares is a taxable
transaction, however, and the certificate holder must recognize gain or loss based upon the
difference between the amount of cash received and the adjusted basis in the fractional
shares. Revenue Ruling 68-633, which held that a conversion of certificate shares into the
underlying stock held by the trust is a taxable event, is revoked by Revenue Ruling 90-7.
However, the holding in Revenue Ruling 90-7 will not be applied adversely to a taxpayer if
the exchange of trust certificates for trust assets occurred before January 29, 1990. We will
keep you informed of developments. Keith D. Lawson Assistant General Counsel KDL:bmb
Attachment

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.