vides that a person other than the grantor shall be treated as the owner of any portion of a trust over which the person has the sole power to vest the trust corpus or income in that person.

Section 671 of the Code provides that if a grantor or other person is treated as the owner of any portion of a trust, then those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust must be included in computing the taxable income and credits of the grantor or other person.

Section 121 of the Code provides a one-time exclusion from gross income of gain from the sale or exchange of property if the taxpayer has attained the age of 55 before the date of the sale or exchange and the taxpayer has owned and used the property as the taxpayer's principal residence for 3 of the last 5 years ending on the date of the sale or exchange. The maximum amount of gain that may be excluded under section 121 is limited to $125,000.

Rev. Rul. 66-159, 1966-1 C.B. 162, considers whether the gain realized from the sale by a trust of property used by the grantor as the grantor's principal residence qualifies for nonrecognition under section 1034 of the Code (relating to rollover of gain on sale of principal residence). The ruling holds that, because the grantor is treated as the owner of the entire trust under sections 676 and 671 of the Code, the sale by the trust will be treated as if made by the grantor.

In the present case, under *H*'s will, *W* had the sole power to vest the trust corpus or income therefrom in any person, including *W*. Therefore, under section 678 of the Code, *W* is treated as the owner of the entire trust for federal income tax purposes, and must, under section 671 of the Code, include items of income, deductions, and credits attributable to the trust in computing *W*'s taxable income and credits.

Since *W* is treated as the owner of the entire trust under sections 678 and 671 of the Code, the sale by the trust will be treated for federal income tax purposes as if made by *W*. Therefore, if *W* makes the election under section 121 on *W*'s tax return, *W* may exclude from gross income the gain from the sale of the trust property, as the requirements of section 121 of the Code have otherwise been met.

HOLDING

W, a beneficiary who is treated under section 678 as the owner of a trust that owns *W*'s residence, is treated as the owner of the residence for purposes of the one-time exclusion of gain from the sale of a residence under section 121 of the Code.

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26 CFR 1.671-3: Attribution or inclusion of income, deductions, and credits against tax.

Whether a grantor's receipt of the corpus of a trust in exchange for the grantor's unsecured promissory note is an indirect borrowing of trust corpus and not a sale for federal income tax purposes. See Rev. Rul. 85-13, below.

Section 675.—Administrative Powers

26 CFR 1.675-1: Administrative powers. (Also Section 671; 1.671-3.)

Grantor owned trusts. A grantor who acquires the corpus of a trust in exchange for the grantor's unsecured promissory note will be considered to have indirectly borrowed the trust corpus. As a result, the grantor will be treated as the owner of the trust and the grantor's acquisition of the trust corpus will not be viewed as a sale for federal income tax purposes. The Service will not follow the *Rothstein* decision.

Rev. Rul. 85-13

ISSUES

(1) Whether a grantor's receipt of the entire corpus of an irrevocable trust in exchange for an unsecured promissory note given to the trustee, the grantor's spouse, constituted an indirect borrowing of the trust corpus which caused the grantor to be the owner of the entire trust under section 675(3) of the Internal Revenue Code.

(2) To the extent that a grantor is treated as the owner of a trust, whether the trust will be recognized as a separate taxpayer capable of entering into a sales transaction with the grantor.

FACTS

In 1980, *A*, an individual, created an irrevocable trust, *T*. *W*, *A*'s spouse, is the trustee of *T*. The trust instrument of *T* provides that all income of *T* is to be paid semiannually to *C*, *A*'s child, for a term of 15 years. Upon expiration of the trust term, or if *C* dies before the trust term expires, the corpus of *T* will be distributed to *C*'s child or to the estate of *C*'s child. Neither *A* nor any other person has a power over or an interest in *T* that would cause *A* to be treated as the owner of *T* under the grantor trust provisions of the Code, section 671 and following.

A funded *T* with a contribution of 100 shares of stock in Corporation *Z*. The 100 shares represented all of the outstanding stock of Corporation *Z*. When *A* funded *T*, *A*'s basis in the shares was $20*x*.

On December 27, 1981, when the fair market value of the Corporation *Z* shares was $40*x*, *W*, as trustee, transferred the 100 shares to *A*. In exchange, *A* gave *W* *A*'s unsecured promissory note with a face amount of $40*x*, bearing an adequate annual rate of interest, payable semiannually, beginning six months following the date on which the shares were transferred to *A*. Principal payments on the note were scheduled to be paid in 10 equal annual installments, the first installment being due 3 years following the date on which the 100 shares were transferred to *A*, December 27, 1984.

On January 20, 1984, *A* sold the 100 shares to an unrelated party for $50*x*. Corporation *Z* did not make any distributions with respect to the 100 shares at any time before the sale of those shares to the unrelated party.

LAW AND ANALYSIS

Under section 675(3) of the Code, a grantor will be treated as the owner of any portion of a trust in respect of which the grantor has directly or indirectly borrowed the trust corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year, unless the loan (1) provides for adequate interest, (2) is adequately secured, and (3) is not made by the grantor or by a related or subordinate trustee who is subservient to the grantor.

Section 1.675-1 of the Income Tax

Regulations explains that, in effect, section 675 of the Code treats the grantor as the owner of a trust if under the terms of the trust instrument, or the circumstances attendant to its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust. Section 675(3) differs from the other provisions of section 675 which provide rules for determining grantor ownership of a trust, because it requires an affirmative act (borrowing) rather than a retained power, before it applies. Nevertheless, the same theme underlies section 675(3) as underlies the other provisions of section 675 which treat the grantor as owning the trust. In all of these cases the justification for treating the grantor as owner is evidence of substantial grantor dominion and control over the trust.

Section 1.671-3(a)(1) of the regulations states that if a grantor is treated as the owner of an entire trust, the grantor takes into account in computing the grantor's income tax liability all items of income, deduction, and credit to which the grantor would have been entitled had the trust not been in existence during the period the grantor is treated as the owner. If the grantor is treated as the owner of a portion of a trust and that portion consists of specific trust property and its income, section 1.671-3(a)(2) provides that all items directly related to that property or apportioned to that property are to be taken into account in computing the grantor's income tax liability.

In this case, *A* has acquired control over and use of the entire trust corpus, the 100 shares of Corporation *Z* stock, in exchange for *A*'s unsecured note. If *A*, instead of giving *W* a note in exchange for the 100 shares, had made a cash payment of $40*x* to *W* and subsequently borrowed that cash, giving *W* the unsecured note to evidence the borrowing, section 675(3) of the Code would be applicable and *A* would be the owner of *T*. Although *A* did not engage in this kind of direct borrowing, *A*'s acquisition of the entire corpus of *T* in exchange for an unsecured note was, in substance, the economic equivalent of borrowing trust corpus. Accordingly, under section 675(3), *A* is treated as the owner of the portion of *T* represented by *A*'s promissory note. Further, because the promissory note is *T*'s only asset, *A* is treated as the owner of the entire trust.

Because *A* is treated as the owner of the entire trust, *A* is considered to be the owner of the trust assets for federal income tax purposes. See *Ringwalt v. United States*, 549 F.2d 89 (8th Cir. 1977), *cert. denied,* 432 U.S. 906 (1977); *Estate of O'Connor v. Commissioner*, 69 T.C. 165 (1977); Example 5, section 1.1001-2(c) of the regulations; Rev. Rul. 81-98, 1981-1 C.B. 40; Rev. Rul. 78-175, 1978-1 C.B. 144; Rev. Rul. 77-402, 1977-2 C.B. 222; Rev. Rul. 74-613, 1974-2 C.B. 153; Rev. Rul. 72-471, 1972-2 C.B. 201; Rev. Rul. 70-376, 1970-2 C.B. 164; Rev. Rul. 66-159, 1966-1 C.B. 162; *but cf.* Rev. Rul. 74-243, 1974-1 C.B. 106. In this case, *A* is considered to be the owner of the promissory note held by the trust. Therefore, the transfer of the Corporation *Z* shares by *T* to *A* is not recognized as a sale for federal income tax purposes because *A* is both the maker and the owner of the promissory note. A transaction cannot be recognized as a sale for federal income tax purposes if the same person is treated as owning the purported consideration both before and after the transaction. See *Dobson v. Commissioner*, 1 B.T.A. 1082 (1925).

A's basis in the shares received from *T* will be equal to *A*'s basis in the shares at the time he funded *T* because the basis of the shares was not adjusted during the period that *T* held them. See Rev. Rul. 72-406, 1972-2 C.B. 462, a ruling involving the determination of a grantor's basis in property upon reversion of that property to the grantor at the expiration of a trust's term.

In *Rothstein v. United States*, 735 F.2d 704 (2d Cir. 1984), the court considered a transaction that is in substance identical to the facts described in this ruling. The court held that the grantor was the owner of a trust under section 675(3) of the Code because by exchanging an unsecured note for the entire trust corpus, the grantor had indirectly borrowed the trust corpus. The court held further, however, that although the grantor must be treated as the owner of the trust, this means only that the grantor must include items of income, deduction, and credit attributable to the trust in computing the grantor's taxable income and credits, and that the trust must continue to be viewed as a separate taxpayer. The court held, therefore, that the transfer of trust corpus to the grantor in exchange for an unsecured promissory note was a sale and that the taxpayer acquired a cost basis in the assets.

In *Rothstein*, as in this case, section 671 of the Code requires that the grantor includes in computing the grantor's tax liability all items of income, deduction, and credit of the trust as though the trust were not in existence during the period the grantor is treated as the owner. Section 1.671-3(a)(1) of the regulations. It is anomalous to suggest that Congress, in enacting the grantor trust provisions of the Code, intended that the existence of a trust would be ignored for purposes of attribution of income, deduction, and credit, and yet, retain its vitality as a separate entity capable of entering into a sales transaction with the grantor. The reason for attributing items of income, deduction, and credit to the grantor under section 671 is that, by exercising dominion and control over a trust, either by retaining a power over or an interest in the trust, or, as in this case, by dealing with the trust property for the grantor's benefit, the grantor has treated the trust property as though it were the grantor's property. The Service position of treating the owner of an entire trust as the owner of the trust's assets is, therefore, consistent with and supported by the rationale for attributing items of income, deduction, and credit to the grantor.

The court's decision in *Rothstein*, insofar as it holds that a trust owned by a grantor must be regarded as a separate taxpayer capable of engaging in sales transactions with the grantor, is not in accord with the views of the Service. Accordingly, the Service will not follow *Rothstein*.

HOLDINGS

(1) *A*'s receipt of the entire corpus of the trust in exchange for *A*'s unsecured promissory note constituted an indirect borrowing of the trust corpus which caused *A* to be the owner of the entire trust under section 675(3) of the Code.

(2) At the time *A* became the owner of the trust, *A* became the owner of the trust property. As a result, the transfer of trust assets to *A* was not a sale for federal income tax purposes and *A* did not acquire a cost basis in those assets. Accordingly, when *A* sold the shares of Corporation *Z* stock on January 20, 1984, *A* recognized gain of $30*x* (amount realized of $50*x* less adjusted basis of $20*x*). Further, this holding would apply even if the trust held other assets in addition to *A*'s promissory note if *A*, under any of the grantor trust provisions, was treated as the owner of the portion of the trust represented by the promissory note because *A* would be treated as the owner of the purported consideration (the promissory note) both before and after the transaction. See section 1.671-3(a)(2) of the regulations.

Section 678.—Person Other Than Grantor Treated as Substantial Owner

26 CFR 1.678(a)-1: Person other than grantor treated as substantial owner; general rule.

Whether a beneficiary that is treated as the owner of the trust under section 678 of the Code is entitled to the one-time exclusion of gain from the sale of a residence owned by the trust. See Rev. Rul. 85-45, page 183.

Subchapter K.—Partners and Partnerships
Part I. Determination of Tax Liability

Section 709.—Treatment of Organization and Syndication Fees

26 CFR 1.709-1: Treatment of organization and syndication costs.

Partnerships; treatment of syndication costs. Syndication costs incurred in connection with the sale of limited partnership interests are chargeable by the partnership to a capital account and can not be amortized.

Rev. Rul. 85-32

ISSUE

May a partnership amortize syndication costs incurred in connection with the sale of limited partnership interests?

FACTS

Promoter *P* formed limited partnership *LP* to purchase and manage hotels. As part of a public offering of limited partnership interests in *LP*, *P* arranged for the printing of a prospectus at a cost of 300*x* dollars.

LAW AND ANALYSIS

Section 709(a) of the Code provides that, except as provided in section 709(b), amounts paid to organize a partnership or to promote the sale of partnership interests are not deductible under Chapter 1 of the Code (Normal Taxes and Surtaxes). Section 709(b)(1) permits a partnership to elect to amortize organizational expenses over a period of not less than 60 months.

Section 709(b)(2) defines organizational expenses as expenditures which are incident to the creation of the partnership, are chargeable to capital account, and are of a character which, if expended incident to the creation of a partnership having an ascertainable life, would be amortized over such life.

Section 1.709-2(a) of the Income Tax Regulations also discusses the definition of organizational expenses and specifically states that syndication expenses are not organizational expenses within the meaning of section 709.

Section 1.709-2(b) of the regulations defines syndication expenses as expenses connected with the issuing and marketing of interests in the partnership. Examples of syndication expenses are brokerage fees; registration fees; legal fees of the underwriter and the issuer for securities advice pertaining to the adequacy of tax disclosures in the prospectus or placement memorandum for securities law purposes; accounting fees for preparation of representations to be included in the offering materials; and printing costs of the prospectus, placement memorandum, and other selling and promotional material. These expenses are not subject to the election under section 709(b) and must be capitalized.

Section 1.709-1(b)(2) of the regulations provides that if there is a winding up and complete liquidation of the partnership prior to the end of the amortization period, the unamortized amount of organizational expenses with respect to which an election has been made under section 709(b) is deductible as a partnership loss to the extent provided under section 165 of the Code in the partnership's final taxable year. However, no deduction is permitted at the partnership or partner level with respect to the partnership's capitalized organization expenses (for which an election under the section 709(b) has not been made) and capitalized syndication expenses.

The 300*x* dollar cost of printing *LP*'s prospectus is an amount paid to promote the sale of partnership interests, and section 709 of the Code prohibits any deduction for the amount. Section 1.709-2(b) of the regulations further provides that the cost of printing the prospectus is a syndication expense that is not eligible for amortization under section 709(b). As section 709 denies any deduction for organization and syndication fees unless allowed under section 709(b), the provisions of section 709 of the Code and the regulations thereunder supersede any other section contained in Chapter 1 of the Code with respect to the deductibility of the cost of printing *LP*'s prospectus.

HOLDING

A partnership may not amortize syndication costs incurred in connection with the sale of limited partnership interests. The syndication costs are expenses chargeable by the partnership to capital account.

Subchapter N.—Tax Based on Income from Sources Within or Without the United States
Part I.—Determination of Sources of Income

Section 861.—Income From Sources Within the United States

26 CFR 1.861-8: Computation of taxable income from sources within the United States and from other sources and activities.

Section 1.882-5 of the regulations applies to the determination of a foreign bank's worldwide interest expenses allowed as deductions under Article 8(3) of the Convention for purposes of computing the U.S. taxable income of the bank's United States permanent establishment. See Rev. Rul. 85-7, page 188.

Part II.—Nonresident Aliens and Foreign Corporations
Subpart A—Nonresident Alien Individuals