

[date]

[address]

Re: Formal Ruling 18-03

Dear [deleted]:

This is a formal ruling for your client [Taxpayer], regarding the applicability of income tax to capital gain on the sale of his interest in a house. This ruling is based upon representations in your email of [date] and our telephone conversations of [dates].

FACTS

Taxpayer's mother died in 1993, leaving a house in an irrevocable testamentary trust. Under the provisions of the trust, the father received a life interest, to occupy the house until his death, with the remainder to the two children. Taxpayer is one of the two remaindermen. The mother's trust was a credit-shelter trust for Federal estate tax purposes.

Taxpayer's father died [date] 2016, at which time Taxpayer and his sister each received an undivided one-half interest in the house. After the father's death, Taxpayer and his sister did not occupy the house or use the house as a primary or secondary residence, and did not rent or otherwise use the house for production of income or depreciate the house. Taxpayer sold his one-half interest in the house to his sister on [date] 2017.

You have asked whether Taxpayer's gain on the sale of his one-half interest is eligible for the 40% exclusion of capital gain under Vermont income tax law.

RULING

Taxpayer’s capital gain on the sale of his interest in the house to his sister is eligible for the 40% exclusion for purposes of Vermont income tax.

DISCUSSION

Vermont income tax law in effect in 2017, the year of Taxpayer’s sale, allowed a taxpayer to elect to exclude from taxable income 40% of qualified capital gain income, as follows:

(21) “Taxable income” means federal taxable income determined without regard to 26 U.S.C. § 168(k) and:

* * *

(B) Decreased by the following items of income (to the extent such income is included in federal adjusted gross income):

* * *

(ii) with respect to adjusted net capital gain income as defined in 26 U.S.C. § 1(h) reduced by the total amount of any qualified dividend income:

either the first \$5,000.00 of such adjusted net capital gain income;

or 40 percent of adjusted net capital gain income from the sale of assets held by the taxpayer for more than three years, except not adjusted net capital gain income from:

(I) the sale of any real estate or portion of real estate used by the taxpayer as a primary or nonprimary residence; or

(II) the sale of depreciable personal property other than farm property and standing timber; or stocks or bonds publicly traded or traded on an exchange, or any other financial instruments; regardless of whether sold by an individual or business;

and provided that the total amount of decrease under this subdivision (21)(B)(ii) shall not exceed 40 percent of federal taxable income

32 V.S.A. § 5811(21).

Federal tax law defines a “capital asset” as all property other than certain excluded items. 26 U.S.C. § 1221(a).¹ The excluded items are inventory held for sale to customers, real property used in a trade or business, depreciable property, certain intellectual property, and miscellaneous other items. Under the Federal definition, Taxpayer’s interest in the house qualifies as a capital asset.

The threshold test under Vermont’s capital gain rules is whether Taxpayer’s gain qualifies as “adjusted net capital gain income as defined in 26 U.S.C. § 1(h).”² “Adjusted net capital gain” in that section is defined as net capital gain minus any capital gain from “unrecaptured Section 1250 gain and 28-percent rate gain, plus qualified dividend income.” 26 U.S.C. § 1(h)(3)(A). “Section 1250” gain is gain on the sale of real property eligible for depreciation under Section 167 of the Internal Revenue Code. 26 U.S.C. § 1250. “28-percent gain” includes gain on “collectibles” (art works, antiques, rare coins and stamps, etc.) and “Section 1202 gain” (gain on qualified small business stock). 26 U.S.C. §§ 1(h)(4),(5); 408(m)(2).

The house was clearly not a “collectible” or small business stock, so Taxpayer’s gain was not 28-percent rate gain. Since Taxpayer never used the house in a trade or business or for the production of income, there is no unrecaptured Section 1250 gain. As a result, his adjusted net capital gain on the house equals his net capital gain on the house.

The next test is whether Taxpayer’s adjusted net capital gain on the house is ineligible for the 40% exclusion because it was gain from either (1) personal property or a financial instrument, or (2) real property “used by the taxpayer as a primary or nonprimary residence.” The house is not

¹ This Ruling does not provide legal advice with regard to Federal tax law. Federal tax law is discussed only to give context to the Ruling with regard to Vermont tax law.

² Federal law denies capital gain treatment for the sale of an asset to certain related entities if the asset in the transferee’s hands will be depreciable. 26 U.S.C. § 1239. It is assumed for purposes of this Ruling that Taxpayer’s transfer is not subject to Section 1239.

personal property or a financial instrument, and Taxpayer never used the house as a primary or nonprimary residence. His gain was therefore not from either of these ineligible types of property.

The final test is whether Taxpayer held the property for more than three years. Vermont's income tax law "is intended to conform the Vermont personal and corporate income taxes with the United States Internal Revenue Code, except as otherwise expressly provided." 32 V.S.A. § 5820(a). There is no express Vermont provision regarding holding periods for purposes of the Vermont capital gain exclusion. Therefore, the Federal rules apply.

Taxpayer's mother died in 1993, leaving the house in a testamentary credit-shelter trust, with lifetime occupancy provision for the husband. Taxpayer's remainder interest is considered created at the date of the mother's death. Since the mother's trust was a credit-shelter trust, and was not a marital trust, the house was not treated as "qualified terminable interest property" (QTIP), and the Federal QTIP rules for basis and holding period do not apply. Taxpayer's basis would be stepped-up to the 1993 fair market value as of the mother's death (or alternate valuation date). Taxpayer's holding period would begin at the creation of his remainder interest, on the date of his mother's death. *Cf.* Internal Revenue Service, Private Letter Ruling P.L.R. 200901008 (Jan. 2, 2009) ("[T]he holding period of property that the taxpayer received as a remainderman under a trust established by his grandmother's will dated from his grandmother's death rather than the date that the taxpayer's remainder interest ripened into possession.").

Conclusion

Since Taxpayer's holding period runs from his mother's date of death in 1993, his holding period at the time of his 2017 sale to his sister would be more than three years, qualifying his capital gain for the Vermont 40% exclusion.

GENERAL PROVISIONS

Issuance of this ruling is conditioned upon the understanding that neither the taxpayer nor a related taxpayer is currently under audit or involved in an administrative appeal or litigation concerning the subject matters of the ruling. This ruling is issued solely to the taxpayer and is limited to the facts presented, as affected by current statutes and regulations.

Other taxpayers may refer to this ruling, when redacted to protect confidentiality, to see the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statutes or regulations.

This ruling will be made public after deletion of the taxpayer's name and any information which may identify the taxpayer. A copy of this ruling showing the proposed deletions is attached, and you may request within 30 days that the Commissioner delete any further information that might identify the taxpayer. The final discretion as to deletions rests with the Commissioner.

You have the right to appeal this ruling within 30 days. 3 V.S.A. §§ 808, 815.

Emily Bergquist

Date

Approved:

Kaj Samsom
Commissioner of Taxes

Date

Commissioner signed the original ruling April 11, 2018