

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 - PLR-130468-00
Date:
December 11, 2001

Decedent =

A =

B =

Trust =

Successor Trust 1 =

Successor Trust 2 =

Successor Trust 3 =

Successor Trust 4 =

GC 1 =

GC 1's spouse =

GGC 1a =

GGC 1b =

GC 2 =

GC 2's spouse =

GGC 2a =

GGC 2b =

GC 3 =

GC 3's spouse =

GGC 3a =

GGC 3a's spouse =

GGGC 3a =

GGGC 3aa =

GGC 3b =

GGC 3c =

GC 4 =

GC 4's spouse =

GGC 4a =

GGC 4a's spouse =

GGC 4b =

GGC 4b's spouse =
GGGC 4b =
GGC 4c =
GGC 4c's spouse =
GGGC 4c =
GGC 4d =

Bank 1 =
 Bank 2 =

State 1 =
 State 2 =

D1 =
D2 =
D3 =
D4 =

Dear _____ :

This letter responds to your letter dated December 8, 2000, and subsequent correspondence, submitted by you as the authorized representative of the trustee of Trust, requesting certain rulings under the Internal Revenue Code.

The information submitted states that Decedent created Trust as an irrevocable trust on D1, with Decedent's child A as trustee, for the benefit of A's issue, the spouses of A's issue, and A's spouse. Decedent died on D2.

Article First of Trust provides the trustee with the discretionary authority to pay part or all of the net income or principal to any one or more of a class of beneficiaries consisting of A's spouse, A's issue, and the spouses of any issue. However, the trustee may not pay net income or principal to any child of A who has not attained his or her twenty-first (21st) birthday. Any accumulated net income is to be added to principal. Unless sooner terminated by payments of principal, Trust is to continue until the date that is twenty-one (21) years after the death of the survivor of the children of A who were living on D1. The children of A alive on D1 were GC 1, GC 2, GC 3, and GC 4.

Article Second of Trust provides that subject to the exercise of the powers conferred in Articles Third and Fourth, at the termination of Trust, the trustee is to pay the entire principal then remaining, forty percent (40%) to A's spouse, and sixty percent (60%), or the whole thereof if his spouse is not then living, to the issue of A then living in equal shares per stirpes, or, if there are no issue then living, to the issue of Decedent's child B then living in equal shares per stirpes.

Article Third of Trust provides A with the discretionary authority at any time during his life to divide the principal then remaining into shares for or among any one or more of a class consisting of A's spouse, his issue, and the spouses of any issue. After

the division, A as trustee is to hold each share as a separate trust fund for the benefit of A's spouse, his issue, and the spouses of any issue. A is to either pay part or all of the net income and the principal of the separate trust fund to the beneficiary or accumulate all or part of the net income and add the same to principal. Upon the death of a beneficiary prior to receiving the entire principal of the separate trust fund for his or her benefit, or in the case of a separate trust fund for a beneficiary who was not living on the date Trust was executed, then upon the termination of Trust (if the termination occurs during the life of the beneficiary), the principal of the separate trust fund then remaining is to be paid to the beneficiary. If the beneficiary is not then living, the trust fund is to be paid in equal shares per stirpes to the issue of the beneficiary then living, or, if there is no issue then living, to the other issue of A then living, or, if there is no issue of A then living, to the issue of B then living.

Article Fourth of Trust provides A with the power to appoint by will the principal of Trust remaining at his death either outright to or in further trust for the benefit of one or more of a class consisting of his spouse, his issue, and the spouses of any issue. This power is to be exercisable whether or not the power conferred in Article Third has been exercised by A, during his lifetime, and if and to the extent that this power is to be validly exercised in this manner the trust fund is to be held or disposed of in accordance with the terms of A's will in lieu of the terms of Trust.

Paragraph XI of Article Seventh of Trust provides that the trustee and each successor trustee, in his or her sole discretion, is fully authorized and empowered with respect to any property held in trust to make a just and equitable division or partition of any property and to distribute portions thereof or undivided interests therein in cash or in kind, and in connection with any division, partition or distribution, to make a binding appraisal of the property.

Article Eleventh of Trust provides that the trustee or each individual successor trustee may designate by instrument in writing an individual or a bank or trust company to serve as successor trustee in the event that he or she should for any reason cease to act. Each designation is to be revocable until the occurrence of the event upon which the same is to become effective. In the event that despite the foregoing provisions there is no trustee, Bank 1 is to become the trustee. A is to receive no compensation for his services as trustee, but each successor trustee is to be entitled to receive and may retain compensation at the rates and in the manner specified by the laws of State 1. No bond or other security is to be required of any trustee acting, and each of them is to have and may exercise all of the duties and powers, discretionary and otherwise, imposed or conferred upon the trustee named, excepting only that powers conferred upon A by name are to be exercisable only by A.

On D3, A exercised his power under Article Third and appointed a portion of Trust principal to separate trusts for the benefit of GC 1, GC 2, GC 3, and GC 4. Each of the trusts continued to operate under the terms of Trust. It is represented that no additions have been made to Trust (or each grandchild's trust) after September 25, 1985.

On D4, A petitioned local court of State 1 to distribute the remaining property in Trust to four new trusts, one for the benefit of each grandchild's family (collectively, the Successor Trusts). The beneficiaries of Successor Trust 1 will be GC 1, GC 1's spouse and children (GGC 1a and GGC 1b). The beneficiaries of Successor Trust 2 will be GC 2, GC 2's spouse and children (GGC 2a and GGC 2b). The beneficiaries of Successor Trust 3 will be GC 3, GC 3's spouse, GC 3's children, GC 3's child's spouse and GC 3's grandchildren (GGC 3a, GGC 3a's spouse, GGGC 3a, GGGC 3aa, GGC 3b, and GGC 3c). The beneficiaries of Successor Trust 4 will be GC 4, GC 4's spouse, GC 4's children, GC 4's children's spouses and GC 4's grandchildren (GGC 4a, GGC 4a's spouse, GGC 4b, GGC 4b's spouse, GGGC 4b, GGC 4c, GGC 4c's spouse, GGGC 4c, and GGC 4d). The petition to distribute the property in each grandchild's trust is subject to the issuance of a favorable ruling from the Internal Revenue Service concerning the transfer tax consequences of the successor trusts.

Except for the beneficiaries, the provisions of all successor trusts are substantially the same as the provisions of Trust except that each successor trust will be created for the primary benefit of only one grandchild, the grandchild's spouse, the grandchild's children, and the grandchild's grandchildren. Bank 2 will be the trustee ("New Trustee") of each successor trust. New Trustee will have the discretionary authority to distribute net income and principal to the grandchild, the grandchild's spouse, and the grandchild's children. Each successor trust will provide that any power to remove and replace trustees and to appoint co-trustees and successor trustees held by a person are to be exercised by that person subject to the requirement that, at all times, all trustees serving must be disinterested persons. A disinterested person is defined as a bank or an individual other than a beneficiary that (i) is either domiciled in State 2 or in a jurisdiction in which the grandchild is not domiciled and (ii) is not, within the meaning of § 672(c) of the Internal Revenue Code, related or subordinate to any beneficiary. Each successor trust will be governed by the laws of State 2 and will terminate no later than the date that is twenty-one (21) years after the death of the last survivor of the children of A who were alive on the date Trust was executed. Each successor trust will receive a pro rata share of each asset held in each grandchild's trust.

Further, each successor trust will grant the grandchild a testamentary power to appoint the balance of the trust to or for the benefit of a limited class of beneficiaries within the grandchild's family. Specifically, the property may only be appointed to the individual's issue who would, if such date were the termination date, be among the recipients of a terminating distribution from Trust. In conjunction with this plan, A intends to release the power to appoint the property to his spouse and issue provided in Article Fourth of Trust.

RULING 1

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss will be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

In order for a transaction to result in a § 1001 taxable event, the transaction must be a sale, exchange or other disposition. Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the severance of a joint tenancy in stock under a state partition action to compel the issuance of separate stock certificates is not a sale or exchange. Similarly, the conversion of a joint tenancy in stock into a tenancy in common is a nontaxable transaction.

In contrast, in Rev. Rul. 69-486, 1969-2 C.B. 159, a trustee made a non-pro rata distribution of trust property pursuant to an agreement of the beneficiaries, although neither the trust instrument nor local law authorized the trustee to do so. The ruling holds that the transaction was equivalent to a pro rata distribution of the trust assets followed by an exchange between the beneficiaries, and was a taxable event under § 1001.

This case is more akin to Rev. Rul. 56-437 than to Rev. Rul. 69-486. The beneficiaries of the Trust will not acquire their interests in the Successor Trusts as a result of an exchange of their interests in the Trust, but by reason of the trustee's authority to divide the Trust under the Trust instrument and state law. The transaction thus is similar to the partition of the property in Rev. Rul. 56-437.

Therefore, the Trust, the Successor Trusts, and the beneficiaries of any of these Trusts will not realize gain or loss under § 1001. Because no gains will be realized, under § 61 no income will result from this transaction to the Trust, the Successor Trusts, or any beneficiary.

RULING 2

Section 1015(a) provides, in part, that if property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person if such property has, for purposes of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of the other person. If, under § 1015, each Successor Trust's basis in an asset transferred to it by the Trust will equal the Trust's basis in the asset at the time of the transfer, then under § 1223(2) each

Successor Trust's holding period for an asset transferred to it by the Trust will include the Trust's holding period for the asset at the time of the transfer.

We conclude that each asset transferred to the Successor Trusts from Trust will have the same basis and holding period as it had prior to the proposed transaction.

RULING 3

Section 643(f) provides that, for purposes of subchapter J, under regulations prescribed by the Secretary, two or more trusts shall be treated as one trust if (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1. For purposes of the preceding sentence, a husband and wife shall be treated as one person.

We conclude that, while the Successor Trusts have the same grantor, they have different primary beneficiaries. Therefore, based on the facts and representations submitted, we conclude that the Successor Trusts will be treated as separate trusts for federal income tax purposes under § 643(f).

RULING 4

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, is deemed to be a transfer of property by the individual possessing the power for gift tax purposes. Section 2514(c) defines the term "general power of appointment" as a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. However, under § 2514(c)(1), a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not a general power of appointment.

Section 25.2514(c)(1) of the Gift Tax Regulations provides that a power of appointment is not a general power if by its terms it is exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate.

In this case, A has a testamentary power to appoint the assets held for the benefit of his family. Because this power may be exercised only in favor of a limited class of beneficiaries within A's family, this power is not a general power of appointment as defined in § 2514. Accordingly, A's power of appointment is not a general power of appointment and the release of this power will not constitute a deemed transfer subject to gift tax under § 2514.

RULING 5

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual, resident or nonresident. Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

In this case, the beneficial interests, rights, and expectancies of New Trustee, GC 1, GC 2, GC 3, or GC 4, and their respective family members will remain substantially the same both before and after the proposed distribution to each successor trust. Accordingly, based on the facts submitted and the representations made, we conclude that the distributions to and the pro rata allocation of Trust assets among the Successor Trusts will not be deemed to be a taxable gift under § 2501.

RULING 6

Section 2601 imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax (GSTT) is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor held a power with respect to the trust that would have caused the value of the trust to be included in the settlor's gross estate for Federal estate tax purposes by reason of § 2038 or by reason of § 2042 if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GSTT if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST or the creation of a new GST.

In this case, the proposed distribution of Trust's corpus to Successor Trust 1, Successor Trust 2, Successor Trust 3, and Successor Trust 4 will not result in a shift of any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the distribution. Further, the proposed distributions will not extend the time for vesting of any beneficial interest in either trust beyond the period provided for in the original trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed distributions of each grandchild's trust principal into four successor trusts, Successor Trust 1, Successor Trust 2, Successor Trust 3, and Successor Trust 4 and any subsequent distribution from, or termination of any interests in, the Successor Trusts will not cause the trusts to lose their exempt status for generation-skipping transfer tax purposes under § 2601.

RULING 7

Section 2041(a)(2) provides that the value of the gross estate is to include the value of all property to the extent of any property with respect to which the decedent has, at the time of death, a general power of appointment created after October 21, 1942.

Section 2041(b)(1) defines "general power of appointment" as a power which is exercisable in favor of the decedent, his estate, his creditors, or creditors of his estate. However, under § 2042(b)(1)(A), a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not a general power of appointment.

Section 20.2041(c)(1) of the Estate Tax Regulations provides that a power of appointment is not a general power if by its terms it is exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate.

In this case, each successor trust provides a respective grandchild with a testamentary power to appoint the assets held for the benefit of his or her family. Because these powers of appointment may be exercised only in favor of a limited class of beneficiaries within the grandchild's family, these powers are not general powers of appointment as defined in § 2041. Furthermore, if a trustee is removed from office, the trustee may only be replaced with another trustee that is not, within the meaning of § 672(c), related or subordinate to any beneficiary of the successor trust. Accordingly, a grandchild's power of appointment is not a general power of appointment and will not cause the property in successor trust to be includible in the grandchild's gross estate under § 2041.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transaction described above under any other provision of the Code.

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

Pursuant to a power of attorney on file with this office, copies of this letter are being forwarded to the trustee of Trust and to the other authorized representative of the trustee of Trust.

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

Enclosures: 2
Copy of a letter
Copy for § 6110 purposes

cc: