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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2-PLR-153651-01
Date:
April 1, 2002

Legend

Decedent =

Sister =

Primary Beneficiary =

Trust 1 =

Trust 2 =

Trustee 1 =

Trustee 2 =

Proposed Trustee 1 =

Proposed Trustee 2 =

State X =

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Dear _____ :

This is in response to your September 26, 2001 letter in which you requested a ruling on the income, gift, estate, and generation-skipping transfer tax consequences of a proposed transfer of Trust 1 corpus to a newly created trust, Trust 2, pursuant to § 10-6.6(b)(1) of the New York Estate, Powers, and Trust Law.

Decedent died testate in 1963. Article EIGHT, paragraph II of Decedent's will established a trust for each of Sister's descendants, per stirpes, living at Decedent's death. Only the trust established for Primary Beneficiary and his descendants (Trust 1) is the subject of this ruling.

Article NINE of Decedent's will limits the number of trustees for Trust 1 to four. The current trustees of Trust 1 are Primary Beneficiary, Trustee 1, (Primary Beneficiary's sibling), and Trustee 2 (Primary Beneficiary's child). Trustee 1, as a sibling of Primary Beneficiary, does not have an interest in Trust 1.

Under applicable New York law, a trustee who is also a beneficiary is precluded from participating in any decision to distribute trust income or corpus to himself or herself. NYEPTL § 10-10.1 (McKinney 2001).

Trustee 1 represents that no actual or constructive additions to Trust 1 have been made since Decedent's death.

Since its creation in 1963, Trust 1 has been administered under the laws of New York. It has periodically petitioned New York courts to replace trustees and to add new trustees. From its creation until 1983, Trust 1 had at least one trustee who was a resident of the State of New York. From 1983 to the present, no trustee and no current beneficiary has been a resident of New York. Primary Beneficiary is a resident of State X and has eight living descendants: three children and five minor grandchildren.

Pursuant to New York Est. Powers & Trusts Law § 10-6.6 (b), Trustee 1 proposes to transfer the corpus of Trust 1 to a new trust, Trust 2. Trust 2 will be situated in State X and will contain substantially identical provisions as those of Trust 1.

New York Est. Powers & Trusts Law § 10-6.6(b) (McKinney 2001) provides that unless the terms of the instrument expressly provide otherwise:

(1) A trustee who has the absolute discretion, under the terms of a testamentary instrument . . . , to invade the principal of a trust for the benefit of one or more proper objects of the exercise of the power, may exercise such discretion by appointing all or part of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created . . . , provided, however, that the exercise of such discretion (A) does not reduce any fixed income

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interest of any income beneficiary of the trust, (B) is in favor of the proper objects of the exercise of the power, and (C) does not violate the limitations of 11-1.7 [which prohibits waivers of liability].

Trust 1's provisions are found in Article EIGHT of Decedent's will. Under Article EIGHT, Paragraph II. A., net income is to be paid to Primary Beneficiary for life, except that, the trustees other than Primary Beneficiary may (i) pay all or part of the income to one or more of Primary Beneficiary's descendants, or (ii) accumulate the income and add it to principal. Under Paragraph II. F. of Article EIGHT, the trustees, other than the current income beneficiary, may pay to the current income beneficiary part or all of Trust 1 principal as the trustees, other than the current income beneficiary, deem advisable in their absolute discretion for any reason whatsoever. The term "current income beneficiary" means the person to whom the current income of any trust is distributable whether pursuant to an express provision or pursuant to the exercise of any discretionary power granted to the trustees.

Under Paragraph II. B. of Article EIGHT, at Primary Beneficiary's death, the remaining Trust 1 principal is to be distributed to or for the use of those appointees, outright or in further trust, as Primary Beneficiary designates by will. However, he may not appoint the property to himself, or his estate, or his creditors, or the creditors of his estate.

Under Paragraph II. C. of Article EIGHT, to the extent Primary Beneficiary does not exercise the power of appointment, the remaining Trust 1 principal will be divided into equal shares per stirpes among Primary Beneficiary's descendants living at his death. Each share will be held as a separate trust for the benefit of the individual descendant (the "Secondary Beneficiary") for whom the share is so set aside. The separate trust will terminate on the first to occur of: (i) 21 years after the death of the survivor of all of Sister's descendants who survived Decedent; or (ii) the death of the Secondary Beneficiary.

Under Paragraph II.C.1. of Article EIGHT, until the termination, the net income is to be paid to the Secondary Beneficiary. However, the trustees other than the Secondary Beneficiary may: (i) pay all or part of the income to one or more of the Secondary Beneficiary's descendants; or (ii) accumulate the income and add it to principal. Under Paragraph II. F. of Article EIGHT, the trustees, other than the current income beneficiary, may pay to the current income beneficiary part or all of the principal as the trustees, other than the current income beneficiary, deem advisable in their absolute discretion for any reason whatsoever.

Under Paragraph II.C.2. of Article EIGHT, if the trust terminates as a result of the Secondary Beneficiary's death, the remaining principal is to be distributed to or for the use of such appointees, outright or in further trust, as the Secondary Beneficiary may appoint by will. However, the Secondary Beneficiary may not exercise the power of appointment in favor of himself, or his estate, or his creditors, or the creditors of his

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estate. Under Paragraph II.C.3. of Article EIGHT, to the extent the Secondary Beneficiary fails to exercise the power, the remaining principal is to be distributed in equal shares per stirpes to the Secondary Beneficiary's descendants living at the time of the Secondary Beneficiary's death. Under Paragraph II.C.4. of Article EIGHT, if the trust terminates as a result of the expiration of 21 years after the death of the survivor of all of Sister's descendants living at Decedent's death, the trust principal is to be distributed to the Secondary Beneficiary.

Trustee 1 represents that the only substantive differences in the provisions of Trust 1 and Trust 2 are as follows:

(1) Trust 2 will provide that it is to be administered and interpreted under the laws of State X; however, no provision of Trust 2 or the trust laws of State X shall be interpreted or applied in any manner that would cause the beneficial interest held by any person to differ from the beneficial interest held by that person under Article EIGHT of Trust 1.

(2) Trust 2 will provide that, notwithstanding any other provision, no exercise of a power of appointment granted in the trust shall result in a termination date for a trust or a share thereunder or created pursuant to a power of appointment granted thereunder which is later than the date twenty-one years after the death of the survivor of all of Sister's descendants living at Decedent's death.

(3) Trust 2 will provide that no person acting as trustee shall participate in a decision to make a discretionary distribution to himself or herself, his or her estate, his or her creditors, the creditors of his or her estate or to a person to whom he or she has a legal obligation. Primary Beneficiary, Trustee 1, Trustee 2, Proposed Trustee 1 (Primary Beneficiary's child), and Proposed Trustee 2 (Primary Beneficiary's child) will be designated as the trustees.

(4) Trust 2 will provide that there shall not be more the five trustees in office at any time. At any time that a current income beneficiary is serving as trustee, there shall be at least one trustee who is neither a current income beneficiary, nor a person with a legal obligation to a current income beneficiary. The individual trustees at any time in office, other than a trustee who has a legal obligation to a current income beneficiary, are authorized to appoint an individual or a bank or a trust company to act as a trustee, in succession to any appointed trustee.

(5) No person or persons has the power to remove a trustee. Trust 2 will provide that a trustee shall cease to act and be removed upon written certification by two physicians that the trustee is incompetent or incapacitated by reason of age, illness, or injury. If a trustee vacancy

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exists which cannot be filled under the authority granted, Primary Beneficiary, if living, or the Secondary Beneficiary will appoint a successor trustee.

(6) Paragraph Fourth, E of Trust 2 will provide that, wherever used in the instrument, the term "current income beneficiary" is defined to mean any person to whom the current income of any trust is distributable whether pursuant to an express provision in the instrument or pursuant to the exercise of any discretionary power granted to the trustee thereunder.

(7) Trust 2 will provide that the trustees may transfer the trust property (or any portion thereof) or the situs of trust administration, or both, at any time and from time to time from one jurisdiction to another and, regardless of any other designation of applicable law, elect in writing that the law of such other jurisdiction shall thereafter govern to the extent as may be necessary and appropriate. However, notwithstanding any other provision, the trustees shall not exercise any power under the trust in any manner that would cause the beneficial interest held by any person to differ from the beneficial interest held by that person under Article EIGHT of Trust 1.

Requested Rulings

Trustee 1 has asked us to rule that:

(1) The transfer of assets from Trust 1 to Trust 2 will not subject distributions from Trust 2 to the generation-skipping transfer tax imposed under Chapter 13 of the Internal Revenue Code.

(2) Assets transferred to Trust 2 will not be included in the gross estate of Primary Beneficiary, any other trust beneficiary or any trustee of either Trust 1 or Trust 2.

(3) The transfer of assets from Trust 1 to Trust 2 will not constitute a gift to Trust 2 or to any beneficiary of Trust 2 for purposes of Section 2501 of the Internal Revenue Code by the trustee making the transfer.

(4) No person, including the trustee of Trust 1 who establishes Trust 2 and who directs the transfer of assets thereto, will be treated as the owner of any portion of Trust 2 for federal income tax purposes under the provisions of Sections 671 through 678 of the Internal Revenue Code.

(5) No gain or loss under Section 1001 of the Internal Revenue Code will be recognized on any trust assets as a result of their transfer to Trust 2.

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Ruling 1

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

Under § 1433 of the Tax Reform Act of 1986 (the Act), the generation-skipping transfer (GST) tax 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.

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. These rules are applicable only for purposes of determining whether an exempt trust retains exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(A) provides that the distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the provisions of chapter 13, if –

(1) Either–

(i) The terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or

(ii) at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court; and

(2) The terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation.

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Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GST tax 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 a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer.

Section 26.2601-1(b)(4)(i)(E), Example 2, considers a situation where, in 1980, Grantor established an irrevocable trust (Trust) for the benefit of Grantor's child, A, A's spouse, and A's issue. At the time Trust was established, A had two children, B and C. A corporate fiduciary was designated as trustee. Under the terms of Trust, the trustee has the discretion to distribute all or part of the trust income or principal to one or more of the group consisting of A, A's spouse or A's issue. Trust will terminate on the death of A, at which time, the trust principal will be distributed to A's issue, per stirpes. Under a state statute enacted after 1980 that is applicable to Trust, a trustee who has the absolute discretion under the terms of a testamentary instrument or irrevocable inter vivos trust agreement to invade the principal of a trust for the benefit of the income beneficiaries of the trust, may exercise the discretion by appointing so much or all of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created, or under the same instrument. The trustee may take the action either with consent of all the persons interested in the trust but without prior court approval, or with court approval, upon notice to all of the parties. The exercise of the discretion, however, must not reduce any fixed income interest of any income beneficiary of the trust and must be in favor of the beneficiaries of the trust. Under state law prior to the enactment of the state statute, the trustee did not have the authority to make distributions in trust. In 2002, the trustee distributes one-half of Trust's principal to a new trust that provides for the payment of trust income to A for life and further provides that, at A's death, one-half of the trust remainder will pass to B or B's issue and one-half of the trust will pass to C or C's issue. Because the state statute was enacted after Trust was created and requires the consent of all of the parties, the transaction constitutes a modification of Trust. However, the modification does not shift any beneficial interest in Trust to a beneficiary or beneficiaries who occupy a lower generation than the person or persons who held the beneficial interest prior to the modification. In addition, the modification does not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. The new trust will terminate at the same date provided under Trust. The example concludes that neither Trust nor the new trust will be subject to the provisions of chapter 13.

Section 26.2601-1(b)(4)(i)(E), Example 4, considers a situation where in 1980, Grantor, who was domiciled in State X, executed an irrevocable trust for the benefit of Grantor's issue. Under the terms of the trust, the trust is to terminate, in all events, no later than 21 years after the death of the last to die of certain designated individuals

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living at the time the trust was executed. The provisions of the trust do not specify that any particular state law is to govern the administration and construction of the trust. In State X, the common law rule against perpetuities applies to trusts. In 2002, the situs of the trust changes to State Y, and the laws of State Y govern the administration and construction of the trust. State Y law contains no rule against perpetuities. However, in view of the terms of the trust instrument, the trust will terminate at the same time before and after the change in situs. Accordingly, the change in situs does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the transfer. Furthermore, the change in situs does not extend the time for vesting of any beneficial interest in the trust beyond that provided for in the original trust. Therefore, the change in situs does not cause the trust to lose exempt status for GST purposes. The example concludes that if, as a result of the change in situs, State Y law governed such that the time for vesting was extended beyond the period prescribed under the terms of the original trust instrument, the trust would not retain exempt status.

In this case, Trust 1, established for Primary Beneficiary and his descendants, was created and became irrevocable before September 25, 1985, and it is represented that no additions have been made to Trust 1 since September 25, 1985. Therefore, Trust 1 is exempt from GST Tax.

Trust 1 must terminate no later than 21 years after the death of the last survivor of Sister's descendants living at Decedent's death (the date Trust 1 was created). Trustee 1 proposes to distribute the assets of Trust 1 to Trust 2 pursuant to a state statute similar to that described in Section 26.2601-1(b)(4)(i)(E), Example 2. The dispositive terms of Trust 2 will be identical to those of Trust 1. Further, Trust 2 must terminate in all events no later than 21 years after the death of the last survivor of Sister's descendants living at Decedent's death, as is the case with Trust 1. Thus, the distribution to Trust 2 will not shift any beneficial interest in Trust 1 to a beneficiary or beneficiaries who occupy a lower generation than the person or persons who held the beneficial interest prior to the modification. In addition, the distribution will not extend the time for vesting of any beneficial interest in Trust 2 beyond the period provided for in Trust 1.

In addition, notwithstanding the change in trust situs, under the terms of Trust 2, the trust will terminate at the same time before and after the change in situs. Further, the terms of Trust 2 expressly prohibit the trustees from exercising any power or discretion provided under State X law that would enlarge, diminish or be inconsistent with the powers and discretions of the trustees under Trust 1, and expressly prohibit the application of the laws of State X in a manner that would cause the beneficial interest held by any person to differ from the beneficial interest held under Trust 1.

Accordingly, we conclude that the distribution of Trust 1 corpus to Trust 2 will not cause Trust 1 or Trust 2 to be subject to the provisions of Chapter 13. Section

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26.2601-1(b)(4)(i)(E), Example 2. Further, the change in situs of Trust 2 will not cause the trust to lose exempt status for GST purposes. Section 26.2601-(b)(4)(i)(E),

Example 4.

Ruling 2

Section 2041(a)(2) provides that the value of the gross estate shall 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, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of a nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b) provides that the term "general power of appointment" means a power exercisable in favor of the individual possessing the power, the individual's estate, the individual's creditors, or the creditors of the individual's estate.

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

In this case, both Trust 1 and Trust 2 provide that a current income beneficiary (any person to whom current income is distributable under an express provision or pursuant to the exercise of a trustee's discretionary power) cannot participate in a decision to: (i) accumulate income or pay it to a descendant; or (ii) distribute trust principal. In addition, Trust 1 and Trust 2 provide Primary Beneficiary with a testamentary power to appoint the remaining principal to anyone other than himself, his estate, his creditors or the creditors of his estate. Thus, Primary Beneficiary does not possess a general power of appointment within the meaning of § 2041(b).

Under Trust 1 and Trust 2, if Primary Beneficiary does not exercise his power of appointment, the principal remaining at his death will be divided into equal shares for his descendants then living. Each share will be held for a respective Secondary Beneficiary and his or her descendants under income and principal provisions identical to those of Trust 1 wherein a current income beneficiary may not participate in any decision to: (i) accumulate income or pay it to a descendant; or (ii) distribute trust principal. In addition, under Trust 1 and Trust 2, a Secondary Beneficiary will possess a testamentary power to appoint the principal remaining at his or her death to anyone other than himself or herself, his or her estate, his or her creditors or the creditors of his or her estate. In these circumstances, a Secondary Beneficiary or other beneficiary will

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not possess a general power of appointment over the trust property.

Consequently, the principal transferred from Trust 1 to Trust 2 will not be includible in Primary Beneficiary's gross estate or the gross estate of any beneficiary of Trust 1 or Trust 2.

Ruling 3

Section 2501 imposes a tax on the transfer of property by gift by any individual.

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations provides that the gift tax also applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

In this case, the dispositive and beneficial interests in Trust 2 will be identical to those of Trust 1. Therefore, no interest in Trust 1 will be gratuitously transferred. Accordingly, the distribution of Trust 1 principal to Trust 2 will not be subject to gift tax under section 2501.

Ruling 4

Section 671 of the Code provides that where it is specified in subpart E of part I of subchapter J of chapter 1 that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D.

Sections 673 through 677 specify the circumstances under which the grantor is regarded as the owner of a portion of a trust.

Section 1.671-2(e)(1) of the Income Tax Regulations provides that for purposes of subchapter J, a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer of property to a trust. In this case, Decedent, the original grantor, has died, and thus can no longer be treated as the deemed owner of Trust 1. If the corpus of Trust 1 became the property of someone (other than in trust) at any time during this transaction, then that person is the grantor of

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part or all of Trust 2 (depending on the extent of that person's property rights in the corpus).

Section 678 provides that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

Based on our analysis of the trust documents and the factual representations submitted, we conclude that the proposed transactions will not cause Trust 1 or Trust 2 to be considered grantor trusts, nor will any trustee or beneficiary of Trust 1 or Trust 2 be considered the owner of any portion of Trust 1 or Trust 2 under sections 671 through 679 of the Code.

Ruling 5

Section 61 of the Internal Revenue Code provides that gross income includes all income from whatever source derived. Section 61(a)(3) specifically includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss is the excess of the adjusted basis provided in section 1011 over the amount realized. Section 1001(c) provides that, except as otherwise provided in Subtitle A, the entire amount of gain or loss determined under section 1001 on the sale or other exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides, as a general rule, that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained. For purposes of section 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional interest. Such an exchange is a disposition under section 1001(a).

An exchange of property results in the realization of gain only if the properties exchanged materially differ. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565.

In the present case, the information submitted and the representations made in

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the ruling request establish that Trust 1 and the principal thereof will be “relocated” essentially for administrative convenience. Under the terms of Trust 2, the primary beneficiary as well as subsequent beneficiaries will possess the same income and remainder interests before and after the establishment of Trust 2. Consequently, since the interests of the beneficiaries under Trust 2 will not materially differ from interests under Trust 1, no gain or loss will be realized under sections 61 and 1001.

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

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to Trustee 1.

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

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