

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4\PLR-101936-03
Date:
MAY 14, 2003

Re:

Legend:

Trust	=
Settlors	=
Settlor	=
Son	=
Grandson 1	=
Grandson 2	=
Mother	=
Wife	=
B	=
C	=
D	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
State	=
State Statute 1	=
State Statute 2	=

Dear _____,

This is in response to your authorized representative's December 18, 2002, submission in which a ruling was requested under § 2501 of the Internal Revenue Code concerning the federal gift tax consequences of a proposed exercise of a power of adjustment under State law.

According to the facts submitted, on Date 2, Settlor created Trust for the benefit of Settlor's son, Son.

The pertinent provisions of Trust provide as follows:

Article First, Paragraph 1 of Trust provides that the trustees are to hold the trust fund during the life of Son, and to collect and receive the rents, issues, income and profits thereof, and after paying all taxes, and other charges and expenses, to accumulate the remaining net rents issues, income and profits until Son becomes 21 years of age, and then to pay over to him all such accumulations of income, and to apply to his use the entire net income of the trust during his life, and upon his death to pay over the principal of the trust fund to his surviving issue in equal shares per stirpes, or if he has no issue, then to divide the same into so many shares that there shall be one for each child of the Settlor who is then living and one for the issue then surviving of each child of Settlor who is not then living, and each share so set apart for a child of the Settlor who is living at the date of Trust is to be added to, and form a part of, the trust created for such child by agreement dated Date 1, and each share so set aside for a child of the Settlor who is born after Date 2 or for the issue of a deceased child of the Settlor is to be paid over to the child, or, in equal shares, per stirpes, to the issue, for whom it was set aside, provided, that the identity of any share set aside for a child of Settlor and added to the trust created for such child by agreement dated Date 1, shall be maintained, and that if such child dies leaving no issue surviving, any part of such share which would, pursuant to the terms of the Date 1 agreement, be added to the trust created for any other child of the Settlor, shall, instead be conveyed, transferred and paid over to such child.

In case no child of Settlor nor any issue of any deceased child of Settlor survives Son, the trustees are to pay over the principal of the trust fund to the Settlor, if he is then living, or if he is not then living, to such persons and in such shares as he may appoint by an instrument executed as a deed and delivered to the trustees or by last Will and Testament.

Article First, Paragraph 2 provides that the trustees are authorized and empowered, but only with the approval of the Settlor so long as he shall live, to pay to Son, from time to time, after he has attained the age of 21, the whole or such portion or portions of the principal of Trust as the trustees in their absolute discretion may deem advisable; and Son's receipt for any such payment will be a complete discharge to the trustees.

Under Article Sixth, Trust is deemed a State trust and is to be in all respects governed by the laws of State.

In an Agreement dated Date 3, Settlor renounced and surrendered the following: 1) the right to approve or disapprove the whole or any portion or portions of any distributions of Trust principal to Son authorized by the trustees, and 2) the right to direct the retention of any investment at any time held by Trust, the sale or exchange of any investment, the purchase of real estate, stocks, bonds or other securities, the voting of any stock held by Trust or the granting of proxies and consents in connection therewith.

Son has two children, Grandson 1 and Grandson 2. Each of Grandson 1 and Grandson 2 has three children. Son had a third child who died on Date 4, leaving no descendants.

The current trustees of Trust are Grandson 1, Grandson 2, B, C, and D.

State Statute 1 provides that where State's Uniform Principal and Income Act applies to a trust and the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, the prudent investor standard also authorizes the trustee to adjust between principal and income to the extent the trustee considers advisable to enable the trustee to make appropriate present and future distributions in accordance with risk and return objectives reasonably suited to the entire portfolio, and where such an adjustment would be fair and reasonable to all of the beneficiaries, so that current beneficiaries may be given such use of the trust property as is consistent with preservation of its value.

Under State Statute 1, in deciding whether and to what extent to exercise the power to adjust the trustee may consider the intent of the settlor, as expressed in the governing instrument; whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income.

State Statute 1 also provides that a trustee may not make an adjustment if the trustee is a current beneficiary or a presumptive remainderman of the trust. Further, a co-trustee who is not a current beneficiary or a presumptive remainderman may not make the adjustment if the adjustment would benefit that trustee directly or indirectly. If there is more than one trustee, a co-trustee who is not a current beneficiary or a presumptive remainderman may make the adjustment if the adjustment would not benefit him directly or indirectly and the exercise of the power by the remaining trustee or trustees is permitted by the terms of the trust.

It is represented that B, C, and D are not current beneficiaries or “presumptive remaindermen” of Trust. B has an indirect contingent interest in Trust. If Son dies before B without descendants, one-half of Trust would pass to a trust created by Settlers under an agreement dated Date1, for his lifetime benefit.

C has an indirect contingent interest in Trust because of his wife’s (Wife) interest in Trust. Wife has an indirect interest in Trust in two circumstances. First, if Son dies before Wife, without descendants, and if Wife’s mother (Mother) is still living, then one-half of Trust would pass to a trust created by Settlers under an agreement dated Date 1, for Mother’s lifetime benefit. Wife is a presumptive remainderman of Mother’s trust, so Wife would receive one-fifth of the one-half interest in the trust upon Mother’s death. Second, if Son dies before Wife, without descendants, and if Mother is not living, then Wife would receive outright one-fifth of the one-half interest in Trust.

It is proposed that B, C, and D will exercise the power of adjustment under State Statute 1 to transfer principal to the income account, and then such income will be distributed to Son under the terms of Trust.

A ruling is requested that the exercise of the power of adjustment by B, C, and D, will not result in any gift tax consequences to Grandson 1 and Grandson 2 under § 2501.

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such 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.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift. Section 2512(b) provides that where property is transferred for less than an adequate consideration in money or money’s worth, then the amount by which the value of the property exceeded the value of the consideration is deemed a gift, that is included in computing the amount of gifts made during the calendar year.

Presumptive remaindermen are “persons presumptively entitled to the next eventual estate.” See, In the Matter of Estate of West, 175 Misc. 1042, 26 N.Y.S. 2d 620 (N.Y. Sur, Ct. 1941) aff’d, 264 A.D. 701, 34 N.Y.S. 2d 405 (N.Y. App. Div. 1942). The word “presumptive” means “assumed,” “supposed.” BLACK’S LAW DICTIONARY 1186 (6th ed. 1991). In this case, Son is the current beneficiary entitled to income from the trust. Upon Son’s death, the principal of Trust will pass to Son’s surviving issue in equal shares per stirpes, (or if Son has no issue, then the principal is to be divided into so many shares so that there is one share for each child of the Settlers who is living and one for the issue surviving of each child of Settlers who is not then living). Accordingly, Son’s children, Grandson 1 and Grandson 2, are the persons presumptively entitled to the next eventual estate with respect to Trust.

As described above, neither B, C, nor D are current beneficiaries or presumptive remaindermen of Trust and the adjustment would not benefit them directly or indirectly. Accordingly, they may exercise the power of adjustment under State Statute 1. We conclude that the exercise of the power of adjustment pursuant to State Statute 1 by B, C, and D, will not result in any gift tax consequences to Grandson 1 and Grandson 2 under section 2501.

The ruling contained in this letter is based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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

Sincerely,

Lorraine E. Gardner
Senior Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter

cc: