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Re

LEGEND

Grantor =  
Daughter =  
Husband =  
Grandchild 1 =  
Grandchild 2 =  
Grandchild 3 =  
Grandchild 4 =  
Trust A =

Trust B =

Trust 1 =  
Trust 2 =  
Trust 3 =  
Trust 4 =  
Trust 5 =  
Trust 6 =  
Trust 7 =  
Trust 8 =  
Trust 9 =  
Trustees =

Date 1 =

Date 2 =

Charity =

State 1 =

State 2 =

Dear \_\_\_\_\_ :

This responds to a letter from your authorized representative dated November 11, 2004, and prior correspondence, requesting rulings on the income, generation-skipping transfer (GST), gift and estate tax consequences resulting from the proposed modifications to several trusts.

You represent the facts to be as follows. On Date 1, Grantor created an irrevocable trust, Trust A. Article ONE of Trust A provides that Trust A is to be divided into five equal shares, one share for Grantor's daughter, Daughter, and one share for each of Daughter's four children, Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4. On creation, Trust A was divided into Trust 1 for the benefit of Daughter, and Trusts 2 through 5, one each for the benefit of each of Grantor's four grandchildren.

Article TWO of Trust A provides that the Trustees may distribute income and principal from Daughter's trust, Trust 1, in the Trustees' discretion to the class of persons composed of Daughter and Daughter's descendants living at the time of payment. On Daughter's death the trust corpus is to be distributed pursuant to Daughter's exercise of a testamentary limited power to appoint Trust 1 corpus among Daughter's descendants. In default of Daughter's exercise of her power of appointment, Trust 1 is to be divided in equal parts to be distributed to the other trusts created under Trust A, or if none, to Grantor's issue then living, or if none, to Charity.

With respect to Trusts 2 through 5 for the benefit of Grantor's grandchildren, Article THREE provides that the Trustees may pay so much of the net income or principal, or both, as the trustees in their discretion determine, to such one or more persons out of a class composed of Daughter, the child for whom such share is set apart, and the descendants of such child, provided that while there is a trust for Daughter, any payments made to Daughter shall be made equally from the trusts existing for Grantor's grandchildren.

On Daughter's death, the corpus of Trusts 2 through 5 is to be distributed pursuant to Daughter's exercise of a testamentary limited power to appoint the corpus of each trust to the child of Daughter for whom the trust was established and that child's descendants. In default of the exercise of the power, Trusts 2 through 5 are to continue until the expiration of 21 years after the death of the last survivor of Daughter, Daughter's Husband, and Grandchildren 1 through 4. If all the beneficiaries of a trust

have died before the end of the trust term, the property of such trust is to be distributed equally to the other remaining trusts, or if none, to the Grantor's issue then living, per stirpes, or if none, to Charity. Upon expiration of the trust term, Trusts 2 through 5 terminate and all property is to be distributed to the issue then living of Daughter's child in respect of whom the trust was originally set apart, per stirpes.

On Date 2, Daughter created an irrevocable trust, Trust B, for the benefit of her descendants. Article FIRST provides that Trust B is to be divided into four equal shares, one share for each of Grandchildren 1 through 4 (Trusts 6 through 9). The Trustees have the discretion to pay so much of the net income or principal, or both, as the corporate trustee in its discretion determines, to such one or more persons out of a class composed of the child for whom the share was set apart and the descendants of such child. On Husband's death, the corpus of Trusts 6 through 9 are to be distributed pursuant to Husband's exercise of a testamentary limited power of appointment with respect to Trusts 6 through 9 exercisable in favor of one or more of Daughter's issue outright or in trust. In default of Husband's exercise, the corpus will continue to be held in trust. On the death of the child for whom the trust was established, the corpus is to be distributed pursuant to the exercise by the child of a testamentary limited power to appoint his or her share among Daughter's issue, outright or in trust. In default of the exercise of any power, the share shall be distributed to the then living issue of the child whose name identified the share. In default of any share being so disposed of, the principal shall be distributed to Daughter's then living issue, or in default thereof, to Daughter's brother and sister, per stirpes, or if none, to the issue of Daughter's uncles, per stirpes, or if none, to Charity. Unless sooner terminated, each of Trusts 6 through 9 are to terminate 21 years after the death of the survivor of Daughter, Daughter's Husband, and Daughter's four children.

Trust A and Trust B are governed by the laws of State 1. There have been no additions to any of the trusts created under Trust A or Trust B since September 25, 1985.

The Trustees propose to transfer the corpus of Trusts 1 through 9 to new trusts. The dispositive terms of the nine new trusts will be identical to the dispositive terms of Trusts 1 through 9. The nine new trust instruments provide that the trust will be governed by the law of State 2. Certain administrative modifications will be made to the trusts with respect to the corporate and individual trustees, and a new corporate trustee will be appointed. A provision will also be added giving the trustees the power to terminate a trust if in the Trustees' sole discretion, the trust is so small as to make continuing such trust inadvisable. With respect to Trusts 1 through 5, a provision will be added that no individual who is both a trustee and a beneficiary of any trust shall participate in the decisions of the trustees as to any discretionary distribution, the termination of such trust, or the exercise of any incidents of ownership over any policies of insurance held by such trust insuring the life of the individual trustee.

You have also represented that an additional provision will be added to each new trust providing that each trust created pursuant to the provisions of the new trust, including any trust created pursuant to a beneficiary's exercise of a limited power of appointment or pursuant to a trustee's exercise of a discretionary power, or otherwise, must terminate, in all events, no later than 21 years after the death of the last survivor of Daughter, Husband, Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4.

State 1 law permits a trustee who has absolute discretion, under the terms of a trust, to invade the principal for the benefit of one or more proper object of the exercise of the power, to 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 or under the same instrument, provided, however that the exercise of such discretion does not reduce any fixed income interest of any income beneficiary of the trust and is in favor of the proper objects of the exercise of the power. The State 1 law provides that the trustee may act without the consent of any interested person and without prior court approval. The Trustees herein represent that they will petition the appropriate court and provide notice to all interested parties.

You have requested the following rulings that the Trustees' proposed transfer of the nine Subtrusts into nine new trusts:

1. Will not cause any of the trusts or the new trusts to lose the status as grandfathered trusts exempt from the GST tax and will not cause a distribution from, or termination of any interests in, any of the trusts or any of the new trusts to be subject to the GST tax.
2. Will not result in the realization by any of the trusts, the new trusts, or a beneficiary of any of the trusts or the new trusts, of any income gain or loss under § 661.
3. Will not result in the realization of any income, gain, or loss under § 61 or § 1001 by any of the trusts, the new trusts, or a beneficiary of any of the trusts or of the new trusts.
4. Will result in the new trusts holding assets with the same basis they had at the time of the Trustees' appointment under § 1015, and will result in holding period for all the assets allocated to each new trust that include the corresponding trust's holding period under § 1223.
5. Will not cause any portion of the assets of any of the trusts or of any of the new trusts to be includible in the gross estate of any beneficiary of any of the trusts or of any of the new trusts under §§ 2035 through 2038.
6. Will not constitute a transfer by any beneficiary of any of the trusts or of any of the new trusts that will be subject to gift tax under § 2501.

## GENERATION-SKIPPING TRANSFER TAX ISSUE -- RULING NO 1

Section 2601 imposes a tax on every GST which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Section 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) provide that the GST tax shall not apply to any GST under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer was not made out of corpus added to the trust after September 25, 1985, (or out of income attributable to corpus so added). Section 26.2601-1(b)(1)(ii) provides that any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in settlor's gross estate under § 2038 or 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 GST tax will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, these rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Unless specifically noted, 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 section 1001.

Under § 26.2601-1(b)(4)(i)(A), the distribution of trust principal from an exempt trust to a new trust will not cause the new 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 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 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.

Section 26.2602-1(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 will pass to C or C's issue. Because the state statute was enacted after Trust was created and required the consent of all of the parties, the transaction constitutes a modification of Trust. However, the modification does not shift any beneficial interest in the trust to a beneficiary or beneficiaries who occupy a lower generation than the person or person 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 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 § 2651) than the person or person 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.

Section 26.2601-1(b)(4)(i)(E), Example 10, considers a situation where the appropriate local court approves a modification of a trust that decreases the number of trustees. The modification pertains to the administration of the trust and 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 it does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust will retain its exempt status.

In the present case, Trust A, Trust B, and the separate trusts created thereunder, Trusts 1 through 9, were irrevocable on September 25, 1985. You have represented that no additions, actual or constructive, have been made to any of the trusts after that date. Accordingly, pursuant to § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the trusts are not subject to the GST tax.

The Trustees propose to distribute the assets of Trusts 1 through 9 into nine separate new trusts pursuant to a state statute similar to that described in § 26.2601-1(b)(4)(i)(E), Example 2. The dispositive terms of the new trusts will be identical to those of Trusts 1 through 9. Further, each new trust and any trust created pursuant to the exercise of a limited power of appointment, or a trustee's discretionary authority, will terminate at the same time its corresponding trust was to terminate, *i.e.*, no later than 21 years after the death of the last to die of Daughter, Daughter's Husband and Grandchildren 1 through 4. Thus, the appointment by the Trustees of Trusts 1 through 9 to the new trusts will not shift any beneficial interest in Trusts 1 through 9 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 new trusts although administered under State 2 law, will not extend the time for vesting of any beneficial interest held under Trusts 1 through 9. See § 26.2601-1(b)(4)(i)(E), Example 4.

Based on the facts and representations, we conclude that the Trustees' appointment of Trusts 1 through 9 into nine separate new trusts and the change in situs of the new trusts will not cause any of the trusts or the new trusts to lose the status as grandfathered trusts exempt from the GST tax and will not cause a distribution from, or

termination of any interests in, any of the trusts or any of the new trusts to be subject to the GST tax. In addition, the proposed modifications are administrative in nature and will not cause the trusts to be subject to the GST tax.

#### INCOME TAX ISSUES – RULINGS NO. 2, 3 AND 4

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 is the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 over the amount realized. Section 1001(c) provides that, except as otherwise provided, the entire amount of the gain or loss on the sale or exchange of property is recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides, as a general rule, that except as otherwise provided in Subtitle A, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially in either kind or in extent, is treated as income or as loss sustained.

For purposes of § 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional property interest. Such an exchange of property is a disposition under § 1001(a). See § 1.1001-1 of the regulations.

An exchange of property results in the realization of gain under § 1001 if the properties exchanged are materially different. 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.

Based on the information submitted and the representations made in the ruling request, the proposed reformation of the Trusts will not cause the interests of the trust beneficiaries to differ materially. The trust beneficiaries will hold essentially the same interests before and after the reformation. Accordingly, the relocation of the trusts’ assets will not cause the trusts or the beneficiaries to recognize any gain or loss from a sale or other disposition of property under §§ 61 and 1001.

Section 1223(2) of the Code provides that, in determining the period for which a taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person if under Chapter 1 of the Code such property has, for the purpose 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 such other person.

In the proposed modification of the instant Trusts, the tax basis of each separate trust in each property received will be the same as the tax basis of the transferring trust in such property. Accordingly, under section 1223(2) the holding period of the separate trusts in each property received will include the holding period of the predecessor trust in that property.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year, but such deduction shall not exceed the distributable net income (DNI) of the estate or trust.

Section 1.661(a)-2(f) of the Income Tax Regulations provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

Based solely on the facts and the representations submitted, we conclude that the trustees' appointment of the four Trusts into four New Trusts will not be viewed as a distribution or termination under § 661 or § 1.661(a)-2(f)(1) and should therefore not result in the realization by the Trusts, the New Trusts, or any beneficiary of any of the Trusts of any of the New Trusts, of any income, gain, or loss under §§ 661 and 662.

#### ESTATE TAX ISSUES – RULING NO. 5

Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest there of the decedent at the time of his death.

Section 2035(a) provides that (1) if the decedent transferred an interest in property or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of the property (or interest

therein) would have been included in the gross estate under §§ 2036, 2037, 2038, or 2042 if the interest or power had been retained by the decedent on the date of death, then the value of the gross estate includes the value of any property (or interest therein) that would have been so included. Under § 2035(b), the gross estate shall be increased by the amount of any gift tax paid by the decedent or his estate on any gift made by the decedent or his spouse during the three year period ending on the date of decedent's death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period that does not in fact end before his death, (1) possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income from the property.

Section 2037(a) provides that the value of the gross estate includes the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate includes the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

In order for §§ 2035 through 2038 to apply, the decedent must have made a transfer of property or any interest therein (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. In the present case, the transfer of Trusts 1 through 9 to the nine new trusts do not

change the beneficial interests of the beneficiaries of Trusts 1 through 9. Thus, the proposed transaction will not constitute a transfer by any beneficiary within the meaning of §§ 2035 through 2038.

#### GIFT TAX ISSUE – RULINGS NO. 6

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 2501 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 2512(a) provides that, if a gift is made is property, the value thereof at the date of the gift shall be considered the amount of the gift. Section 2512(b) provides that where property is transferred for less than adequate and full 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 to be a gift, and is included in computing the amount of gifts made during the calendar year.

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 passes or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

In this case, the dispositive provisions and beneficial interests in the new trusts will be identical to those of Trusts 1 through 9. Therefore, no interest in Trusts 1 through 9 will be gratuitously transferred. Accordingly, the appointment of the assets from Trusts 1 through 9 to the nine separate new trusts will not be subject to the gift tax under § 2501.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statements executed by the appropriate parties. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

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

In accordance with the power of attorney on file with this office a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

George L. Masnik  
Chief, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure  
Copy for section 6110 purposes

cc: