

**Internal Revenue Service**

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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Date:

January 10, 2012

Grantor 1 =

Grantor 2 =

Trustee =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year 1 =

Year 2 =

Year 3 =

Merger =

Agreement

Court =

State 1 =

State 2 =

State Statute =

Beneficiaries =

(individually,  
Beneficiary)

Daughter =

Dear :

This responds to your letter dated July 15, 2011, and subsequent correspondence, requesting rulings regarding the generation-skipping transfer (GST), income, and gift tax consequences of a proposed merger of Trust 1, Trust 2, Trust 3, and Trust 4.

The facts submitted and representations made are as follows. Grantor 1 and Grantor 2 are husband and wife. Beneficiaries are the grandchildren of Grantors.

On Date 1, Grantor 1 created a revocable trust, Trust 1, for the benefit of Grantor 1's and Grantor 2's daughter, Daughter, and her issue. In Year 1, Grantor 1 died, at which time Trust 1 became irrevocable.

On Date 2, Grantor 2 created a revocable trust, Trust 2, for the benefit of Daughter and her issue. Thereafter, Grantor 2 created two additional trusts: Trust 3 on Date 3 and Trust 4 on Date 4. Trust 3 and Trust 4 are for the benefit of Beneficiaries. In Year 2, Grantor 2 died, at which time Trust 2 became irrevocable. Daughter died in Year 3 survived by four children, Beneficiaries.

Date 1, Date 2, Date 3, Date 4, Year 1, and Year 2, are all dates prior to September 25, 1985. Under the terms of each of the four trust instruments, four separate subtrusts were created, one for the benefit of each of Daughter's four children. Thus, a total of 16 subtrusts were created, four for each child. Each trust is governed by the laws of State 1.

Under the terms of each trust, Trustee currently must distribute all of the income to Beneficiaries during their lifetime. No principal may be distributed to any Beneficiary. While the distribution provisions of the trusts are the same, the ultimate period for vesting and termination of the trusts itself differs.

The parties propose certain modifications to Trust 1, Trust 2, Trust 3, and Trust 4 as set forth in an agreement, Merger Agreement. The parties propose to merge the sixteen trusts into four trusts, one for each respective Beneficiary. Paragraph 1 of Merger Agreement provides that on its effective date, Trust 2, Trust 3, and Trust 4 shall merge into Trust 1, to be known as Surviving Trust. Merger Agreement provides that Trustee has determined the fair market value of all trusts, as well as the fractional portion of each Surviving Trust attributable to the original trusts. Merger Agreement provides for the same mandatory income distribution to all Beneficiaries as set forth in the original trusts and, upon the death of a Beneficiary, the fractional portions of Surviving Trust will be interpreted, construed, and administered by reference to the original trust documents. Merger Agreement also provides that, although all

Beneficiaries currently have living descendants, in the event any Beneficiary dies without living descendants, the fractional portions of Surviving Trust shall be interpreted, construed, and administered by reference to the original trust documents. With respect to the termination provisions and the vesting of assets in Beneficiaries, Merger Agreement also provides that the fractional portions of Surviving Trust shall be interpreted, construed, and administered by reference to the original trust documents.

The parties also propose to change the situs of each trust to State 2 with respect to questions concerning the administration of the trusts. The laws of State 1 will continue to apply with respect to questions of validity, including whether and when a trust terminates pursuant to their terms.

State Statute provides that, after notice to the qualified beneficiaries, a trustee may combine two or more trusts into a single trust or divide a trust into two or more separate trusts, if the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes of the trust.

On Date 5, Court issued an order approving the above modifications to Trust 1, Trust 2, Trust 3, and Trust 4, subject to the issuance of a favorable private letter ruling from the Internal Revenue Service that the proposed modifications would not impact the GST exempt nature of the trusts.

You represent that no additions have been made to Trust 1, Trust 2, Trust 3, or Trust 4 after September 25, 1985.

### Requested Rulings

1. The modification of Trust 1, Trust 2, Trust 3, and Trust 4 so that the laws of State 2 apply to such trusts with respect to questions of administration will not impact the GST exempt nature of such trusts;
2. The merger of certain trusts within Trust 1, Trust 2, Trust 3, and Trust 4 will not impact the GST exempt nature of such trusts;
3. No gain or loss will be recognized for federal income tax purposes under § 1001 by the trusts, or by any of the beneficiaries of the trusts as a result of the proposed merger of certain trusts within Trust 1, Trust 2, Trust 3, and Trust 4;
4. The assets of the merged trusts under the proposed merger will have the same basis under § 1015 and the same holding period under § 1223 before and after the proposed merger; and
5. The proposed merger will not constitute a taxable gift by any person under § 2501.

## GENERATION-SKIPPING TRANSFER TAX ISSUE -- RULINGS NO. 1 AND 2

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations 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 § 1001.

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. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), Example 6, considers a situation where, in 1980, Grantor established an irrevocable trust (Trust) for the benefit of Grantor's child, A, and A's issue. In 1983, Grantor's spouse also established a separate irrevocable trust for the benefit of the same child and issue. The terms of the spouse's trust and Grantor's

trust are identical. In 2002, the appropriate local court approved the merger of the two trusts into one trust to save administrative costs and enhance the management of the investments. The merger of the two trusts 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 persons who held the beneficial interest prior to the merger. In addition, the merger 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 that resulted from the merger will not be subject to the provisions of chapter 13.

In the present case, Trust 1, Trust 2, Trust 3, and Trust 4 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 proposed merger pursuant to Merger Agreement is similar to Example 6 in § 26.2601-1(b)(4)(i)(E). State Statute permits a trustee to merge the assets of the trust into a single trust estate after giving notice to the qualified beneficiaries and provided that the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes of the trust. Although the vesting periods and termination dates of Trust 1, Trust 2, Trust 3, and Trust 4 differ, Merger Agreement contains provisions to ensure that Surviving Trust does not extend the time for vesting of any beneficial interest in the trusts and further provides that each trust will terminate on the same date on which each trust would have terminated prior to the proposed merger. Court has approved the proposed Merger Agreement. Under these circumstances, the proposed merger will not shift a beneficial interest to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, the proposed merger will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trusts. Finally, the proposed modification to provide that the laws of State 2 apply with respect to questions of administration is administrative in nature. See section 26.2601-1(b)(4)(i)(E), Example 4.

Accordingly, based on the facts submitted and the representations made, we conclude that:

1. The proposed merger of Trust 1, Trust 2, Trust 3, and Trust 4 pursuant to Merger Agreement will not affect the grandfathered status of these trusts and will not cause any distributions from Surviving Trust or distributions upon termination to become subject to GST tax provided there are no post-merger additions to Surviving Trust.
2. The proposed modification that the laws of State 2 apply to such trusts with respect to questions of administration will not affect the GST exempt nature of such trusts.

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

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(b) defines the amount realized from the sale or disposition of property as the sum of any money received plus the fair market value of any property received.

Section 1001(c) provides that, except as otherwise provided in subtitle A, the entire amount of gain or loss determined under § 1001 on the sale or exchange of property shall be 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 either in kind or in extent, is treated as income or loss sustained.

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). There is a material difference when the exchanged properties embody legal entitlements “different in kind or extent” or if they confer “different rights and powers.” *Id.* at 565.

Section 1015(b) provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss.

Section 1223(2) 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 present case, there will be no sale or exchange because there will be no transfer of money or property. The beneficiaries will possess the same interests before and after the merger of the trusts into Surviving Trust. The proposed transaction is merely a merging of the assets for administrative convenience. Accordingly, neither the trusts nor their beneficiaries will recognize gain or loss under § 1001 as a result of the proposed merger.

Based on the facts submitted and the representations made, we conclude that the assets of the merged trusts will have the same basis under § 1015 and the same holding periods under § 1223 before and after the proposed merger.

#### GIFT TAX ISSUE – RULING NO. 5

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

Based on the facts submitted and the representations made, we conclude that the beneficial interests of the trust beneficiaries will not change as a result of the proposed merger of the trusts as described above. Accordingly, we conclude that the proposed merger pursuant to Merger Agreement as described above will not cause any beneficiary to be considered as having made a taxable gift and will not constitute a taxable gift to any beneficiary under § 2501.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. The rulings in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Code are in effect during the period at issue.

This ruling is directed only to the taxpayer 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 letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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.

Sincerely,

Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures:

Copy for § 6110 purposes

cc: