

Internal Revenue Service

Department of the Treasury

Index Number:1001.00-00; 1015.03-01;
1223.00-00; 2001.01-00; 2501.00-00;
2601.00-0

Washington, DC 20224

Number: **200031041**
Release Date: 8/4/2000

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:4/PLR-114401-99

Date:

May 05, 2000

Re: Letter Ruling request for:

Legend:

Settlor A -
Settlor B -
Trustee -
Primary Beneficiary -
Trust 1 -

Trust 2 -

Trust 3 -

Dear _____ :

This is in reference to the letter dated August 18, 1999, and other submissions in which your authorized representatives requested rulings regarding the effect of the consolidation of three trusts for federal income, estate, gift, and generation-skipping transfer (GST) tax purposes.

In 1949, Settlor A and Settlor B established Trust 1, an irrevocable trust, for the benefit of the Primary Beneficiary and her issue. In 1962, Settlor B established Trust 2, also for the benefit of the Primary Beneficiary and her issue. In addition, pursuant to the will of Settlor B, who died in 1966, an irrevocable trust, Trust 3, was created for the benefit of the Primary Beneficiary and her issue. The dispositive and administrative provisions of Trust 1, Trust 2, and Trust 3 are substantially similar and are described below. The current trustees of each of the three trusts are Trustee (an independent corporate trustee), the Primary Beneficiary, and two other individuals. All of the trusts are governed by the laws of the State of Michigan. Currently, the assets of Trust 1, Trust 2, and Trust 3 consist of cash and marketable securities.

Dispositive Provisions of Trust 1, Trust 2, and Trust 3:

Trust 1, Trust 2, and Trust 3 each provide that, during the life of the Primary Beneficiary, the independent trustee has the discretion to distribute some or all of the net income to the Primary Beneficiary and her descendants.

Upon the Primary Beneficiary's death, each trust provides that the principal will be distributed in equal shares for the benefit of the Primary Beneficiary's immediate descendants living at that time or, if none, for the benefit of the descendants of the settlor(s). Each share for a descendant of the Primary Beneficiary will be held in a separate trust (secondary trust). Under the terms of Trust 1, Trust 2, and Trust 3, the net income of each secondary trust is to be distributed to the respective descendant (and/or descendants of that descendant) of the Primary Beneficiary at the discretion of the independent trustee based on the descendant's needs, best interests, and welfare. The three trusts differ only as to the minimum distributions from income and corpus (if income is insufficient) that are to be made to the descendants each year. Trust 1 requires minimum distributions of \$500 per year to each descendant; Trust 2 limits the minimum distribution to \$150 per year; Trust 3 does not require any minimum distribution.

Each of the secondary trusts provides that the independent trustee, in its sole discretion, may distribute any or all of the trust corpus to the respective trust beneficiary of a primary or secondary trust for that beneficiary's suitable support or emergency needs.

Trust 1, Trust 2, and Trust 3 each provide that, upon the death of the beneficiary of a secondary trust (the immediate descendant of the Primary Beneficiary) prior to termination of the secondary trust, the independent trustee has the discretion to distribute the net income of the secondary trust to the surviving descendants of that respective beneficiary.

Trust 1, Trust 2, and Trust 3 have different termination provisions. Trust 1, and/or any secondary trust created under Trust 1, must terminate in all events no later than the death of the last survivor of all descendants of Settlor A and Settlor B living on the date that Trust 1 was created. Trust 2, and/or any secondary trust created under Trust 2, must terminate in all events no later than 20 years and 11 months after the death of the last survivor of Settlor B and the descendants of Settlor B who were living on the date that Trust 2 was created. Trust 3, and/or any secondary trust created under its terms, must terminate in all events no later than 20 years and 11 months after the date of death of any descendants of Settlor B living at the date of Settlor B's death.

Upon termination, each trust provides that distributions will be made to the beneficiary and any descendants of the beneficiary of each secondary trust in order to

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compensate for any unequal distributions of income or principal during the trust term. Any remainder will be distributed to the beneficiary, if he or she survives, or to the descendants, per stirpes, of the beneficiary. If the beneficiary has no living descendants, the remainder will be distributed to the descendants, per stirpes, of the Primary Beneficiary, or, if there are none, to the descendants of the settlor(s).

Under the terms of all three trusts, no individual trustee may make or participate in any decision to authorize discretionary payments of income or principal or to make loans to or for the benefit of himself. Any discretionary decision by the independent trustee regarding distributions is final and binding in all respects. The independent trustee of each trust has the authority to terminate any primary or secondary trust in the event of any action, legislative or otherwise, that would defeat the purpose of the trust. Each trust provides that it will have four trustees.

You represent that there have been no additions, actual or constructive, to Trust 1, Trust 2, or Trust 3 after September 25, 1985.

Trust Consolidation:

The Primary Beneficiary is living and presently has 10 children, 26 grandchildren, and 2 great-grandchildren. Under the current terms of Trust 1, Trust 2, and Trust 3, upon the death of the Primary Beneficiary, each trust will be split into ten separate secondary trusts (one for each child as the immediate descendant) resulting in the creation of a total of 30 separate trusts. In order to reduce the resulting administrative fees, the trustees of Trust 1, Trust 2, and Trust 3 will consolidate the trusts that will be created under Trust 1, Trust 2, and Trust 3 when the Primary Beneficiary dies.

The trustees of Trust 1, Trust 2, and Trust 3 have obtained judicial approval in the appropriate local court effecting consolidation of the trusts under an agreement entered into by the Primary Beneficiary, her descendants, and all other interested parties. Each child has affirmatively consented to the consolidation. Under the terms of the agreement, upon the death of the Primary Beneficiary, the secondary trusts provided for under Trust 1, Trust 2, and Trust 3 for each "immediate descendant" (child) of the Primary Beneficiary will be consolidated into one trust (combined secondary trust) for the benefit of that child and that child's descendants. Assuming that all 10 children (or their descendants) survive the Primary Beneficiary, the consolidation will result in the creation of 10 trusts, rather than the 30 trusts that would have been created under the current arrangement. Other than the termination dates and the minimum distribution requirements, described below, the relevant terms of Trust 1, Trust 2, and Trust 3 are identical.

Each combined secondary trust will consist of the secondary trusts provided for under Trust 1, Trust 2, and Trust 3 for a specific child or that child's descendants will be

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treated as a single trust for all purposes. However, the trustees of each combined secondary trust will retain the option to separate the combined secondary trust into two or three trusts on the basis of the pre-consolidation form, if the trustees determine that such action is in the best interests of the beneficiaries of the combined secondary trust.

Each combined secondary trust will be administered pursuant to the terms of Trust 2. However, at the time each combined secondary trust is created, the value of each of the secondary trusts created under Trust 1, Trust 2, and Trust 3 for a specific child or that child's descendants (original secondary trusts) will be established in order to comprise a proportionate percentage of the entire combined secondary trust's initial value. This proportionate percentage will be utilized in the event that the combined secondary trust is subsequently separated, either pursuant to an election by the trustees, or because part of the combined secondary trust terminates, as described below. In the event that it becomes necessary to separate a combined secondary trust, the amount separated will be determined by use of the following formula: the value of the combined secondary trust upon separation will be multiplied by a fraction, the numerator of which will be the fair market value of the share of the applicable original secondary trust as of the date of the consolidation, and the denominator of which will be the fair market value of the shares of the combined secondary trusts (representing shares of two or more of the original secondary trusts, as the case may be) as of the date of the consolidation.

The minimum distribution requirements of the original secondary trusts created under Trust 1 and Trust 2 will be aggregated in each combined secondary trust. However, in the event that a combined secondary trust is separated pursuant to termination or trustee decision, the minimum distribution requirements will be adjusted in order to be consistent with the applicable original secondary trusts.

In order to accommodate the different termination dates for Trust 1, Trust 2, and Trust 3, each combined secondary trust will be separated pursuant to the formula described above, at the time that Trust 1, Trust 2, and Trust 3, respectively, would each terminate. Each separate share so terminated will be disbursed consistent with the terms of the applicable trust. Thus, each combined secondary trust will terminate in three different stages and dispositions will be made consistent with the terms of Trust 1, Trust 2, and Trust 3, as appropriate.

Each of the combined secondary trusts will be administered under the laws of the State of Michigan. The consolidation has been approved by the appropriate local court under the laws of the State of Michigan, which authorizes a trustee to perform any act which a prudent man would perform for the purposes of the trust from time of creation of the trust until final distribution of the assets of the trust. Mich. Comp. Laws § 27.5821 (1979). Section 27.5829(1) provides that, in the general administration of a trust, a trustee shall exercise his best judgment and discretion for what he believes to

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be the best interest of the trust and the persons designated to benefit from the trust.

You request rulings that:

1. The consolidation of the trusts will not cause any trust, secondary trust, or combined secondary trust to lose its exempt status for generation-skipping transfer tax purposes.
2. The consolidation of the trusts will not cause any beneficiary of a trust, a secondary trust, or a combined secondary trust to have made a taxable gift for Federal gift tax purposes.
3. The consolidation of the trusts will not cause any beneficiary of a trust, a secondary trust, or a combined secondary trust to include their interests in the trust, a secondary trust, or a combined secondary trust in their gross estate for Federal estate tax purposes.
4. The consolidation of the trusts will not cause any trust, secondary trust, or combined secondary trust to recognize any gain or loss from the sale or other disposition of property under §§ 61 or 1001 of the Internal Revenue Code.
5. Pursuant to § 1015, the basis of each trust in each asset received from a trust, secondary trust, or combined secondary trust will be the same as the transferring trust's basis in each asset.
6. Pursuant to § 1223(2), the holding period of each trust, secondary trust, or combined secondary trust in any asset received from a trust, a secondary trust, or a combined secondary trust will include the holding period of the transferring trust.

Issues 1, 2 & 3: (Federal estate, gift, and generation-skipping transfer tax consequences)

Section 2601 imposes a tax on every generation-skipping transfer made after October 26, 1986.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

You have represented that Trust 1, Trust 2 and Trust 3 were irrevocable on September 25, 1985, and no additions have been made to any of the trusts after that

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date.

A modification of a trust that is otherwise exempt for GST tax purposes under the 1986 Act will generally result in a loss of its "grandfathered" exempt status if the modification changes the quality, value, or timing of any powers, beneficial interests, rights or expectancies originally provided for under the terms of the trust.

The terms of Trust 1, Trust 2 and Trust 3 with respect to the interests of the Primary Beneficiary and her issue are nearly identical except for differences in the termination dates and minimum distribution requirements. In the present situation, after the consolidation there will be no change in the dispositive provisions with respect to the property previously held in Trust 1, Trust 2, and Trust 3. However, in order to account for the differences in the termination dates of Trust 1, Trust 2, and Trust 3, at the time that one of the original trusts would have terminated, a portion of each combined secondary trust will be separated and distributed pursuant to the terms of the original trust that terminated. The portion separated from the combined secondary trust will be derived based on the value of the original secondary trust at the date of the consolidation, pursuant to the formula set forth above. Also, the differences in the minimum distribution requirements will be taken into account so that the minimum distribution requirements in the combined secondary trusts will be consistent with those requirements in the original trusts. The trustees will hold the same property after the consolidation and the interests of all the beneficiaries will remain unchanged.

Accordingly, we conclude that the consolidation will not change the quality, value, or timing of any powers, beneficial interests, rights or expectancies originally provided for under the terms of Trust 1, Trust 2, and Trust 3. In addition, the consolidation will not constitute an addition to Trust 1, Trust 2, or Trust 3, and will not cause Trust 1, Trust 2, Trust 3, any secondary trust, or any combined secondary trust to lose otherwise exempt status for purposes of the generation-skipping transfer tax.

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.

In this case, the interest of each beneficiary will remain the same after the proposed consolidation. Accordingly, based on the facts submitted and the representations made, the consolidation will not cause any beneficiary of Trust 1, Trust 2, Trust 3, a secondary trust, or a combined secondary trust to have made a taxable gift for Federal gift tax purposes under § 2501. Likewise, the consolidation will not result in the inclusion of any beneficiary's interest in the beneficiary's gross estate for federal estate tax purpose (except to the extent that any interests may otherwise be includible).

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Issue 4: (Federal income tax consequences)

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 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.

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.

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." 499 U.S. at 565.

Based on the information submitted and the representations made in the ruling request, the beneficiaries will possess the same interests before and after the consolidation of the Trusts and the assets will be consolidated for administrative convenience. The consolidation provisions in the probate court order providing for the dividing out from the consolidated trust of each of the original three trusts at each of the trusts' original termination dates, are sufficient to preserve the beneficiaries rights under the original trusts. Additionally, the separation provisions prevent the beneficiaries from gaining any additional rights that they did not have under the original trust documents. Accordingly, we conclude that no sale or exchange under § 1001 will occur as a result of the consolidation. In addition, no gain or loss will be realized by the Trusts or by any of the beneficiaries as a result of the consolidation.

Issues 5 & 6: (Basis and holding period)

Section 1015(b) provides that, if the property is acquired by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer.

Section 1.1015-2(a) provides that, in the case of property acquired by transfer in

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trust (other than by a transfer in trust by gift, bequest, or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. In addition, the principles in § 1.1015-1(b) concerning the uniform basis are applicable in determining the basis of property where more than one person acquires an interest in property by transfer in trust. Section 1.1015-1(b) provides that property acquired by gift has a single or uniform basis although more than one person may acquire an interest in the property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017.

Because § 1001 will not apply to the consolidation of Trust 1, Trust 2, and Trust 3, the basis of the assets in the combined secondary trusts will be the same as the basis of the assets currently held in Trust 1, Trust 2, and Trust 3.

Section 1223 provides that, in determining the period for which that taxpayer has held property however acquired, there is included the period for which the property was held by any other person if, under chapter 1 of the Code, the property has, for the 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. Therefore, because that the assets will have the same basis after the consolidation as before the consolidation, we conclude that each of the assets in the post-consolidation trusts will have a holding period that includes the holding period during which the asset was held in the pre-consolidation trusts.

A copy of this letter should be attached to any income, gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

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 the 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 set forth above, no opinion is expressed concerning the Federal tax consequences of the facts described above under the cited provisions or any other provision of the Code.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

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

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Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Trust 1, Trust 2, and Trust 3's authorized representative.

Sincerely,
Assistant Chief Counsel
(Passthroughs and Special Industries)
By Robert Honigman
Acting Assistant to the Branch Chief,
Branch 4

Enclosure

Copy for section 6110 purposes