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Person to Contact:

Telephone Number:

Refer Reply To:

CC:P&SI:Br.7-PLR-112976-99

Date:

July 27, 2000

Legend:

Taxpayer:

Trustees:

Trust 1:

Trust 2:

Trust 3:

Trust 4:

Church:

A:

B:

C:

a:

b:

c:

d:

e:

Dear _____ :

We received the letter dated, July 22, 1999, and subsequent correspondence

from your representative in which you request a ruling concerning the income and generation-skipping transfer (GST) tax consequences of the proposed consolidation of Trust 1, Trust 2, Trust 3, and Trust 4 (collectively, the Trusts) under §§ 1001, 1015, 1223 and 2601 of the Internal Revenue Code. This letter is in response to your request.

The represented facts are as follows: Taxpayer is the sole income beneficiary of four trusts for her lifetime and is also a co-trustee of each of the trusts. Taxpayer was alive when each of the four trusts were created. Three of the four trusts were created originally for the benefit of the Taxpayer's mother who is deceased. When Taxpayer's mother died, those three trusts were subdivided into separate trusts for Taxpayer and Taxpayer's siblings. The three trusts that were created for the benefit of the Taxpayer by the subdivision of the original trusts are Trust 1, Trust 2 and Trust 3. Trust 1 is an inter vivos trust established by Taxpayer's great-aunt on a. Trust 2 is a testamentary trust established under the will of Taxpayer's grandfather on b. Trusts 3 is a testamentary trust established on c under Article Eleventh D.1.(b) of the will of Taxpayer's grandmother. Trust 4 also was established for the benefit of Taxpayer on c under Article Eleventh D.1.(a) of the will of Taxpayer's grandmother.

The dispositive provisions of the Trusts are summarized as follows:

TRUST 1:

Article Fourth provides that the share so created for each of said four children of niece (Taxpayer's mother) who shall survive her shall be held by the Trustee and administered as a separate trust, and the Trustee shall pay the net income to the respective child or apply the same to his or her use for his or her care, support, or education until the death of the child, whereupon the separate trust shall terminate and the Trustee shall transfer and pay over the principal thereof then existing as follows: (a) to the surviving issue of the child who was the beneficiary of the separate trust, in equal shares per stirpes, or in default of such issue; (b) to the then living issue of said niece, in equal shares per stirpes, or in default of such issue; (c) to the then living issue of brother, in equal shares per stirpes, or in default of any such issue; (d) to Church.

TRUST 2:

Article Fourth provides that out of the balance of the decedent's residuary estate decedent directs the executors to pay all death taxes to which all or any portion of decedent's taxable estate may be subject, and divide the remainder into two equal parts as follows:

Paragraph A of Article Fourth provides that one such part decedent gives, devises, and bequeaths to trustees hereinafter named to invest the same and to keep the same invested and pay the income as it accrues in convenient periodic installments to or for the benefit of Taxpayer's mother, for her life.

Paragraph A of Article Fourth further provides that upon Taxpayer's mother's death decedent directs trustees to divide the corpus thereof into as many equal parts as Taxpayer's mother shall leave children surviving her and deceased children who leave issue who survive her. Decedent directs the trustees to continue to hold in trust each of such equal parts for the benefit of each of Taxpayer's siblings who survive Taxpayer's mother if such surviving child was living or conceived at the time of decedent's death. Each such equal part to be set aside for issue of any deceased child of Taxpayer's mother, decedent directs trustees to divide into such number of equal portions as there may be such issue and to continue to hold in trust each of such equally divided parts for each of such issue if such issue are living or conceived at the time of decedent's death.

The State Court construed the last two subparagraphs of Article Fourth paragraph A to provide that upon the death of a child of Taxpayer's mother the remainder of such deceased child's trust shall be paid over and distributed to the issue of such child, per stirpes. If the child is not survived by issue, the trust remainder shall be distributed to the issue of Taxpayer's mother, per stirpes; provided, however, the share of any remainderman who is a child of Taxpayer's mother shall be added to the principal of such child's trust to be administered and distributed in accord with the terms and provisions thereof.

TRUST 3:

Article Eleventh Paragraph (D)(1)(b) of Trust 3 provides that the remaining seven-eighths (7/8) of such equal part, or the whole of such equal one-half of the balance of decedent's residuary estate, in the event Taxpayer, predeceases decedent without leaving issue who survive decedent, decedent gives, devises and bequeaths to trustees hereinafter named to invest the same and to keep the same invested and pay the income as it accrues in convenient periodic installments to or for the benefit of Taxpayer's mother for her life.

Paragraph (D)(1)(b)(1) of Article Eleventh provides that upon the death of Taxpayer's mother, decedent directs trustees to divide the corpus thereof into five equal parts for the benefit of each of decedent's five grandchildren (Taxpayer and her siblings); and decedent directs the trustees to pay the net income from each of said trusts to or for the benefit of the respective grandchild beneficiary of each such trust, except that during the minority of such grandchild decedent's trustee may accumulate the income if not required for the support and education of such grandchild.

Paragraph (D)(1)(b)(2) of Article Eleventh provides that upon the death of each grandchild, or upon Taxpayer's mother's death, if such grandchild has predeceased Taxpayer's mother, decedent gives and bequeaths the principal of his or her respective trust to his or her issue per stirpes living at that time, or if he or she dies leaving no issue who survive Taxpayer's mother, decedent directs trustees to divide the principal of said trust into as many equal shares as there may be grandchildren living at that time and grandchildren who have died leaving issue who are them living, and decedent

directs trustees to continue to hold in trust one of such respective shares for the life of each such living grandchild and to pay over to the issue per stirpes of any deceased grandchild one such share so set apart for such issue as aforesaid.

TRUST 4:

Paragraph (D)(1)(a) of Article Eleventh provides that one-eighth of such equal one-half of the balance of decedent's residuary estate decedent gives, devises and bequeaths to trustees hereinafter named to invest the same and to keep the same invested and pay the income as it accrues in convenient periodic installments to or for the benefit of my granddaughter, Taxpayer, for her life.

Paragraph (D)(1)(a)(1) of Article Eleventh provides that upon decedent's granddaughter's death, decedent gives, devises or bequeaths the corpus of said trust to the children then living of Taxpayer in equal shares per stirpes.

Paragraph (D)(1)(a)(2) of Article Eleventh provides that in the event Taxpayer dies without leaving issue, decedent gives, devises and bequeaths upon Taxpayer's death, the corpus of said trust to the issue then living of Taxpayer's mother, in equal shares per stirpes.

Taxpayer represents that the Trusts were irrevocable on September 25, 1985, and there have been no additions, actual or constructive, to them since that date.

Taxpayer proposes to consolidate the four Trusts into Trust 3 (Consolidated Trust). Taxpayer has obtained an order from Court authorizing the consolidation. On e, Court ordered that Trust 3, Trust 4, Trust 2, and Trust 1 are consolidated into the Consolidated Trust with Trustees continuing as co-Trustees, effective as of d, with the condition that in the event Taxpayer dies without surviving descendants, that upon her death, the four trusts will spring back into existence, with their relative values in the same proportion as they were on d.

The Taxpayer has four children who are from A to B years old. Taxpayer's siblings also have children. If the Taxpayer has surviving issue when she dies, all four trusts will terminate on Taxpayer's death and will be distributed to her issue per stirpes. In the event that the Taxpayer dies without surviving issue, Court has ordered that the Trusts will spring back into existence, so that each of the Trusts can be distributed in accordance with their original terms. On Taxpayer's death without issue, C would be transferred back into Trust 4 and the remaining assets in Trust will spring back into existence in Trust 1, Trust 2, and Trust 3 with their relative values in the same proportion as they were on d.

You have requested the following rulings:

1. The consolidation of the 4 Trusts into the Consolidated Trust will not constitute

a GST under § 2601.

2. Any subsequent GST from the Consolidated Trust will remain exempt from the GST tax under § 2601, provided that there are no post-consolidation additions to the Consolidated Trust.

3. No gain or loss will be recognized under § 1001 by any of the 4 Trusts or by the Taxpayer, as beneficiary of the 4 Trusts, as a result of the proposed consolidation.

4. The assets distributed from the 4 Trusts into the Consolidated Trust will have the same basis and holding periods under §§ 1015 and 1223 before and after the proposed consolidation.

RULINGS 1 AND 2:

Section 2601 imposes a tax on every generation-skipping transfer (within the meaning of subchapter B).

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a)(1) provides that the term "taxable termination" means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless--(A) immediately after the termination, a non-skip person has an interest in the property, or (B) at no time after the termination may a distribution (including distributions on termination) be made from the trust to a skip person. Section 2612(b) provides that the term "taxable distribution" means any distribution from a trust to a skip person (other than a taxable termination or a direct skip). Section 2612(c)(1) provides that the term "direct skip" means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613(a) provides that the term "skip person" means--(1) a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or (2) a trust--(A) if all interests in the trust are held by skip persons, or (B) if--(i) there is no person holding an interest in the trust, and (ii) at no time after such transfer may a distribution (including distributions on termination) be made from the trust to a non-skip person.

Section 26.2601-1(a)(1) of the Generation-Skipping Transfer Tax Regulations provides that except as otherwise provided in § 26.2601, the provisions of chapter 13 of the Internal Revenue Code of 1986 (Code) apply to any generation-skipping transfer (as defined in § 2611) made after October 22, 1986.

Section 26.2601-1(b)(1)(i) provides that the tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata

portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) (Property includible in the gross estate under § 2038) or (C) (Property includible in the gross estate under § 2042), any trust in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from chapter 13 by § 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13.

Section 26.2611-1 provides that a generation-skipping transfer is an event that is either a direct skip, a taxable distribution, or a taxable termination. The determination as to whether an event is a generation-skipping transfer is made by reference to the most recent transfer subject to the estate or gift tax.

A modification of a generation-skipping trust that is otherwise exempt under § 26.2601-1(b)(1)(i) will generally result in a loss of its exempt or “grandfathered” 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 Trusts.

The Trusts are generation-skipping trusts because the Trusts provide for distributions to persons that are two or more generations below the grantors’ generation. Thus, unless the Trusts are excepted from the GST tax provisions by reason of § 26.2601-1(b)(1)(i), the Trusts would be subject to the GST tax.

Based on the information submitted and the representations made, the Court has ordered that if the Taxpayer dies without surviving issue, each of the Trusts will spring back into existence, so that each of the Trusts can be distributed in accordance with their original terms. Therefore, we conclude that under the proposed consolidation of the Trusts the interests of the income beneficiaries will remain the same as their interests are under the original Trusts and the timing of the termination of the Trusts will remain the same as the timing of the termination under the original Trusts. Furthermore, the value of the income or corpus interest of each income beneficiary will not change materially as a result of the consolidation of the Trusts. Accordingly, we conclude that the proposed consolidation of the Trusts will not change the quality, value, or timing of any powers, beneficial interests, rights, or expectancies originally provided for under the terms of the Trusts.

Based on the information submitted and the representations made, we also conclude that the consolidation of the Trusts into the Consolidated Trust will not constitute a GST under § 2601 and that any subsequent GST from the Consolidated Trust will remain exempt from the GST tax under § 2601, provided that there are no post-consolidation additions, actual or constructive, to the Consolidated Trust.

RULING 3:

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 other disposition of property as the sum of any money received plus the fair market value of the property (other than money) 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.

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). 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.

The essential question is whether, upon the consolidation of the Trusts, Taxpayer will have different rights to trust income or principal than she currently has. If Taxpayer were to die without leaving issue the merger of the Trusts has the potential to undermine the rights of some contingent remaindermen. It is represented, however, that the merged trust will require that if Taxpayer dies without issue that the Trusts will be proportionately divided and distributed according to the original terms of each trust. Given this representation, we believe that the interests of the beneficiaries will not change when the Trusts are consolidated.

Based on the information submitted and the representations made, we conclude that, under the proposed consolidation, no gain or loss will be realized under §§ 61 or 1001 by the Trusts or Taxpayer. We believe that the Consolidated Trust embodies substantially identical legal entitlements and is, consequently, not materially different.

RULING 4:

Section 1015(b) provides that if property is acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by gift, bequest, or devise), the basis 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 on the transfer under the law applicable to the year in which the transfer is made.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by 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 on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Because the proposed merger of the Trusts will not result in the realization of gain or loss under § 1001, or income under § 61, the basis of the assets held in the Consolidated Trust will be the same as the basis of those assets prior to the merger.

Section 1223(2) of the Code provides that in determining the period for which the taxpayer has held property, however acquired, there will be 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 purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

As noted above, the basis of the assets held in the Consolidated Trust will be the same as the basis of those assets prior to the merger. Based on the information submitted and the representations made, we conclude that the assets distributed from the Trusts into the Consolidated Trust will have the same basis and holding periods under §§ 1015 and 1223 before and after the proposed consolidation.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code.

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

Sincerely,
Christine E. Ellison
Branch Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)