

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-133875-02

Date: **SEPTEMBER 30, 2002**

Re:

Legend:

Trustor =
Trust 1 =
Trust 2 =
Trust 3 =
Trust 4 =
Child A =
Child B =
C =
D =
E =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
State =
State Statute =
Case 1 =

Case 2 =

Dear :

This is in response to your letter, dated June 18, 2002, in which rulings were requested concerning the estate and gift tax consequences of proposed amendments to four trusts and the proposed merger of four trusts into one trust.

On Date 1, Trustor created three irrevocable trusts, Trust 1, Trust 2, and Trust 3. The three trusts were created for the primary benefit of Trustor's two daughters, Child A and Child B. Each of the trusts own life insurance policies on the life of Trustor. It is represented that each trust is the owner of the insurance policies that have been assigned to the trust. Additionally, it is represented that Trustor has retained no "incidents of ownership" under § 2042 of the Internal Revenue Code and § 20.2042-1(c)(4) of the Estate Tax Regulations, in any of the policies and, accordingly, Trustor and Trustor's estate have not retained any rights to the economic benefits of the policies and have no power to change the beneficiaries, to surrender or cancel the policies, to assign the policies, to revoke an assignments, to pledge the policies for a loan, or to obtain from the insurer a loan against the surrender value of the policies.

The terms of Trust 1 and Trust 2 are substantially identical except that Trust 1 is for the primary benefit of Child A and Trust 2 is for the primary benefit of Child B. The trustees of Trust 1 and Trust 2 are D and E. Under § 3.1(a) of each trust the trustees are authorized, during the respective primary beneficiary's lifetime, to distribute the net income and principal to the beneficiary, her children, and more remote issue in such amounts, whether equal or unequal, as the trustees determine, in their discretion. Any undistributed income is to be accumulated and added to principal. Under § 3.1(b), if prior to Trustor's death, the trustees determine that it is not desirable to continue the trust, the trustees, in their discretion, may terminate the trust and distribute the trust property to the Trustor's then living issue. Under § 3.2 of each trust, the beneficiary, her children, and her more remote issue are given a right to withdraw trust principal (including the contribution) having a value equal to the contribution divided by the number of persons having a right of withdrawal immediately after the contribution is made. A right of withdrawal not exercised within 45 days from the date that notice is received by the beneficiary that a contribution has been made shall not be cumulative and shall lapse.

Upon Trustor's death, each trust will continue for the primary benefit of the trust's respective beneficiary. If the primary beneficiary is under age thirty, the trustees are to distribute net income and principal, at least quarterly, in their discretion, for the beneficiary's support, education, general welfare and comfort taking into consideration other resources available to the beneficiary. However, while the primary beneficiary is under age twenty-five the trustees, in their discretion, may accumulate income not deemed to be needed by the primary beneficiary and add it to principal. Each trust is to terminate when the primary beneficiary attains age thirty. At that time, the trustees are to distribute all remaining trust property to the respective primary beneficiary. If the primary beneficiary dies before attaining age thirty, the trustees are to distribute the remaining principal and undistributed income to one or more members of a class composed of Trustor's children and more remote issue, as the beneficiary appoints by will. If the beneficiary fails to exercise her testamentary power of appointment or if the beneficiary is not living at Trustor's death, then upon Trustor's death, the trustees are to distribute the remaining principal and any undistributed income of the trust to the beneficiary's issue, but if there are no such beneficiaries living at that time, the trustees

are to distribute the remaining principal and any undistributed income of the trust to Trustor's issue.

Trust 3 is for the benefit of Child A and Child B, and Trustor's former spouse, C. The trustees of Trust 3 are D and E. Under the terms of Trust 3, § 3.1(a) provides that during Trustor's lifetime, the trustees are to distribute so much or all of the net income or principal among the members living at the time of payment of a group composed of the Trustor's children and more remote issue in such amounts, whether equal or unequal, as the trustees, in their discretion, determine, accumulating any income balance. Under § 3.1(b), if prior to Trustor's death, the trustees determine that it is not desirable to continue the trust, the trustees, in their sole discretion, may terminate the trust and distribute the trust property to the Trustor's then living issue. Trust 3 does not provide Child A or Child B with a withdrawal power. Trust 3 provides that upon the death of Trustor, the trust will continue for the benefit of C. However, pursuant to a divorce decree on Date 3, C released all her rights in Trust 3. As a result, §§ 3.5-3.8 of Trust 3 direct that, upon Trustor's death, the trust assets will be split into shares for Child A and Child B. If a child has attained age thirty, her share will be distributed to her outright. If a child has not attained age thirty, the child's share will be distributed to Trust 1 or Trust 2, respectively.

On Date 2, Trustor established another irrevocable trust, Trust 4, for the benefit of Child A, Child B, and their children. The trustees of Trust 4 are D and E. Under §§ 3.1 and 3.2 of Trust 4, Child A, Child B, and the children of a deceased child are provided a withdrawal right for 30 days following receipt of notice of any contribution to Trust 4. Under § 4.1 of Trust 4, the trustees are authorized, during Trustor's lifetime, to distribute the net income and principal to Child A and Child B, in such amounts, whether equal or unequal and at such time or times, as the trustees determine, in their discretion, is necessary or desirable for the best interests of Trustor's issue. Any undistributed income will be accumulated and added to principal. Section 4.2 provides that the trustees may terminate Trust 4 at any time and distribute the trust assets to Trustor's issue living at the time of the termination.

Under § 5.1, upon Trustor's death, the assets of Trust 4 are to be divided into equal parts for each of Trustor's children living at Trustor's death or who have predeceased Trustor but have left living children. The trustees are then directed to hold each daughter's share in a separate trust until the respective child reaches age forty. The net income of each trust is to be distributed to the beneficiary at least quarterly. The trustees are authorized to make discretionary distributions of principal for the beneficiary's health, education, support, and general welfare. Upon attaining age forty, the trustees are directed to distribute the remaining principal and undistributed income to the respective beneficiary of each trust.

Under § 5.3(c) of Trust 4, the trustees have the power to terminate a beneficiary's trust and distribute part or all the remaining principal at any time after the beneficiary's thirtieth birthday if the trustees determine, in their discretion, that the

beneficiary has demonstrated sufficient maturity and judgment. Under § 5.3(b)(1) of Trust 4, if either beneficiary dies prior to attaining age forty, the beneficiary may appoint by will the assets in the trust in favor of Trustor's issue. In default of such appointment, the remaining trust assets are to be distributed to the beneficiary's issue, but if there are none, to the Trustor's issue then living.

It is represented that E is Trustor's brother and that D is a retired employee of Trustor. It is further represented that Trustor has no preexisting agreement with either D or E regarding the beneficial enjoyment or disposition of the assets of any of the trusts. The property was transferred by Trustor to each of the three trusts on Date 1 and to the fourth trust on Date 2. Trustor is currently living and both dates are more than three years ago as of the date of this ruling.

Currently, Child B is pregnant. The trustees propose, prior to the end of the pregnancy term, to amend the four trusts and merge the four trusts into one trust. State Statute provides that upon the written consent, acknowledged or proved in the manner required by the laws of State for the recording of a conveyance of real property, of all the persons beneficially interested in a trust of property, heretofore or hereafter created, the creator of such trust may revoke or amend the whole or any part thereof by an instrument in writing acknowledged or proved in like manner, and thereupon the estate of the trustees ceases with respect to any part of such trust property, the disposition of which has been revoked. Unborn children are not beneficially interested persons within the meaning of State Statute 1. Case 1. Accordingly, the consent of the unborn child is not required for the proposed amendments to the four trusts and the proposed merger of the four trusts into one trust.

It is represented that it is inefficient to administer the four trusts separately. The trustees propose to merge the four trusts into one trust to facilitate administration. The trustees propose to amend each trust under the authority of State Statute, so that each trust will have substantially identical terms and, then, merge the four trusts into one trust. Under State law, trustees are authorized to merge identical trusts. Case 2. It is represented that Child A, Child B, and the contingent remaindermen will have aggregate beneficial interests in the merged trust following the merger that are substantially identical to their rights prior to the amendments and merger.

The proposed amendments to the trusts are as follows. Trust 1 and Trust 2 will be amended to provide that the exercise of the withdrawal power is limited to 30 days instead of 45 days and, under § 3.1, the mandatory quarterly distributions of income after age twenty-five will be removed. Further, Trust 1 will be amended to provide that the trust will terminate upon Child A reaching the age of forty rather than thirty. Trust 3

will be amended to provide the beneficiaries with a withdrawal power for 30 days following any contribution to Trust 3. Section 3.4 of Trust 3 will be deleted as a result of C's release of her benefits, pursuant to her divorce decree, that are reflected in the trust. Trust 4 will be amended, in pertinent part, in order to meet the requirements under § 1361(e) for an electing small business trust and to provide that the net income of the trust is to be distributed by the trustees, in their discretion, for the beneficiary's health, education, support, and general welfare. Section 8.1(o) will be added to Trust 4 to authorize the trustees to grant a beneficiary a general power of appointment when appropriate for generation skipping transfer tax purposes. After the proposed amendments are made to each trust, the trustees will merge the four trusts into one trust.

You have requested the following rulings:

1. The proposed amendments to the four trusts and the merger of the four trusts into one trust will not cause the value of any assets under the four trusts to be included in Trustor's gross estate under §§ 2033, 2035, 2036, 2038, 2041, and 2042.
2. The proposed amendments to the four trusts and the merger of the four trusts into one trust will not cause the Trustor to be deemed to have made a taxable gift under § 2514.

Ruling Request 1.

Section 2001(a) 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 shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2035(a)(1) and (2) provide that if the decedent made a transfer (by trust or otherwise) of an interest in any 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 the value of such property (or any interest therein) would have been included in the decedent's gross estate under §§ 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

Section 2036(a) provides that the value of the decedent's 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 life or for any period not ascertainable without

reference to his death or for any period which does not in fact end before his death, (1) the 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 therefrom.

Section 2038(a)(1) 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 case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power) to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Section 20.2038-1(a)(2) of the Estate Tax Regulations provides that § 2038 does not apply if the decedent's power could be exercised only with the consent of all parties having an interest (vested or contingent) in the transferred property, and if the power adds nothing to the rights of the parties under local law. Similarly, § 2038 does not apply to a power held solely by a person other than the decedent. However, if the decedent had an unrestricted power to remove or discharge a trustee at any time and appoint himself trustee, the decedent is considered as having the powers of the trustee.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) defines the term "general power of appointment" as a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Under § 2042(2), the value of the gross estate includes the value of all property to the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.

Section 20.2042-1(c)(2) provides that the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally, the term has reference to the right of the insured or his estate to the economic benefits

of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke the assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy.

Trustor has not retained any interest in the property in the four trusts for purposes of § 2033. The amendments to the four trusts and the merger of the four trusts into one trust will not be considered a transfer of an interest or a relinquishment of a power by Trustor for purposes of § 2035. Trustor has not retained, for his life, the right, either alone or in conjunction with any person, to designate who will possess or enjoy the property or income from the merged trust, within the meaning of § 2036. Trustor has not retained any power, either alone or in conjunction with another person, to alter, amend, revoke, or terminate the merged trust within the meaning of § 2038. Further, Trustor will not possess a general power of appointment as defined under § 2041 with respect to the merged trust. The merged trust, not the Trustor, will be the owner of the life insurance policies for purposes of § 2042. Additionally, Trustor has represented that he possesses no incidents of ownership in the policies, under § 2042. Accordingly, we conclude that the value of the property in the merged trust will not be includible in Trustor's gross estate under § 2033, 2035, 2036, 2038, 2041, or 2042.

Ruling Request 2.

Section 2501 provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

The amendments to the four trusts and the merger of the four trusts into one trust will not constitute the exercise or release of a general power of appointment by the Trustor, within the meaning of § 2514(b). Accordingly, the amendments to the four trusts and the merger of the four trusts into one trust will not be treated as a deemed transfer of property by the Trustor for purposes of § 2501.

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 the ruling, it is subject to verification on examination.

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

The 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.

Sincerely yours,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special
Industries)

Enclosure

Copy for section 6110 purposes