

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-127229-01

Date:

OCTOBER 02, 2002

In Re:

Legend

Wife =

Husband =

Daughter =

Grandson =

Trust 1 =

Trust 2 =

Wife's Trust Agreement =

Trust 3 =

Trust 4 =

Trust 5 =

Husband's Trust Agreement =

Date 1 =

Date 2 =

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Date 3 =

Will =

State =

Corporation =

Dear :

This responds to a letter dated April 30, 2001, and subsequent correspondence, requesting rulings regarding the income, gift, and generation-skipping transfer (GST) tax consequences of the proposed consolidation of certain trusts.

FACTS

The facts submitted and representations made are as follows. Trust 1 and Trust 2 were established under the revocable trust agreement of Wife's Trust Agreement upon the Date1 death of Wife for the lifetime benefit of Husband. At his death on Date 3, Husband exercised the special powers of appointment granted him under Article V, Section D and Article VI, Section D of Wife's Trust Agreement to direct that the trust assets of Trust 1 and Trust 2, respectively, would continue to be held in those trusts, except that, in lieu of the provisions of Articles VII and VIII of Wife's Trust Agreement, the provisions of Husband's Will would govern each trust.

On Date 2, Trust 3 and Trust 4 were established under substantially identical trust instruments pursuant to which Husband transferred to each trust a different personal residence and retained an income interest in each residence for five years. Husband died during the five year term and the value of each residence was included in his gross estate for federal estate tax purposes.

Trust 5 was established under Husband's Trust Agreement upon his death.

The dispositive provisions of Trusts 1, 2, 3, 4, and 5 are identical. The trustee of each trust has discretion to distribute any amounts of income to any among the daughter of Wife and Husband (Daughter) and her issue for their proper health, maintenance, support, education, and for the establishment of a personal business. The trustee has discretion to distribute any amounts of principal for the proper health of Daughter or for the proper health and education of her issue, or for a loan for the establishment of a personal business of any such issue of the settlor of the trust, subject to specified limits.

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Each of the five trusts contains the following termination provision:

The trust established hereunder shall terminate on the later of (i) twenty-one (21) years after the death of the last survivor of such of the issue of Settlor who are living at Settlor's death and beneficiaries of the trust to be terminated, or (b) 90 years after Settlor's death. The foregoing alternate conditions shall be applied using the [State] Uniform Statutory Rule Against Perpetuities law and rules of construction, as amended. However, if the Internal Revenue Service or state law hereafter limited the generation-skipping tax exemption available to this trust to a shorter period of perpetuities limitation than [State] law permits, the shorter limitations period shall apply so to preserve the limitations. Except as provided below [in the grant of a power of appointment to Daughter's issue], upon termination, the entire principal and income shall be distributed per stirpes to the issue of [Daughter]. If no issue of Settlor exist at any time or the term hereof expires without issue of Settlor surviving, the Trust Estate shall be disposed of under the rules of intestacy of [State].

Daughter and her child, Grandson, were the only issue of Wife and of Husband living at Wife and Husband's respective deaths. Corporation is currently serving as trustee of Trusts 1, 2, 3, 4, and 5.

For administrative convenience, the trustee proposes to consolidate Trusts 1, 2, 3, 4, and 5 (the consolidated trust). The consolidated trust will be administered under the terms of Trust 5. Upon the date of consolidation, the value of each of the five trusts will be established and recorded by the trustee. Thus, should separation of the consolidated trust ever become necessary, the amount to be separated will be determined as follows. The date of separation value of the consolidated trust will be multiplied by a fraction, the numerator of which will be the date of consolidation fair market value of the applicable original trust, and the denominator of which will be the date of consolidation fair market value of the consolidated trust.

The trust instruments governing Trusts 1, 2, 3, 4, and 5 expressly permit consolidation of each trust with other trusts created by Husband or Wife with the same beneficiaries, trustee, and dispositive provisions. You represent that, under the law of State, the trustee is not required to seek court approval to consolidate the trusts.

You represent that the assets of the five trusts consist of cash, marketable securities and real estate. Trusts 1, 2, 3, 4, and 5 became irrevocable after September 25, 1985. You represent that each of these five trusts has an inclusion ratio of zero due to the allocation of Wife's GST exemption to Trusts 1 and 2 on Wife's Form 706, United

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States Estate (and Generation-Skipping Transfer) Tax Return by her executors and due to the allocation of Husband's GST exemption to Trusts 3, 4, and 5 on Husband's Form 706 by his executors. There have been no other additions or contributions to any of the trusts which would result in any of the trusts having an inclusion ratio other than zero.

You have requested the following rulings:

1. The proposed consolidation of Trusts 1, 2, 3, 4, and 5 will not subject Trusts 1, 2, 3, 4, and 5 or any distributions from the consolidated trust to the GST tax.
2. The proposed consolidation of Trusts 1, 2, 3, 4, and 5 will not constitute an actual or constructive addition to any of the trusts for purposes of the GST tax.
3. Following the proposed consolidation of Trusts 1, 2, 3, 4, and 5, the consolidated trust will be exempt from the GST tax.
4. The proposed consolidation of Trusts 1, 2, 3, 4, and 5 will not cause any beneficiary of a trust or any beneficiary of the consolidated trust to have made a taxable gift for federal gift tax purposes.
5. The proposed consolidation of Trusts 1, 2, 3, 4, and 5 will not cause any trust, including the consolidated trust, to recognize any gain or loss from the sale or other disposition of property under § 61 or § 1001.
6. Pursuant to § 1015, the basis of the consolidated trust in each asset received will be the same as the transferring trust's basis in such asset.
7. Pursuant to § 1223(2), the holding period of each asset transferred to Trust 5 will include the period for which the property was held by the transferring trust.

LAW AND ANALYSIS

Generation-Skipping Transfer Tax Ruling Requests Nos. 1, 2, and 3

Section 2601 of the Internal Revenue Code imposes a tax on each generation-skipping transfer which includes under § 2611(a) a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986.

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Section 2602 provides that the amount of the tax imposed by § 2601 is (1) the taxable amount (determined under subchapter C), multiplied by (2) the applicable rate (determined under subchapter E).

Section 2641 provides that the term “applicable rate” means, with respect to any generation-skipping transfer, the product of (1) the maximum Federal estate tax rate, and (2) the inclusion ratio with respect to the transfer.

Section 2631(a) provides that for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of \$1,000,000 (adjusted for inflation) that may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 2642(a) provides that the inclusion ratio is the excess, if any, of 1 over the applicable fraction determined for the trust from which the transfer is made, or in the case of a direct skip, the applicable fraction determined for the skip. The applicable fraction is a fraction in which the numerator is the amount of GST exemption allocated to the trust, or in the case of a direct skip, allocated to the property transferred in the skip, and the denominator is the value of the property transferred to the trust or transferred in the direct skip, reduced by any Federal estate tax or State death tax actually recovered from the trust attributable to the property and any charitable deduction allowed under §§ 2055 and 2522 with respect to the property.

Section 26.2654-1(a)(2)(i) of the Generation-Skipping Transfer Tax Regulations provides that, if there is more than one transferor with respect to a trust, the portions of the trust attributable to the different transferors are treated as separate trusts for purposes of chapter 13.

It is represented that Trusts 1, 2, 3, 4, and 5 each have an inclusion ratio of zero due to allocations of Wife’s and Husband’s GST exemptions to the respective trusts at their deaths. There have been no other additions or contributions to any of the trusts. As a result, the inclusion ratio of each trust prior to the consolidations is zero. Therefore, subsequent to the consolidation, the portion of the consolidated trust attributable to Wife and the portion of the consolidated trust attributable to Husband will be treated as separate trusts for purposes of chapter 13 and each portion will have a zero inclusion ratio for purposes of § 2601.

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

1. The proposed consolidation of Trusts 1, 2, 3, 4, and 5 will not subject Trusts 1, 2, 3, 4, and 5 or any distributions from them to the GST tax.
2. The proposed consolidation of Trusts 1, 2, 3, 4, and 5 will not constitute an actual or constructive addition to any of the trusts for purposes of the GST tax.
3. Following the proposed consolidation of Trusts 1, 2, 3, 4, and 5, the consolidated trust will be exempt from the GST tax.

Gift Tax Ruling Request No. 4

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.

In this case, the interest of each beneficiary will remain the same after the proposed consolidation of Trusts 1, 2, 3, 4, and 5 as it was prior to the proposed transaction. Accordingly, based on the facts submitted and the representations made, we conclude that the consolidation of Trusts 1, 2, 3, 4, and 5 will not cause any beneficiary of these trusts or any beneficiary of the consolidated trust to have made a taxable gift for federal gift tax purposes.

Income Tax Ruling Requests Nos. 5, 6, and 7

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 shall be the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized. 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.

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Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for other property differing materially either in 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.

An exchange of property results in the realization of gain under § 1001 if the properties exchanged are materially different. Cottage Savings Ass'n 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.

In the present case, the information submitted and the representations made establish that the trusts will be consolidated for administrative convenience. Each beneficiary will possess the same income and remainder interests before and after the consolidation of the trusts. Thus, the interests of the beneficiaries in Trusts 1, 2, 3, 4, and 5 will not be materially different from their interests in the consolidated trust and no sale or exchange under § 1001 will occur as a result of the consolidation. Consequently, no gain or loss will be realized by the trusts or the consolidated trust under § 61 or § 1001.

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 recognized.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which the property was held by any other person, if under chapter 1 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 the taxpayer's hands as it would have in the hands of the other person.

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

5. The proposed consolidation of Trusts 1, 2, 3, 4, and 5 will not cause any trust, including the consolidated trust, to recognize any gain or loss from the sale or other disposition of property under § 61 or § 1001.

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6. Pursuant to § 1015, the basis of the consolidated trust in each asset received will be the same as the transferring trust's basis in such asset.

7. Pursuant to § 1223(2), the holding period of each asset transferred to Trust 5 will include the period for which the property was held by the transferring trust.

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

This 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 yours,

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

Enclosure

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