

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:

June 06, 2003

TY:

Legend

Grantor =

Country A =

Trust =

Date X =

Amount 1 =

Country B =

Foreign Trustee =

Date Y =

Year Z =

Dear :

This is in response to your letter, dated December 30, 2002, in which you requested rulings concerning the proper income, gift, and generation-skipping transfer ("GST") tax treatment of the domestication of a foreign trust.

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.

FACTS

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Grantor, who at the time was a resident and citizen of Country A, established the Trust on Date X. The Trust was initially funded with Amount 1; no additional capital contributions have been made. Foreign Trustee, a banking institution organized under the laws of Country B, was appointed trustee. The Trust is a foreign trust under sections 7701(a)(30)(E) and 7701(a)(31)(B) of the Internal Revenue Code.

The Trust is an irrevocable trust established for the primary benefit of Grantor's grandchildren. The beneficiaries include citizens and residents of the United States. Grantor retained no powers that caused him to be treated as the owner of the Trust under section 671.

Clause 1(b) of the Deed of Trust defines "Perpetuity Date" as the day preceding the one hundred fiftieth anniversary of the date of the Deed.

Clause 3(a) provides that until the Trust Division Event, the Trustees shall be authorized to distribute to or for the benefit of Grantor's then living grandchildren as much of the net income and/or principal of the Trust Fund as the Trustees deem advisable for the education of the grandchildren.

Clause 3(b) provides that the Trust Division Event shall occur upon the earlier of (i) a grandchild of Grantor attaining 25 years of age, or (ii) the death of all grandchildren of Grantor. Upon the Trust Division Event, the Trust shall terminate, and the Trustees shall divide the assets of the Trust into equal shares for Grantor's grandchildren, or, if any of them are not living at the Trust Division Event, then for the deceased grandchild's issue on a per stirpes basis. Each such share or part of a share allocated to a descendant of Grantor who is living at the Trust Division Event shall be placed in a separate trust, and the Trustees thereafter shall hold, administer, and distribute said trust for the primary benefit of the descendant to whom such share is allocated and for the benefit of such descendant's issue in accordance with the provisions of Clause 4.

Clause 4 provides that if a trust is to be established for the primary benefit of a beneficiary and for the benefit of such beneficiary's issue, which trust is to be held, administered and/or distributed in accordance with the provisions of this Clause 4 (each such trust is referred to in the Deed as a "Dynasty Trust"), the Trustees shall manage, invest and reinvest the assets of each such Dynasty Trust and shall distribute the income and principal of each such Dynasty Trust in accordance with the following provisions:

- (a) During the term of each Dynasty Trust, the Trustees shall distribute to or for the benefit of the Beneficiary for whose primary benefit such Dynasty Trust is established and for such Beneficiary's issue as much of the income and/or principal of such Beneficiary's Dynasty Trust as the

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Trustees deem necessary or advisable to provide for the education and health of such Beneficiary and such Beneficiary's issue. During the term of each Dynasty Trust, the Trustees also shall distribute to or for the benefit of any one or more among such Beneficiary and such Beneficiary's issue who is at least 25 years of age as much of the income and/or principal of such Beneficiary's Dynasty Trust as the Trustees deem necessary or advisable to provide for the maintenance and support in reasonable comfort of such Beneficiary and such Beneficiary's issue who are at least 25 years of age.

- (b) Upon the first to occur of (1) the death of the Beneficiary for whose primary benefit such Dynasty Trust is established, or (2) the Perpetuity Date, such Dynasty Trust shall terminate.

Clause 11 of the Schedule to the Deed of Trust provides that the Trust shall be governed in all respect by the laws of the Trust Domicile. Country B is the first Trust Domicile, but the Trustees may by deed change the Trust Domicile to any other jurisdiction that would recognize the validity of the Trust and the respective interests of the beneficiaries.

Due to a change in circumstances, Grantor established residency in the United States on Date Y, a date that is less than 5 years after Date X. Since Date Y, Grantor has been treated as the owner of the Trust pursuant to section 679 and has paid U.S. income tax on the income of the Trust. Grantor became a U.S. citizen in Year Z.

The Trust's advisors have determined that it would be in the best interest of the beneficiaries of the Trust to convert the Trust to a domestic trust. The Trustee Selection Committee plans to change the trustee from Foreign Trustee to an institution organized and established under the laws of the United States or of one of the several states in the United States ("U.S. Resident Trustee"). The Perpetuity Date will be changed, if necessary, to comply with the applicable law.

RULINGS REQUESTED

1. The domestication of the Trust and the Trust's resulting change in status from a foreign grantor trust to a domestic nongrantor trust will not cause a gain recognition event under section 684(a) of the Code and section 1.684-2(e) of the Income Tax Regulations at the time of the domestication or at Grantor's death.
2. No aspect of domestication, including the Trust's change of status from a foreign grantor trust to a domestic nongrantor trust and the change of fiduciary from Foreign Trustee to U.S. Resident Trustee, will give rise to a gift for purposes of

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section 2501, nor will future distributions from the Trust be subject to the gift tax.

3. No aspect of domestication, including the Trust's change of status from a foreign grantor trust to a domestic nongrantor trust and the change of fiduciary from Foreign Trustee to U.S. Resident Trustee, will cause the GST tax under section 2601 to apply to an otherwise taxable termination or taxable distribution from the Trust and the Dynasty Trusts.

LAW AND ANALYSIS

Ruling 1

Section 671 provides that where it is specified in subpart E of part 1 of subchapter J, chapter 1 of the Code that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 679(a)(1) provides that a United States person who directly or indirectly transfers property to a foreign trust shall be treated as the owner for his taxable year of the portion of such trust attributable to such property if for such year there is a United States beneficiary of any portion of such trust.

Section 679(a)(4) provides that if a nonresident alien individual has a residency starting date within 5 years after directly or indirectly transferring property to a foreign trust, section 679 and section 6048 shall be applied as if such individual transferred to such trust on the residency starting date an amount equal to the portion of such trust attributable to the property transferred by such individual to such trust in such transfer.

Section 684(a) provides that, except as provided in regulations, in the case of any transfer of property by a United States person to a foreign estate or trust, for purposes of subtitle A of the Code, such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of the fair market value of the property so transferred over the adjusted basis of such property in the hands of the transferor.

Section 684(b) provides that section 684(a) shall not apply to a transfer to a trust by a United States person to the extent that any person is treated as the owner of such trust under section 671.

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Section 1.684-2(e) of the Income Tax Regulations provides that if any portion of a foreign trust is treated as owned by a U.S. person under subpart E of part I of subchapter J, chapter 1 of the Code, and such portion ceases to be treated as owned by that person under such subpart (other than by reason of an actual transfer of property from the trust to which section 1.684-2(d) applies), the U.S. person shall be treated as having transferred, immediately before (but on the same date that) the trust is no longer treated as owned by that U.S. person, the assets of such portion to a foreign trust. Section 1.684-2(e) addresses a situation where a trust is a foreign trust both before and after it ceases to be treated as owned by a U.S. person and the only change is the trust's status for purposes of subpart E. Immediately following the change in the trust's status, the assets are held in a foreign trust that is taxable under section 641 et seq. and is not generally subject to U.S. income tax except to the extent it derives income from sources within the United States.

In this case, the Trust currently is a foreign trust. Although the Trust's beneficiaries include citizens and residents of the United States, section 679 was not applicable on Date X, when the trust was created, because Grantor was a nonresident alien. When Grantor became a resident of the United States on Date Y, a date that was less than 5 years after Date X, section 679(a)(4) caused section 679(a)(1) to become applicable. Consequently, Grantor has been treated as the owner of the Trust since Date Y.

If the Trust becomes a domestic trust, section 679 will cease to apply and the Trust will cease to be treated as owned by Grantor under subpart E. When the Trust becomes a domestic trust, section 684(a) will have no application, because the domestication of the Trust is not treated as a transfer to a foreign trust. Section 684 and Section 1.684-2(e) of the Income Tax Regulations apply only to transfers to foreign trusts.

Therefore, based upon the information submitted and the representations made, we conclude that the domestication of the Trust and the trust's resulting change of status from a foreign grantor trust to a domestic nongrantor trust will not cause a gain recognition event under section 684(a) and section 1.684-2(e) of the Regulations at the time of domestication or at Grantor's death.

Ruling 2

Section 2501(a)(1) provides that a tax, computed as provided in section 2502, is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides that the tax imposed by section 2501 shall apply 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; but in the case of a nonresident not a

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citizen of the United States, the tax shall apply to a transfer only if the property is situated within the United States.

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 an adequate 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 a gift.

Section 25.2511-2(b) of the Gift Tax Regulations provides that a gift of property is complete to the extent the donor has so parted with dominion and control as to leave him no power to change its disposition, whether for his own benefit or for the benefit of another.

Section 25.2511-1(b)(1) provides that in the case of a gift by a nonresident not a citizen of the United States, if the gift was made on or after January 1, 1967, by a donor who was not an expatriate to whom section 2501(a)(2) was inapplicable on the date of the gift by reason of section 2501(a)(3) and paragraph (a)(3) of section 25.2501-1, the gift tax applies only if the gift consisted of real property or tangible personal property situated within the United States at the time of the transfer.

Section 25.2511-1(g)(1) provides, in part, that the gift tax is applicable only to a transfer of a beneficial interest in property. It is not applicable to a transfer of bare legal title to a trustee.

In this case, Grantor made a completed gift at the time that he transferred property to the Trust. Furthermore, the transfer of title from Foreign Trustee to U.S. Resident Trustee would not result in a taxable gift. Therefore, based upon the information submitted and the representations made, we conclude that no aspect of domestication, including the Trust's change of status from a foreign grantor trust to a U.S. nongrantor trust and the change of fiduciary from Foreign Trustee to U.S. Resident Trustee, will give rise to a gift for purposes of section 2501, nor will future distributions from the Trust be subject to the gift tax.

Ruling 3

Section 2601 imposes a tax on each generation-skipping transfer. Section 2611(a) provides that the term "generation-skipping transfer" means -- (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term "taxable termination" means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in

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trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such 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 for purposes of chapter 13, 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 if all interests in such trust are held by skip persons, or if there is no person holding an interest in such trust, and at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 2663(2) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of chapter 13 including regulations (consistent with the principles of chapters 11 and 12) providing for the application of this chapter in the case of transferors who are nonresidents not citizens of the United States ("NRA transferors").

Section 26.2663-2(b)(2) of the Generation-Skipping Transfer Tax Regulations provides that chapter 13 applies to a taxable distribution or a taxable termination to the extent that the initial transfer of property to the trust by a NRA transferor, whether during life or at death, was subject to the Federal estate or gift tax within the meaning of section 26.2652-1(a)(2).

Section 26.2652-1(a)(2) provides, in part, that, for purposes of chapter 13, a transfer is subject to Federal gift tax if a gift tax is imposed under section 2501(a) (without regard to exemptions, exclusions, deductions, and credits).

In this case, Grantor transferred property to the Trust while he was a nonresident alien. The original transfer to the Trust was not subject to Federal gift tax because neither Grantor nor the Trust property had U.S. situs. Because the initial transfer was not subject to the Federal gift or estate tax, the GST tax does not apply to distributions from and terminations of the Trust. Therefore, based upon the information submitted and the representations made, we conclude that no aspect of domestication, including the Trust's change of status from a foreign grantor trust to a domestic nongrantor trust and the change of fiduciary from Foreign Trustee to U.S. Resident Trustee, will cause the

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GST tax to apply to an otherwise taxable termination or taxable distribution from the Trust and the Dynasty Trusts under section 2601.

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. In particular, no opinion is expressed or implied concerning whether the Trust will be a domestic trust following the change of fiduciary from Foreign Trustee to U.S. Resident Trustee.

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 the taxpayer.

Sincerely,

M. Grace Fleeman
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(International)

cc: