Internal Revenue Service

Number: **200449019**
Release Date: 12/3/04
Index Number: 2601.00-00, 1001.00-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:04 – PLR-122778-04
Date: JULY 22, 2004

In Re:

Legend

Trust 1 =

Trust 2 =

Settlor =
Daughter 2 =
Date 1 =
Date 2 =
Trustees =
Court =

State =
State Statute =

Dear :

This is in response to the April 21, 2004 letter and subsequent correspondence, concerning the generation-skipping transfer (GST) tax and income tax consequences of the proposed merger of two trusts.

The facts and representations submitted are summarized as follows: Settlor executed an irrevocable trust agreement, Trust 1, dated Date 1, which is prior to

September 25, 1985. Trust 1 was created for the primary benefit of Settlor's daughter, Daughter 2. The trustees of Trust 1 are Trustees.

Article One of Trust 1 provides, in part, that the Trustees shall hold, manage, invest and reinvest the trust property, shall collect the income therefrom and shall pay the net income in convenient installments, in such proportions and with such exclusions as the Trustees shall deem advisable, among the following class of persons: Daughter 2, a child of Settlor; the spouse of said child; the issue of said child; the respective spouses of the issue of said child; the brothers and sisters of said child; their respective spouses; their issue and the respective spouses of such issue; or the Trustees shall have the right to and are authorized to accumulate any or all of such net income, as they shall deem advisable, and add the same to the principal of the trust property. Further, in the event that any payment of income authorized to be made to any individual beneficiary shall be insufficient in the opinion of the Trustees to defray the expenses of any illness, accident or other emergency, or to provide for the proper maintenance, support and education of such beneficiary, the Trustees are authorized to use from time to time so much of the principal of the trust property as the Trustees may deem advisable therefor.

Article Two of Trust 1 provides, in part, that this trust shall continue in effect, unless sooner terminated as herinafter provided, until twenty-one (21) years after the death of the last to die of the four children of the Settlor living at the date this agreement or until the earlier failure of all living takers in the class of persons above described in Article One hereof.

The Trustees, however, are authorized to terminate this trust in whole or in part before the time aforesaid, whenever they deem it to be in the best interest of the beneficiaries of this trust or for any other reasons advisable to do so.

Upon any termination of Trust 1, the Trustees shall transfer, deliver and pay over the then trust property to the said child of the Settlor, if such child is then living, and if not, to the then living issue of the said child, per stirpes. Failing such then living issue, the then trust property shall be divided equally among and added to the other three trusts of even date with this agreement established by the Settlor for his other children and their families, for which trusts there are takers then living. And, failing all such then living takers, the then trust property shall be transferred, delivered and paid over to such charitable organization or organizations as the Trustees shall select.

On Date 2, a date prior to September 25, 1985, Settlor executed a second irrevocable trust agreement, Trust 2, for the primary benefit of Settlor's daughter, Daughter 2. The trustees of Trust 2 are Trustees.

The terms of Trust 2 are virtually identical to the terms of Trust 1. Trust 1 and Trust 2 have identical dispositive provisions and identical beneficiaries. The only significant variation between Trust 1 and Trust 2 is contained in the fiduciary powers

provision of Trust 2, Article Nine. Specifically, Trust 2 permits the trustees of Trust 2 to delegate to each other their rights, power and duties thereunder: Any of the Trustees shall have full power and authority to delegate from time to time [to] any one or more of the other Trustees by an instrument in writing any or all of such Trustee's rights, power and duties hereunder.

Since the establishment of Trust 1 and Trust 2, the trusts have been separately administered under State law. It is represented that this separate administration has proved to be costly and cumbersome resulting in frequent duplication in connection with investment oversight, court filing requirements, annual accounting statements and tax reporting matters.

State Statute provides that the court, for cause shown, may authorize the combination of separate trusts with substantially similar provisions upon such terms and conditions and with such notice as the court shall direct notwithstanding that the trusts may have been created by separate instruments and by different persons.

Trustees propose to file a petition to State Court to seek the court's permission to combine the assets of Trust 1 with Trust 2, and to seek State Court authority to administer the combined assets under the provisions of Trust 2. The petition will further provide that the merger of Trust 1 and Trust 2 is contingent upon the issuance of a ruling by the Internal Revenue Service that the merger will not result in a forfeiture of Trust 2's exempt status from GST tax.

Trust 1 and Trust 2 were irrevocable on September 25, 1985. It is represented that no actual or constructive additions have been made to Trust 1 and Trust 2 after that date.

You have requested the following rulings:

1) The proposed merger of Trust 1 into Trust 2, with the combined corpus thereof being administered in accordance with Trust 2, will not give rise to a constructive addition to Trust 2 nor otherwise cause Trust 2 to lose its grandfathered exempt status under GST tax provisions of section 2601.

2) The proposed merger of Trust 1 into Trust 2 will not cause either of Trusts 1 or 2 to recognize gain or loss for purposes of section 1001, and the basis of the assets of Trust 1 and Trust 2, as well as the holding period of those assets, will remain the same after the proposed merger.

Issue 1

Section 2601 imposes a tax on each generation-skipping transfer (GST) which includes under section 2611 a taxable distribution, a taxable termination, and a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. See section 26.2601-1(b)(1)(v) regarding constructive additions.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. A modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 6, considers a situation where, in 1980, Grantor established an irrevocable trust for Grantor's child and the child's issue. In 1983, Grantor's spouse also established a separate irrevocable trust for the benefit of the same child and issue. The terms of the spouse's trust and Grantor's trust are identical. In 2002, the appropriate local court approved the merger of the two trusts into one trust to save administrative costs and enhance the management of the investments. The merger of the two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the merger. In addition, the merger does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust that resulted from the merger will not be subject to the provisions of chapter 13.

In the present case, Trust 1 and Trust 2 were irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, were made to Trust 1 or Trust 2 after that date.

The merger of Trust 1 into Trust 2 is substantially similar to the situation described in Example 6 of section 26.2601-1(b)(4)(i)(E). The merger of Trust 1 into Trust 2 will not result in a shift of any beneficial interest in the trust assets to any

beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the merger. Trust 2 will terminate on the same date that Trust 1 was required to terminate. Thus, the merger will not extend the time for vesting of any beneficial interest in the surviving trust beyond the period provided for in Trust 1 and Trust 2.

Accordingly, we conclude that, based on the facts submitted and the representations made, the proposed merger of Trust 1 into Trust 2, with the combined corpus thereof being administered in accordance with Trust 2, will not give rise to a constructive addition to Trust 2 nor otherwise cause Trust 2 to lose its grandfathered exempt status under GST tax provisions of section 2601.

Issue 2

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 is the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss is the excess of the adjusted basis provided in section 1011 over the amount realized. Section 1001(c) provides that, except as otherwise provided, the entire amount of the gain or loss on the sale or exchange of property is 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 in either kind or in extent, is treated as income or as loss sustained.

For purposes of section 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 section 1001(a). See section 1.1001-1.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that a partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests in order to extinguish their survivorship interests.

An exchange of property results in the realization of gain under section 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.

Trust 1 and Trust 2 have substantially similar provisions. The Trusts have identical dispositive provisions and identical beneficiaries. The proposed merger of Trust 1 into Trust 2 will not result in any change in the beneficial interests of any beneficiary.

Based on the information submitted and the representations made in the ruling request, the proposed merger of Trust 1 into Trust 2 will not result in a material difference in the beneficial interests of any beneficiary. The beneficiaries will hold the same interests before and after the merger. Accordingly, the proposed merger will not cause any of the trusts to recognize any gain or loss from the sale or other disposition of property under sections 61 or 1001.

Section 1011 provides that the adjusted basis for determining gain or loss from a sale or other disposition of property, whenever acquired, is the basis as determined under section 1012 or other applicable sections. Section 1012 provides that the basis of property is the cost of the property except as otherwise provided in subchapter O.

In the present case, the basis of the assets in Trust 1 and Trust 2 are determined under section 1012 and other sections in subchapter O. As the proposed merger of the two separate trusts will not constitute a sale or other disposition of property for purposes of section1001, no gain or loss will be realized under section 1.1001-1. Accordingly, the basis of the assets in the surviving trust after the proposed merger will remain the same as the basis of those assets in the current trusts before the merger.

Section 1223(2) provides that, in determining the period for which a taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person if under chapter 1 of the Code such 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 such other person.

As mentioned above, the basis of the assets in the surviving trust after the proposed merger will remain the same as the basis of those assets in the current trusts before the merger. Accordingly, the holding periods of the assets in the surviving trust after the proposed merger will include the holding periods of the assets in the current trusts before the merger.

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

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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

Enclosures
Copy for section 6110 purposes
Copy of this letter

cc:

cc: