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Person To Contact:
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Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-122207-07
Date: AUGUST 19, 2008

Re:

LEGEND:

Decedent =
Trust =

GST Trust =

A =

Corporate Fiduciary =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Year =

State =

Local Court =

a =

\$x =

Case 1 =

Case 2 =

Case 3 =

Case 4 =

State Statute 1 =

State Statute 2 =

State Statute 3 =

Dear

This letter is in response to your authorized representative's letter of April 20, 2007, and subsequent correspondence, in which rulings are requested under §§ 61, 1001, and 2601 of the Internal Revenue Code.

The facts and representations are as follows. Decedent executed a revocable trust (the "Trust") on Date 1. A was designated as the trustee. The Trust was amended on Date 2 and further amended on Date 3. The Trust became irrevocable at Decedent's death on Date 4. Decedent's will provided for the residue of his estate to pass to the Trust. A was designated as the executor of the estate. A and Corporate Fiduciary (together, the "Trustee") are the present co-trustees of the Trust.

Article IV of the Trust provides that, following Decedent's death, the trust estate is to initially be held in further trust and administered as specified. The Trustee may first pay Decedent's last illness and funeral expenses, other obligations incurred for Decedent's support, any claims against or expenses incurred in the administration of the estate, and the estate, inheritance, succession, generation-skipping transfer and other death taxes attributable to any portion of Decedent's taxable estate.

Article IV, Paragraph 4.2, provides that the Trustee is to distribute "an amount equal to [Decedent's] GST exemption not allocated to lifetime direct skips, free of all estate, inheritance, generation-skipping, and other transfer taxes" to a trust (the "GST Trust") for the benefit of Decedent's issue. (A trust to hold one-third of the trust estate for the benefit of Decedent's surviving spouse is created in Paragraph 4.1, and another trust to hold the balance of the Trust property for the benefit of Decedent's issue is created in Paragraph 4.3.)

Article VI, Paragraph 6.2, provides that the Trustee is authorized to continue to hold and operate, to sell, or to liquidate, at the risk of the trust estate, any business, partnership interest, or the stock of any closely held corporation that the Trustee receives or acquires under the Trust. The Trustee is authorized to guarantee any loans, at the risk of the trust estate, made to any business, partnership, or closely held corporation in which the Trust holds an interest.

Article VIII, Paragraph 8.3, provides that the Trust is to be construed and administered in accordance with the laws of State.

At the time of his death, Decedent had an available GST tax exemption amount of \$x. This amount was allocated to the GST Trust on the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, filed for Decedent's estate.

At Decedent's death, the Trust assets consisted of Decedent's business interests

that were indebted and subject to creditors' claims. It was not possible to immediately satisfy the outstanding debts and obligations. Therefore, the Trustee continued to administer the Trust for a years. During that time, the Trustee followed a plan of measured liquidation of assets and used the proceeds to pay the debts and obligations. The Trust was released from its final obligation in Year. By that time, the value of the Trust assets had substantially increased.

The Trustee is preparing to distribute the Trust assets to the designated trusts. A ruling is requested to the effect that the GST Trust is entitled to receive a fractional portion of the Trust assets, thereby sharing in the assets' post-death appreciation. In this way, the \$x GST tax exemption allocated to the transfer, based on the date of death value, would apply to a pro rata portion of the Trust's post-death appreciation.

On Date 5, the Trustees filed an unopposed petition in Local Court asking the court to determine whether the GST Trust is to be funded with a pecuniary amount or a fractional share. On Date 6, Local Court held that the Trust provides for the GST Trust to be funded with a fractional share.

You have requested the following rulings:

- (1) The GST Trust is entitled to a fractional share of the Trust assets; and
- (2) The funding of the GST Trust will not result in gain or loss for federal income tax purposes.

ISSUE 1:

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court held that where the federal tax liability turns upon the character of a property interest transferred by the decedent under state law, federal authorities are not bound by the determination made of that property interest by a state trial court. When the application of a federal statute is involved, the decision of a state trial court as to an underlying issue of state law should *a fortiori* not be controlling. Rather, the state's highest court is the best authority on its own law. If there is no decision by the state's highest court, then federal authorities must apply what they find to be the state law after giving 'proper regard' to relevant rulings of other courts of the State. In this respect, the federal authority may be said to be, in effect, sitting as a state court.

The Trust is to be construed under the laws of State. Under State law, in construing a trust, the trustor's intent must be ascertained from the whole instrument. Case 1. A pecuniary bequest is a bequest of a specified set dollar amount, stated in dollars or determined by formula, and payable in that amount regardless of the fluctuation in value of the decedent's property between the date of death and the date of

payment. Case 4. See C.J.S. Wills § 1141 (2008) stating:

The amount of a legacy, and the determination of how it is to be paid out, depends on the testator's intention as expressed in the will. The amount . . . may be expressed in precise figures, or it may be made determinable on some reasonable basis of computation . . . "An amount" as used in a will indicates a true pecuniary bequest, or a bequest of a certain fixed amount unaffected by the appreciation or depreciation of assets and not a fractional bequest [Emphasis supplied.]

See also, State Statute 2. If the pecuniary bequest is not distributed within one year after the testator's death, the bequest bears interest thereafter. State Statute 3.

Under State law, when a settlor indicates in a trust that a primary purpose of the trust is to satisfy his debts and obligations, the trust term does not end at the settlor's death. Rather the trust term ends when the purpose is fulfilled. The provisions for distributing the trust assets to the remaindermen take effect only after the primary purpose has been achieved. Case 1; Case 2; Case 3. See also, State Statute 1.

After considering the provisions of the Trust in the context of State law, as would be determined by the highest court of that state, we conclude that the transfer to the GST Trust under Article IV, Paragraph 4.2, of the Trust, is of a pecuniary amount. The provision for "an amount equal to [Decedent's] GST tax exemption" is explicit. It is a prototypical pecuniary bequest in State. There is no other provision in the Trust that suggests otherwise. Moreover, the Trust provisions indicate that the Trust was to be held, first, as the source for payment of Decedent's debts, obligations, liens, creditors' claims, etc. Under State law, distribution of the \$x amount to the GST Trust could be made only after that primary purpose was accomplished. However, the \$x pecuniary amount was to bear interest after the first year of Decedent's death.

Section 2601 imposes a tax on every generation-skipping transfer, made by a transferor to a skip person. A generation-skipping transfer is defined under § 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. Section 2642(a)(2) provides generally that the applicable fraction is a fraction (A) the numerator of which is the amount of the GST exemption allocated to the trust under § 2631(a), and (B) the denominator of which is the value of the property transferred to the trust.

Under §§ 2631(a) and (c) for purposes of determining the inclusion ratio, every individual is allowed a GST exemption amount that may be allocated by such individual (or by his executor) to any property with respect to which the individual is the transferor. The GST exemption amount for any calendar year is equal to the applicable exclusion

amount under § 2010(c) for such year.

In this case, Decedent's available GST tax exemption of \$x has been allocated to the \$x pecuniary transfer to the GST Trust. That is the amount (plus annual statutory interest) that is distributable to the GST Trust under the terms of the Trust. Consequently, to the extent that additional value is distributed to the GST Trust, the trust will not be exempt from GST tax.

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

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under ' 1001(c), 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 1.661(a)-2(f) of the Income Tax Regulations provides, in part, that gain or loss is realized by a trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount or of specific property other than that distributed.

Section 1014 provides rules governing the basis of property acquired from a decedent. Sections 1.1014-4(a)(1) and (a)(2) provide generally that persons acquiring property from a decedent have a uniform basis and a common acquisition date for titles relating to the property.

Section 1.1014-4(a)(3) provides that the principles found in § 1.1014-4(a)(1) and (a)(2) do not apply to property transferred by an executor, administrator or trustee, to an heir, legatee, devisee, or beneficiary under circumstances such that the transfer constitutes a sale or exchange. In an example under § 1.1014-4(a)(3), a trust satisfied a specific bequest of \$10,000 with appreciated securities worth \$9,000 on the date of the decedent's death but worth \$10,000 when distributed. The trust realized a gain of \$1,000 on the transfer, and the basis of the securities in the hands of the beneficiaries was \$10,000.

Because the funding of the GST Trust in this case is treated as a transfer in satisfaction of a pecuniary legacy for federal tax purposes, then under the regulations previously cited, the Trust will realize gain or loss under § 1001(a).¹ See also Kenan v. Commissioner, 114 F.2d 217 (2nd Cir. 1940).

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.

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 taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

JAMES F. HOGAN
Senior Technician Reviewer, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

¹ The distribution of a specific dollar amount in cash would not result in the realization of gain or loss under § 1001 because the basis of cash is its face amount. The distribution of the specific property itself also would not be a taxable event to the trust. See Bittker & Lokken, Federal Taxation of Income, Estates and Gifts, Vol. 2, para. 40.4.2 (Warren, Gorham and Lamont, 3d ed., 2000).