

**Internal Revenue Service**

Department of the Treasury  
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Third Party Communication: None  
Date of Communication: Not Applicable  
Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-111537-10

Date:

September 08, 2010

In Re:

Legend

Settlor	=
Son	=
Trust A	=
Trust B	=
Trust C	=
Trust 1	=
Trust 2	=
Trust 3	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Year 5	=
Year 6	=
Year 7	=
Year 8	=
<u>X</u>	=
<u>Y</u>	=
Date 1	=
Date 2	=
State	=
State Statute 1	=

Dear \_\_\_\_\_ :

This letter responds to your March 10, 2010 letter and other correspondence requesting federal income, gift, and generation-skipping transfer (GST) tax rulings with respect to the proposed consolidation of three trusts.

The facts submitted are as follows:

During Settlor's life, Settlor established three separate trusts, Trust A, Trust B, and Trust C. Trust A and Trust B are irrevocable trusts. Trust C was a revocable trust. In Years 1 through 8, Settlor transferred funds to Trust A. In Years 6 through 8, Settlor transferred funds to Trust B. Settlor timely filed Form 709, United States Gift (and Generation-Skipping Transfer) Tax Returns for each of the transfers to Trust A and Trust B. Settlor also allocated his GST exemption to each of the transfers in an amount sufficient to create an inclusion ratio of zero for each trust. Pursuant to Trust A and Trust B, upon Settlor's death, Trust A and Trust B would be divided into separate trusts to benefit each of his children and his or her issue. Trust C became irrevocable on Settlor's death and that instrument provided that, upon Settlor's death, Trust C would be divided into separate trusts to benefit each of his children and his or her issue.

Settlor died on Date 1, Year 8. Son survived Settlor. Following the death of Settlor and pursuant to Trusts A, B, and C, separate trusts were established for each child. Three trusts were established to benefit Son and his issue. Specifically, the trustee of Trust A established Trust 2, the trustee of Trust B established Trust 3, and the trustee of Trust C established Trust 1. Since a sufficient amount of Settlor's GST exemption had already been allocated to Trusts A and B to create an inclusion ratio of zero for those trusts, Trust 2 and Trust 3 also have an inclusion ratio of zero. Pursuant to Trust C, the executor of Settlor's estate allocated Settlor's remaining GST exemption to Trust 1 on Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. This allocation was in an amount sufficient to create an inclusion ratio of zero for Trust 1.

The terms of Trusts 1, 2, and 3 are almost identical. Son is the trustee of all three trusts. Trusts 1, 2, and 3 are all administered under State law.

Article V, Section A(2)(a) of Trust 1, Article III, Section D(2)(a) of Trust 2, and Article III, Section D(2)(a) of Trust 3 provide that the trustee shall distribute X percent of the income of each separate trust, no less frequently than annually, to the child for whom the trust was established or, unless otherwise appointed by the child, *per stirpes* to the issue of that deceased child. Any income not so distributed shall be accumulated and added to principal.

Article V, Section A(2)(b) of Trust 1, Article III, Section D(2)(b) of Trust 2, and Article III, Section D(2)(b) of Trust 3 provide that the trustee shall distribute trust principal from each separate trust for the proper health, education, maintenance, and support of the child for whom the trust was established or, unless otherwise appointed by that child for the proper health, education, maintenance, and support of the issue of that child.

Article V, Section A(4) of Trust 1, Article III, Section D(4) of Trust 2, and Article III, Section D(4) of Trust 3 provide that each child of the Settlor, or the issue of a deceased child of the Settlor has a testamentary special power of appointment to appoint income or principal to the issue of a child of Settlor.

Article III, Section D(3) of Trust 2 and Trust 3 provide that the trust shall terminate on the later of 21 years after the death of the last surviving of such of the issue of Settlor who are beneficiaries of the trust and living upon execution of this trust, or 90 years after the trust's creation, or such longer duration as applicable law affecting the relevant trust may permit. Article V, Section A(3) of Trust 1 provides that the trust shall terminate on or before Y years after the creation of all nonvested powers or interests in property subject to such trusts and shall be distributed in liquidation.

Article V, Section A(3) of Trust 1, Article III, Section D(3) of Trust 2, and Article III, Section D(3) of Trust 3 provide that upon termination the entire principal and income shall be distributed *per stirpes* to the issue of the child for whom the trust was established.

In order to serve the best interests of the beneficiaries and to reduce administrative costs, the trustee intends to consolidate Trusts 1, 2 and 3 by transferring the assets of Trusts 2 and 3 to Trust 1. Article VII, Section G of Trust 1, Article VI, Section F of Trust 2, and Article VI, Section F of Trust 3 provide that two or more trusts created hereunder, or under an instrument created by any other person with the same beneficiaries, trustees, and substantially the same dispositive provisions, may be consolidated for ease and efficiency of administration. This may be done by adding the assets of the Trust Estate to another trust estate or by receiving assets from another trust estate and adding them to the Trust Estate. State Statute 1 provides that "After notice to the qualified beneficiaries, a trustee may combine two or more trusts into a single trust or divide a trust into two or more separate trusts, if the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes of the trusts or trust, respectively." Pursuant to State Statute 1, Notice of Trust Consolidation was provided to the interested parties on Date 2.

Pursuant to the terms of the trusts, Trusts 2 and 3 have the same perpetuities period. However, Trust 1 has a perpetuities period that differs from that of Trusts 2 and 3 and that does not follow the common law rule against perpetuities. Because the existing trusts have different perpetuities provisions, the eventual termination dates may

vary from trust to trust. To account for this difference, at the time of consolidation, the individual values of each of the three trusts will be established and recorded on a ledger in order to determine each trust's proportionate percentage of the entire combined trust's initial value. This proportionate percentage will be utilized in the event the combined trust is subsequently separated, either pursuant to an election by the trustees, or because part of the combined trust terminates. In the event that it becomes necessary to separate one of the combined trusts, the amount separated will be determined under the following formula: the value of the combined trust upon separation will be multiplied by a fraction, the numerator of which will be the fair market value of the share of the applicable original trust as of the date of the consolidation, and the denominator of which will be the fair market value of the shares of the combined trusts (representing shares of two or more of the original trusts, as the case may be) as of the date of the consolidation.

You have requested the following rulings:

1. The proposed consolidation of Trust 2 and Trust 3 into Trust 1 will not subject Trusts 1, 2 or 3 or any distributions from Trusts 1, 2, or 3 to the GST tax.
2. The consolidation of Trust 2 and Trust 3 into Trust 1 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 Trust 2 and 3 into Trust 1, Trust 1 will remain exempt from the GST tax.
4. The consolidation of Trust 2 and Trust 3 into Trust 1 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 consolidation of Trust 2 and Trust 3 into Trust 1 will not cause any trust or 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 from a trust will be the same as the transferring trust's basis in each asset.
7. Pursuant to § 1223(2), the holding period of each trust or consolidated trust in any asset received from a trust will include the holding period of the transferring trust in such asset.

#### ISSUES 1 – 3:

Section 2601 of the Internal Revenue Code imposes a tax on each generation-skipping transfer.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means with respect to any generation-skipping transfer, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 26.2601-1(b)(4)(i) of the Generation Skipping-Transfer Tax Regulations 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 under §§ 26.2601-1(b)(1), (2) or (3) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy §§ 2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 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. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), Example 6, considers a situation where, in 1980, the Grantor establishes 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 § 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 example concludes that the trust that resulted from the merger will not be subject to the provisions of chapter 13.

This case involves facts that are similar to Example 6 in § 26.2601-1(b)(4)(i)(E) except that Trusts 1, 2, and 3 were created and funded after September 26, 1985. The rules in § 26.2601(b)(4)(i) apply in the case of trusts that are exempt from GST tax because the trusts were in existence and irrevocable prior to September 26, 1985. No guidance has been issued concerning modifications that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trusts to result in an inclusion ratio of zero. At a minimum, a modification that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of such a trust.

Assuming no post-consolidation additions are made to the consolidated trust, we conclude that the consolidation of Trust 2 and Trust 3 into Trust 1, as described above, will not shift any beneficial interest in the trusts to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, the consolidation of the trusts will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in Trust 1, Trust 2 or Trust 3.

Accordingly, based on the information submitted and the representations made, we conclude that the proposed consolidation of Trust 2 and Trust 3 into Trust 1 will not affect the GST status of these trusts and will not cause any distributions from the consolidated trust or distributions upon termination of the consolidated trust to become subject to GST tax.

#### ISSUE 4:

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by an individual, resident or nonresident. Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred 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 will be considered the amount of the gift. Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration received shall be deemed a gift.

Based on the facts submitted and the representations made, we conclude that the beneficial interests of the trust beneficiaries will not change as a result of the proposed consolidation of Trust 2 and Trust 3 into Trust 1, as described above. Accordingly, based upon the facts provided and the representations made, we rule that the proposed consolidation of Trust 2 and Trust 3 into Trust 1 will not result in a transfer by any of the

beneficiaries that is subject to federal gift tax under § 2501.

ISSUE 5:

Section 61(a)(3) provides that gross income includes gains derived from dealing in property. Under § 1001(a), the gain from the sale or other disposition of property is the excess of the amount realized therefrom over the adjusted basis (provided in § 1011), and the loss is the excess of the adjusted basis over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations treats as income or as loss sustained the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent.

In Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), the Supreme Court examined the issue of what constitutes a material difference in exchanged properties or a disposition of property for purposes of the realization requirement implicit in § 1001(a). In Cottage Savings, a savings and loan association sold 90-percent participation interests in 252 mortgage loans to four other lenders. Simultaneously, the association purchased 90-percent participation interests in 305 mortgage loans held by these lenders. The exchanged properties were derived from loans made to different obligors, secured by different homes, and thus embodied legally distinct entitlements. The association claimed a deduction under § 165(a) for the adjusted difference between the face value of the participation interests the association had traded and the fair market value of the participation interests it had received.

The Supreme Court set forth a test for determining whether exchanged properties are materially different for purposes of § 1001: their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, at 565. Because the mortgages had different mortgagors and were secured by different properties, the loans were materially different. The Supreme Court therefore held that the taxpayer actually sustained a loss for purposes of § 165(a).

In this case, Trust 2 and Trust 3 will be consolidated into Trust 1 for administrative convenience. The beneficiaries will possess the same interests before and after the consolidation of the trusts. Both before and after the consolidation, each beneficiary is entitled to the same income and/or remainder interests in the assets of all the trusts. The interests of the beneficiaries in Trust 1, Trust 2, and Trust 3 will not materially differ from their interests in Trust 1 following the consolidation.

Accordingly, we conclude that the consolidation of Trust 2 and Trust 3 into Trust 1 will not be considered to be a sale or other disposition of trust property and, thus, will not cause any beneficiary, trust, or consolidated trust to recognize any gain or loss from the sale or other disposition of property under §§ 61 or 1001.

ISSUES 6 & 7:

Section 1015 provides that if property is acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized by the grantor on such transfer.

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

Because there is no gain or loss recognized on the consolidation under § 1001, the assets transferred from Trust 2 and Trust 3 to Trust 1 will have the same basis before and after the consolidation under § 1015. Consequently, based upon the facts submitted and the representations made, we conclude that pursuant to § 1223(2), the holding period of each trust or consolidated trust in any asset received from a trust will include the holding period of the transferring trust in such asset.

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

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.

The GST tax rulings in this letter apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.



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.

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

Sincerely,

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

Enclosure:

Copy of letter for section 6110 purposes

cc: