

Internal Revenue Service

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Person To Contact:
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Telephone Number:

Refer Reply To:
CC:PSI:B04
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Date: April 9, 2019

In Re:

Legend

Date 1 =
Settlor =
Trust =

Bank =
Son =
Child 1 =
Child 2 =
Child 3 =
Child 4 =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Date 2 =
Agreement =

Date 3 =
Court =
State Statute =

Dear _____ :

This letter responds to your personal representative's letter of September 4, 2018, and subsequent correspondence, in which rulings are requested on the income, gift and generation-skipping transfer (GST) tax consequences of a court-approved termination of Trust.

The facts and representations submitted are as follows:

On Date 1, a date prior to September 25, 1985, Settlor created an irrevocable trust, Trust, for the benefit of Son. The material purpose of Trust was to ensure that Son receive an income stream for his support. Under the terms of the Trust agreement, the trustees are required to distribute all of the net income of Trust to Son, and, upon his death, distribute the remainder to his issue, per stirpes. The Trust agreement does not authorize any distributions of principal during Son's life. Son has four living adult children (Current Remaindermen) and eight living grandchildren, four of whom are adults (Successor Remaindermen). None of Son's descendants has a predeceased child with living issue. Son and Bank are currently serving as co-trustees of Trust.

State Statute provides, in relevant part, that matters that may be resolved by a nonjudicial settlement include termination of the trust, provided that court approval of such termination is obtained in accordance with this section, and the court must conclude that continuance of the trust is not necessary to achieve any material purpose of the trust. State Statute further provides that upon such termination, the court may order the trust property distributed as agreed by the parties to the agreement or otherwise as the court determines is equitably consistent with the purposes of the trust.

On Date 2, Son, the Current Remaindermen and the Successor Remaindermen entered into Agreement. Agreement states that the continuance of Trust "is no longer necessary to achieve any clear material purpose of such trust because [Son]'s net worth has grown significantly, such that he does not need income from [Trust] for his support." Agreement further provides for the termination of Trust and the distribution of Trust's assets among Son, the Current Remaindermen and the Successor Remaindermen in accordance with the actuarial value of each beneficiary's share (Proposed Distribution). Specifically, Agreement provides that after the date of termination,

the trustees shall, as expeditiously as possible, value [Trust's] assets, determine the appropriate distributions to be made upon [Trust's] termination pursuant to this Agreement and terminate [Trust]. Upon such termination, the Trustees shall distribute, on a pro rata or in-kind basis, as the Trustees shall, in their sole discretion, determine, all of the [Trust's] assets to [Son], [Current Remaindermen] and [Successor Remaindermen]

in accordance with their actuarial interests calculated as of the Termination Date.

The termination and Proposed Distribution is contingent upon Court approval and a favorable private letter ruling from the Internal Revenue Service. On Date 3, Court approved Agreement.

It is represented that Trust was irrevocable prior to September 25, 1985, and that no additions, actual or constructive, have been made to Trust.

The trustees request the following rulings:

1. The termination of Trust and the Proposed Distribution will not cause Trust, or any distributions from Trust, to become subject to GST tax under chapter 13 of the Code.
2. The termination of Trust and the Proposed Distribution will not cause any of the beneficiaries of Trust to be treated as making a taxable gift.
3. The termination of Trust and the Proposed Distribution will cause Son and the Successor Remaindermen to recognize long-term capital gain, and will cause the Current Remaindermen to recognize capital gain on the unrealized appreciation of the assets received by Son and the Successor Remaindermen upon termination.

Ruling 1

Section 2601 imposes a tax on every GST, which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

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. In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus (unless specifically noted), 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 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 § 26.2601-1(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. 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 GST or the creation of a new GST.

In the present case, Trust was irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, have been made to Trust after that date.

Based on the facts submitted and the representations made, we conclude that the termination of Trust and the Proposed Distribution will neither cause a beneficial interest to be shifted to a beneficiary who occupies a generation lower than the beneficiaries who held the interests prior to the termination, nor extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original Trust, as long as the actuarial values of the trust accurately represent the actuarial value of each beneficiary's interest. Accordingly, we rule that the court-approved termination and Proposed Distribution will not cause Trust, or any terminating distributions from Trust, to become subject to GST tax under chapter 13 of the Code.

Ruling 2

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any 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 the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate and full 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 that is included in computing the amount of gifts made during the calendar year.

In the present case, the beneficial interests, rights, and expectancies of the beneficiaries will be substantially the same, both before and after the termination and Proposed Distribution, as long as the actuarial values of the trust accurately represent the actuarial value of each beneficiary's interest. Thus, we conclude that no transfer of property will be deemed to occur as a result of the termination and Proposed Distribution. Accordingly, based on the facts submitted and representations made, we conclude that the termination and Proposed Distribution will not result in a transfer by any beneficiary of Trust that is subject to the gift tax under § 2501.

Ruling 3

Section 1015(b) provides that if property is acquired 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 to the grantor on the transfer.

Section 1.1015-2(a)(2) of the Income Tax Regulations provides that the principles stated in § 1.1015-1(b) apply in determining the basis of property where more than one person acquires an interest in property by transfer in trust.

Section 1.1015-1(b) provides that property acquired by gift has a uniform basis, and that the proportionate parts of that basis represented by the interests of the life tenant and remainder interest holder are determined under rules provided in § 1.1014-5.

Section 1001(e)(1), however, provides that in determining gain or loss from the sale or disposition of a term interest in property, that portion of the adjusted basis of the interest which is determined pursuant to § 1015 (to the extent that the adjusted basis is a portion of the entire adjusted basis of the property) shall be disregarded. Under § 1001(e)(2), the term "term interest in property" includes an income interest in a trust, but does not include a remainder interest. Section 1001(e)(3) provides that § 1001(e)(1) does not apply to a sale or other disposition which is a part of a transaction in which the entire interest in property is transferred to any person or persons. See § 1.1001-1(f).

Section 1222(3) provides that the term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than one year.

Section 1221(a) defines the term "capital asset" as property held by the taxpayer with certain listed exceptions not applicable here.

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 the property was held by any other person, if the property has the same basis in the taxpayer's hands as it would have in the hands of that other person.

Rev. Rul. 72-243, 1972-1 C.B. 233, provides that the proceeds received by the life tenant of a trust, in consideration for the transfer of the life tenant's entire interest in the trust to the holder of the remainder interest, are treated as an amount realized from the sale or exchange of a capital asset under § 1222. The right to income for life from a trust estate is a right in the estate itself. See McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946), cert. denied, 330 U.S. 826 (1947).

In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries, an exchange that required recognition of gain under § 1001.

Although the proposed transaction takes the form of a distribution of the present values of the respective interests of Son, the Current Remaindermen, and the Successor Remaindermen, in substance it is a sale of Son's and the Successor Remaindermen's interests to the Current Remaindermen. Rev. Rul. 69-486.

The amounts received by Son as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Rev. Rul. 72-243. Because Son's basis in the income interest of Trust is a portion of the entire basis of the property under § 1015(b), and because the disposition of Son's term interests is not part of a transaction in which the entire interest in Trust is transferred to a third party, Son's adjusted basis in Son's interest in Trust is disregarded under § 1001(e). Son's holding period in the life interests in Trust exceeds one year. Accordingly, based on the facts submitted and representations made, the entire amount realized by Son as a result of the early termination of Trust will be long-term capital gain under § 1222(3).

Similarly, the amounts received by the Successor Remaindermen as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Cf. Helvering v. Gambrill, 313 U.S. 11, 15 (1941), 1941-1 C.B. 364 (The phrase "property held by the taxpayer" under a prior law holding period rule relating to capital gains and losses includes not only full ownership, but also any interest owned whether vested, contingent, or conditional). The Successor Remaindermen's holding period in their interests in Trust also exceeds one year.

Accordingly, under § 1222(3), the gain determined under § 1001(a) by the Successor Remaindermen as a result of the early termination of Trust will be long-term capital gain.

In addition, to the extent that a Current Remainderman exchanges property, including property deemed received from Trust, for the interests of Son and the Successor Remaindermen, the Current Remainderman will recognize gain or loss on the property exchanged. Accordingly, based on the facts submitted and representations made, for purposes of determining gain or loss, the amount realized by each Current Remainderman on the exchange of property for Trust interests held by Son and the Successor Remaindermen will be equal to amount of cash and fair market value of the trust interests received in exchange for the transferred assets. Section 1.1001-1(a) and Rev. Rul. 69-486.

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 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) 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 your authorized representatives.

Sincerely,

Leslie H. Finlow

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):
Copy for § 6110 purposes
Copy of this letter