Internal Revenue Service

Number: **201042004**
Release Date: 10/22/2010

Index Number: 2501.00-00, 2514.04-01, 2041.11-00, 2036.00-00, 2037.00-00, 2038.00-00, 2601.04-03, 2642.00-00, 1001.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-102552-10
Date:
July 20, 2010

Re:

Husband =
Trust =
Date 1 =
Date 2 =
Wife =
Child 1 =
Trust A =
Child 2 =
Trust B =
Child 3 =
Trust C =
Date 3 =
Will =
Trust D =
Trust E =
Trust F =
Date 4 =
State Court =
Date 5 =
State Statute =
Date 6 =

Dear :

This responds to your January 14, 2010, letter requesting rulings on the federal income, estate, gift, and generation-skipping transfer tax consequences of the modification and proposed merger of certain trusts.

FACTS

You represent the following facts: Husband executed Trust on Date 1. Trust became irrevocable upon the death of Husband on Date 2, a date occurring before September 25, 1985. Pursuant to the terms of Trust, upon the death of Husband, the trust property was divided into three separate and equal trusts, one for the benefit of each of Child 1 and Child 1's children (Trust A), Child 2 and Child 2's children (Trust B), and Child 3 and Child 3's children (Trust C).

Wife predeceased Husband on Date 3, a date occurring before September 25, 1985. Pursuant to the terms of Will, the residue of Wife's estate was divided into three separate and equal trusts, one for the benefit of each of Child 1 and Child 1's children (Trust D), Child 2 and Child 2's children (Trust E), and Child 3 and Child 3's children (Trust F).

Trust B and Trust E, with respect to Child 2 and Child 2's children, are the subject of this ruling request. The distribution provisions in Trust B and Trust E are nearly identical except that Trust E provides for an additional distribution subject to a contingency that has expired. It is represented that no person has contributed assets to either Trust B or Trust E since Date 2 or Date 3, respectively, and there have been no additions (actual or constructive) to either of Trust B or Trust E since Date 2 or Date 3, respectively.

The pertinent terms of Trust B and Trust E are as follows:

The trustee of Trust B and Trust E shall pay the net income of the respective trust to Child 2 until the complete distribution of that fund or until the prior death of Child 2. The trustee of Trust B and Trust E also shall pay to Child 2 in each calendar year such amounts from the principal of the respective trust as Child 2 may direct, but not exceeding the value of 5 percent of the principal of the respective trust. In both Trust B and Trust E, this lifetime right is not cumulative.

During any period in which Child 2 is not acting as trustee of Trust B or Trust E, the trustee of the respective trust may distribute principal to Child 2 as that trustee considers necessary for the support, maintenance, medical care, and education of Child 2 and Child 2's dependents, taking into consideration the other income and cash resources known to the trustee to be available to Child 2 for these purposes.

Upon the death of Child 2, the remaining principal and accrued or undistributed income of Trust B shall be distributed per stirpes to the then living descendants of Child 2, if any, and otherwise per stirpes to the then living descendants of Husband. Similarly, the remaining principal and accrued or undistributed income of Trust E, upon the death of Child 2, shall be distributed per stirpes to the then living descendants of Child 2, if any, and otherwise per stirpes to the then living descendants of Wife. Any distributions under these provisions to Child 1 or Child 3, upon the death of Child 2, shall be added

to the principal of the trusts created for Child 1 and Child 3 under Trust and Will. Any distributions under these provisions to a beneficiary who has not attained the age of 30 vests in that beneficiary immediately, but may be retained in trust for the benefit of that beneficiary until the beneficiary attains the age of 30.

All trusts created under Trust are to terminate at the expiration of twenty-one years after the death of the last to die of Husband's descendants who are living at the time of execution of Trust on Date 1. All trusts created under Will are to terminate at the expiration of twenty-one years after the death of the last to die of Wife's descendants who are living at the time of Wife's death on Date 3. Husband's descendants living at the time of execution of Trust are the same persons as Wife's descendants living at the time of Wife's death.

On Date 4, Child 2, acting in the capacity of trustee of Trust B and Trust E, filed a complaint in State Court seeking to modify the terms of Trust B and Trust E to limit the time Child 2 may exercise the power to withdraw to the month of January in each calendar year (rather than at any time during each calendar year, as originally provided). On Date 5, State Court determined that the trustee of Trust B and Trust E had satisfied the requirements for reforming the trusts under the state law. Accordingly, State Court entered an order modifying Trust B and Trust E to provide that Child 2 may only exercise the withdrawal right over the respective trusts during the month of January in each calendar year.

State Statute provides that the trustee has the power to consolidate two or more trusts having substantially similar terms into a single trust. Pursuant to the authority granted by State Statute, the trustee of Trust B and Trust E executed a "Merger of Trusts" on Date 6. In the Merger of Trusts, the trustee of Trust B and Trust E represents that the trustee has determined that Trust B and Trust E have substantially similar terms, within the meaning of State Statute. The Merger of Trusts further provides that: (1) the trustee will transfer all of the assets of Trust B, as well as any right of Trust B to receive additional assets in the future, to Trust E; (2) the trustee of Trust E, in her capacity as trustee, will assume the liabilities of Trust B once it is combined with Trust E; (3) Trust B will terminate and the terms of Trust E will control the future disposition of Trust E; and (4) the actions in paragraphs (1) through (3) are subject to and conditioned upon the receipt of a favorable ruling from the Internal Revenue Service on the rulings requested.

You have requested the following rulings:

1. The modification and merger of Trust B and Trust E will not result in a transfer by Child 2 or any beneficiary of Trust B or Trust E which is subject to the gift tax under § 2501 of the Internal Revenue Code.

2. The modification and merger of Trust B and Trust E will not cause any trust to lose its grandfathered status under § 26.2601-1 of the Generation-Skipping Transfer Tax regulations.

3. After the modification and merger of Trust B and Trust E, Child 2 will not possess a general power of appointment over the principal of surviving Trust E under § 2041 for federal estate tax purposes, except to the extent of Child 2's unexercised 5 percent withdrawal right over Trust E if Child 2 dies during the month of January.

4. The modification and merger of Trust B and Trust E will not cause any portion of the assets of surviving Trust E to be includible in the gross estate of Child 2 under § 2036, 2037, or 2038.

5. No gain or loss will be recognized for purposes of § 61 or 1001 as a result of the modification and merger of Trust B and Trust E.

LAW AND ANALYSIS

Ruling 1

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during the calendar year.

Section 2511(a) provides that the gift tax 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.

Section 2514(b) provides that the exercise or release of a general power of appointment shall be deemed the transfer of property by the individual possessing the power.

Section 2514(c) provides that the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or creditors of his estate.

Section 2514(e) provides that the lapse of a power of appointment during the life of the individual possessing the power shall be considered a release of such power. The rule shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of $5,000 or 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied.

In this case, each beneficiary will have the same interest in the assets of Trust E, the surviving trust, as he or she had in the assets of Trust B and Trust E before the

modification of Trust B and Trust E and the subsequent merger of Trust B into Trust E. Because the beneficial interests, rights, and expectancies of the beneficiaries are substantially similar both before and after the modification and merger, no transfer of property for less than adequate and full consideration in money or money's worth will occur as a result of the modification and proposed merger. Accordingly, based on the facts submitted and representations made, we conclude that the modification of Trust B and Trust E and the merger of Trust B into Trust E will not cause a beneficiary of surviving Trust E to have made a taxable gift under chapter 12.

Ruling 2

Section 2601 provides that a tax is imposed on every generation-skipping transfer made by a "transferor" to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer (GST) 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), 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.

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. The regulation provides that the rules contained in the paragraph are generally applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Unless the regulations specifically provide otherwise, 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 by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the tax 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 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, provides as follows: 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 this case, Trust B and Trust E are exempt from the GST tax because they were irrevocable on or before September 25, 1985, and no actual or constructive additions have been made to Trust B or Trust E since that date.

With respect to the modification, Child 2 continued to have a noncumulative power to withdraw 5 percent of the value of the assets of Trust B and Trust E after the modification. However, after the modification, the withdrawal right became exercisable only during the month of January of each year, rather than at any time during the year. The modification does not result in a shift of any beneficial interest in Trust B or Trust E to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification. Further, the modification did not extend the time for vesting of any beneficial interest in Trust B or Trust E beyond the period provided for in the original trusts.

With respect to the proposed merger, the trustee of Trust B and Trust E is authorized by State Statute to merge the trusts when the terms of the trusts are substantially similar, as they are in this case. The merger of the two trusts will not shift a beneficial interest in the trust to a beneficiary who occupies a lower generation than the persons holding the beneficial interests prior to the merger. Further, the merger will not extend the time for vesting of a beneficial interest in the trusts beyond the period provided for in the original trusts.

Under these circumstances, based on the facts submitted and representations made, we conclude that the modification of Trust B and Trust E and the proposed merger of Trust B into Trust E will not cause surviving Trust E to lose its exempt status for GST purposes.

Rulings 3 and 4

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the decedent's gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the three-year period on the date of the decedent's death.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038.

Section 2041(b)(1) provides that, with certain exceptions, the term “general power of appointment” means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or creditors of his estate. A power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not a general power of appointment.

Section 2041(b)(2) provides that the lapse of a power of appointment during the life of the individual possessing the power shall be considered a release of the power. This rule applies only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of $5,000 or 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

In this case, based on the facts submitted and representations made, the modification and proposed merger of Trust B and Trust E, as described above, does not constitute a transfer within the meaning of §§ 2036 through 2038 and does not cause the exercise or release of a general power of appointment within the meaning of § 2041. Accordingly, we conclude that the modification and proposed merger of Trust B into Trust E will not cause any portion of surviving Trust E to be includible in the gross estate of Child 2 under § 2036, § 2037, or § 2038. Further, we conclude that the modification and proposed merger will not cause Child 2 to possess a general power of appointment over any portion of the value of the assets of surviving Trust E, except to the extent of Child 2’s unexercised 5 percent withdrawal right over Trust E if Child 2 dies in the month of January.

Ruling 5

Section 61(a)(3) provides that gross income means all income from whatever source derived, including 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.

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

Section 1.1001-1(c)(1) provides that a loss is not ordinarily sustained prior to the sale or other disposition of the property for the reason that until such sale or other disposition occurs there remains the possibility that the taxpayer may recover or recoup some of the adjusted basis of the property. Until some identifiable event fixes the actual sustaining of a loss and the amount thereof, the loss is not taken into account.

An exchange of property results in the realization of gain or loss under § 1001 if the properties are materially different. Cottage Savings Assoc. v. Commissioner, 499 U.S. 554 (1991). Properties exchanged are materially different if the properties embody legal entitlements "different in kind or extent" or if the properties confer "different rights and powers." Id. at 565. In Cottage Savings, the Supreme Court held that mortgage loans made to different obligors and secured by different homes embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Id. In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is material to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 564-65.

In Silverstein v. United States, 419 F.2d 999 (7th Cir. 1969), aff'g 293 F. Supp. 1106 (N.D. Ill. 1968), cert. denied, 397 U.S. 1041 (1970), the court held that a nonrealization event occurs when, despite the form of the transaction, in substance the taxpayer holds the same property interest after a transaction as before, is as secure with respect to the interest after a transaction as before, and there is no realistic difference in the value of the property interest held as a result of the transaction.

In this case, State Statute clearly authorizes the consolidation by a trustee of 2 or more trusts “having substantially similar terms” into a single trust.” It has been represented that the trustee of the two merging trusts has determined that the terms of the two trusts created for her benefit are “substantially similar.” In addition, no beneficiaries are acquiring new or additional interests in surviving Trust E as a result of the merger of Trust B into Trust E. Moreover, there does not appear to be any reciprocal exchange of legal rights and entitlements involving Child 2 or any of the other beneficiaries under the trusts here. Therefore, no “exchange” has occurred under § 1001. Accordingly, there is no material difference in the legal rights and entitlements of Child 2 or any other beneficiary following the merger of the two trusts compared to what they had before the merger.

Therefore, based on the facts submitted and representations made, we conclude that the proposed merger of Trust B into Trust E will not result in the realization under § 1001 of any gain or loss to Trust B, Trust E, Child 2 or to any beneficiary of Trust B or Trust E.

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 in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

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 your authorized representative.

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.

Sincerely,

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