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Date:

February 24, 2011

Re:

Legend

Grantor =

Taxpayer =

Trust =

Co-Trustee =

Date 1 =

State =

State Statute =

Dear :

This letter responds to your authorized representative's letter of September 7, 2010, and subsequent correspondence, requesting rulings on the proposed early distribution of trust principal to the remainder beneficiaries of the trust.

Facts

The facts and representations submitted are summarized as follows: On Date 1, a date prior to September 25, 1985, Grantor created an irrevocable trust, Trust, for the benefit of Taxpayer and her issue. Taxpayer is currently the primary beneficiary of Trust. Taxpayer's three children are the remainder beneficiaries of Trust. Taxpayer and Co-Trustee are the trustees of Trust.

Section 6(a) of Trust provides that the net income of the trust shall be accumulated and added to the principal and shall not be distributed to any beneficiary except the ultimate beneficiaries of the principal and corpus of the trust at the

termination of the trust, unless the trustee shall, in his absolute discretion, determine that the income thereof or some portion thereof should be distributed.

Section 8(a) of Trust provides that the trust shall continue during the life of Taxpayer and then continue or be distributed as therein provided. Section 8(c) generally provides that in the absence of Taxpayer's exercise of a limited power of appointment by will, if Taxpayer dies leaving issue, the trust estate shall cease and be distributed among such issue, *per stirpes*.

Section 8(e) of Trust provides, in part, that the "[t]rustee may, in his discretion, distribute to or use and apply for the benefit of any beneficiary from time to time entitled to the receipt or application of net income hereunder, if it were then distributed, such amounts out of the principal serving the income of such beneficiary as the Trustee shall deem necessary for his health, support or maintenance."

Taxpayer, as primary beneficiary, has submitted an affidavit with her ruling request affirming that (1) her income and resources are sufficient to maintain her current standard of living for the remainder of her lifetime and any foreseeable emergencies; (2) her financial condition prevents her from receiving any income or principal from the trust pursuant to the terms of the trust; and (3) she has received no distributions from the trust in the past and does not anticipate any in the future.

Co-Trustee has submitted an affidavit stating that, under the terms of the trust, distributions may only be made to Taxpayer in the case of emergency. Co-trustee also affirms that from one year prior to becoming Co-Trustee to the present, no distributions have been made to Taxpayer.

Taxpayer and her children, the remainder beneficiaries, are cooperating with Co-Trustees of Trust in seeking State court approval for an early distribution of a portion of the trust principal to the remainder beneficiaries. The remainder of the principal is to remain in Trust until Taxpayer's death under the terms of Trust, which will benefit Taxpayer in the event of an emergency and benefit the remainder beneficiaries as provided in Trust.

You have requested the following rulings:

1. Taxpayer, the remainder beneficiaries, and Trust will not recognize any gain as a result of the early distribution of the trust principal to the remainder beneficiaries.
2. Trust will retain its generation-skipping transfer (GST) exemption after the distribution.
3. Taxpayer will not make a gift as a result to the early distribution of a portion of the trust principal to the remainder beneficiaries.

Ruling 1:

Section 61 of the Internal Revenue Code provides, in part, that gross income means all income from whatever source derived, including gains derived from dealings in property.

Section 1001 provides, in part, that gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis and that, except as otherwise provided, the entire amount of gain or loss on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides, in part, that except as otherwise provided in subtitle A of the Code, 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, is treated as income or as loss sustained.

Section 1.1002-1(a) provides that as the general rule with respect to gain or loss realized upon the sale or exchange of property as determined under § 1001, the entire amount of such gain or loss is recognized except in cases where specific provisions of subtitle A of the code provide otherwise.

Section 1.1002-1(d) provides that ordinarily, to constitute an exchange, the transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

The generally acknowledged definition of income is any and all “undeniable accessions to wealth, *clearly realized*, over which the taxpayers have complete dominion.” *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955) (emphasis added). Thus, income must be clearly realized in order to be recognized and taxable. Generally, taxpayers realize income upon the occurrence of a specific realization event and are not otherwise taxed merely for the appreciation in value of assets. See, e.g., *Eisner v. Macomber*, 252 U.S. 189 (1919) (holding, *inter alia*, that a stock dividend, consisting of new stock issued to the stockholders in proportion of their previous holdings, for profits capitalized, without any distribution of profits, is not “income” for federal income tax (16th Amendment) purposes). Sales and exchanges are examples of specific realization events.

In general, a gift or other transfer without reciprocal consideration is not treated as a sale or exchange or as a distribution of property that results in a realization of income by the donor. See, e.g., § 1.1001-1(e) (illustrating that the gift portion of a transfer is not treated as gain realized). The same would be true of a transfer from a trust as provided in the terms of the trust agreement or by court order modifying the trust agreement. Such a transaction is not a realization event in which property differing in kind or extent is being exchanged. In addition, gross income does not include the value of property acquired by gift, bequest, devise or inheritance. See § 102.

Based on the information submitted, Taxpayer, the remainder beneficiaries, and Trust will not recognize gain as a result of the early distribution of a portion of the trust principal to the remainder beneficiaries because the distribution will not constitute a sale, exchange, or other realization event. Also, there is no accession of wealth to Taxpayer or Trust. In addition, to the extent that any portion of the early distribution of the trust principal and accumulated income (previously taxed to the trust) constitutes a gift, bequest, devise or inheritance to the remainder beneficiaries, it will not constitute includable income to the remainder beneficiaries for federal income tax purposes because of the exclusion provided under § 102.

Ruling 2:

Section 2601 imposes a tax on each generation-skipping transfer. Under section 1433(b)(2)(A) of the Tax Reform Act of 1986 Act and § 26.2601-1(b)(1)(I) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the 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)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

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 generation-skipping transfer tax 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 generation-skipping transfer 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 paragraph (b)(4)(i)(A), (B), or (C) of this section) 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, but only if -

(1) 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

(2) 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.

State Statute provides that a noncharitable irrevocable trust may be modified on consent of all the beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust.

Based on the facts presented and representations made, we conclude that if State court issues an order approving the early distribution of a portion of the trust principal to the remainder beneficiaries, as discussed above, this distribution will not shift any beneficial interest in 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 modification. In addition, the early distribution of a portion of the trust principal to the remainder beneficiaries will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. Accordingly, based on the facts submitted and the representations made, we conclude that if, under a State court order, the trustees of Trust make an early distribution of the trust principal to the remainder beneficiaries, such a distribution will not cause Trust to be subject to the generation-skipping transfer tax imposed by chapter 13.

Ruling 3:

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 the tax imposed by § 2501 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 25.2511-1(c)(1) of the Gift Tax Regulations provides that the gift tax applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

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.

Taxpayer attests that Taxpayer has never received a distribution from Trust and that her income and resources are sufficient to maintain her current standard of living for the remainder of her lifetime. However, that does not negate the fact that under Section 6(a) of Trust, Taxpayer has an income interest entitling her to distributions of income in the case of emergency and at the discretion of the trustee. The interest may be nominal, however, the value of the gifted interest is a factual determination, not a determination of whether or not Taxpayer has made a gift of the interest.

Based upon the facts submitted and representations made, we conclude that Taxpayer will make a gift of her interest in the portion of the early distribution of the trust principal to the remainder beneficiaries. The value of this gift is a question of fact and the Service does not rule on such factual determinations. See Rev. Proc. 2011-1, 20011-1 I.R.B. 1, 13.

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 specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. Specifically, we are not ruling on the application of §§ 2652(a)(1)(B) and 2702 to the gift by Taxpayer to her children.

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.

Sincerely,

Office of Associate Chief Counsel
(Passthroughs & Special Industries)

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

Enclosures
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cc: