Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201129021**
Release Date: 7/22/2011

Index Number: 2601.01-00, 2601.03-01, 1001.02-07, 1223.00-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-144517-10

RE:

Date:
April 08, 2011

Legend

Husband
Wife
Daughter
Son
Daughter-in-law
Date 1
Date 2
Date 3
Date 4
Date 5
Circuit Court
State Statute 1
State Statute 2
State Statute 3
Trust A
Trust B
Trust 1

Trust 2

a

Dear :

This letter responds to a letter from your authorized representative dated October 27, 2010, requesting a ruling on the income and generation-skipping transfer tax (GST) consequences of the proposed consolidation of Trust 1 and Trust 2.

The facts and representations submitted are summarized as follows:

On Date 1, a date prior to September 26, 1985, Wife and Husband each executed separate wills. Wife's will provided for the creation of Trust A for the benefit of Husband, if he survives Wife, and their issue. Husband's will provided for the creation of Trust B for the benefit of Wife, if she survives Husband, and their issue. On Date 2, a date prior to September 26, 1985, Wife died and Trust A became irrevocable. On Date 3, a date prior to September 26, 1985, Husband died and Trust B became irrevocable.

Trust A and Trust B contain identical provisions with respect to the distribution and termination of the trusts for the beneficiaries. Trust A and Trust B provide that the trustee is to distribute to Husband and Wife, respectively, so much of the net income of the trust as the trustee, in his sole and absolute discretion, deems advisable for the Husband's and Wife's care, support, comfort, and pleasure, and distribute the balance of the net income to such of the issue of Husband and Wife and in such proportions as the trustee, in his sole and absolute discretion, deems advisable for the purposes of support, maintenance, care, comfort, and education. Upon the death of Husband or Wife, the trustee is to divide the property then in trust into two shares of equal value, to be set apart, held and administered by the trustee as separate trusts. One trust is to be known as Daughter's Trust and the other is to be known as Son's Trust. Trust 1 is Son's share of Trust A and Trust 2 is Son's share of Trust B.

Trust 1 and Trust 2 provide that during the lifetime of Son or Daughter-in-law, the trustee is to distribute to Son, if he is living, or to Daughter-in-law, if Son is deceased, so much of the net income of the trust as the trustee, in his sole and absolute discretion, deems advisable. The balance of any income may be distributed to Son's issue, in the sole discretion of the trustee, for the purposes of support, maintenance, care, comfort, and education. After the death of both Son and Daughter-in-law, the trustee is to distribute the net income to Son's issue, *per stirpes*. The trustee may also, at any time during the term of the trusts, distribute to or for the benefit of Son, Daughter-in-law, or Son's issue such amounts, if any, of the principal of the trusts, aggregating not more than $a as to all beneficiaries in any calendar year, as the trustee may deem advisable for the purposes of support, maintenance, care, comfort, and education. The trusts are to terminate upon the earlier of: (1) the death of Son, Daughter-in-law, and all of Son's issue; (2) 21 years after the death of the last survivor of Son, Daughter-in-law, or the currently living grandchildren of Husband and Wife; or (3) the time when all property in the trust has been distributed. Upon termination, the property in the trusts is to be distributed to Son's issue, *per stirpes*.

On Date 4, Circuit Court issued an order, in accordance with State Statute 1 and State Statute 2, that the trustee may distribute each year to the beneficiaries who would otherwise be entitled to a distribution of income under the terms of Trust 1 and Trust 2, an amount not to exceed the product of (a) a percentage not to exceed 5 percent multiplied by (b) the average market value of the trusts' assets as of December 31 for

the three years preceding the year in which the distributions are to be made. Trust 1 and Trust 2 have also been modified respecting the appointment of trustees. These modifications were also identical.

State Statute 3 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 materially impair rights of any beneficiary or adversely affect achievement of the purposes of the trust.

On Date 5, Circuit Court issued an order authorizing the consolidation of Trust 1 and Trust 2 into a single trust, the Consolidated Trust. The order provides that the interests of the income beneficiaries will remain the same as their interests under the original Trusts, and the timing of the termination of the Trusts will remain the same as the timing of the terminations under the original Trusts. The beneficiaries will not have different rights to trust income or materially diminished rights to principal than currently provided.

The trustees represent that no additions have been made to the principal of either Trust 1 or Trust 2 after September 25, 1985.

You have requested the following rulings:

1. The consolidation of Trust 1 and Trust 2 into the Consolidated Trust will not constitute a generation-skipping transfer under § 2601 of the Internal Revenue Code.

2. Any subsequent generation-skipping transfer from the Consolidated Trust will remain exempt from the GST, provided that there are no post-consolidation additions to the Consolidated Trust.

3. No gain or loss will be recognized under § 1001 by either Trust 1 or Trust 2 or by any of the beneficiaries of those trusts as a result of the proposed consolidation.

4. The assets distributed from Trust 1 and Trust 2 into the Consolidated Trust will have the same basis and holding periods under §§ 1015 and 1223 before and after the proposed consolidation.

LAW AND ANALYSIS

Rulings 1 and 2

Section 2601 imposes a tax on each generation-skipping transfer. The term Aggeneration-skipping transfer@ is defined in § 2611 as a taxable distribution, a taxable termination, or a direct skip.

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.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST 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)(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 under § 26.2601-1(b) 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 paragraph § 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 GST 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, considers a situation where in 1980, 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.

In this case, Trust 1 and Trust 2 will be consolidated into the Consolidated Trust. The Date 4 proposed consolidation will not result in a shift of any beneficial interest in the Trusts to any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the Date 4 proposed consolidation will not extend the time for vesting of any beneficial interest in the new trust beyond the period provided for in Trust 1 and Trust 2 before the consolidation. Trust 1 and Trust 2 were in existence and funded prior to September 26, 1985. The trustees represent that no additions have been made to the principal of either trust after September 25, 1985. Accordingly, based on the facts presented and representations made, we conclude that the consolidation of Trust 1 and Trust 2 into the Consolidated Trust will not constitute a generation-skipping transfer under § 2601. Furthermore, any subsequent generation-skipping transfer from the Consolidated Trust will remain exempt from the GST, provided that there are no post-consolidation additions to the Consolidated Trust. While you have not requested a ruling on the Date 4 Circuit Court order to confer the trustee with the power to make adjustments between principal and income pursuant to State Statute 2, we note that this modification is similar to Example 12 of § 26.2601-1(b)(4)(i)(E) and would not result in the loss of GST exempt status for either Trust 1 or Trust 2.

Ruling 3

Section 1001(a) provides that 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 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 over the amount realized.

Section 1001(b) defines the amount realized from the sale or disposition of property as the sum of any money received plus the fair market value of any property received.

Section 1001(c) provides that, 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 1.1001-1(a) of the Income Tax Regulations provides, as a general rule, that except as otherwise provided in subtitle A, 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 loss sustained.

An exchange of property results is the realization of gain under § 1001 if the properties exchanged are materially different. Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991). There is a material difference when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." 499 U.S. at 565.

In the present case, there will be no sale or exchange because there will be no transfer of money or property. The beneficiaries will possess the same interests after the consolidation of Trust 1 and Trust 2 into the Consolidated Trust as before. The proposed transaction is merely a consolidation of the assets for administrative convenience. Accordingly, based on the facts presented and representations made, we conclude that neither the trusts (Trust 1 and Trust 2) nor the beneficiaries will recognize gain or loss under § 1001 as a result of the consolidation of the trusts into the Consolidated Trust.

Ruling 4

Section 1015(b) provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss recognized.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by a transfer in trust (other than a transfer in trust by gift, bequest or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased by the amount of gain or decreased in the amount of loss recognized to the grantor under the law applicable to the year in which the transfer was made.

Section 1.1015-2(a)(2) applies the uniform basis principles in § 1.1015-1(b) for determining the basis of property where more than one person acquires an interest in property by transfer in trust.

Under § 1.1015-1(b), property acquired by gift has a single or uniform basis although more than one person may acquire an interest in the property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017.

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

In this case, § 1001 does not apply to the proposed transaction. Thus, based upon the facts provided and the representations made, we conclude that the assets distributed from Trust 1 and Trust 2 into the Consolidated Trust will have the same basis under § 1015 and holding period under § 1223 both before and after the proposed consolidation.

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

Except as expressly provided herein, we express no opinion on the federal tax consequences of the transactions under the cited provisions or under any other provisions of the Code.

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.

Sincerely,

_____

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

Enclosures
Copy for § 6110 purposes
Copy of this letter