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Department of the Treasury
Washington, DC 20224

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RE:

Legend

Grantor
Trust 1
Trust 2
Trust 3
Child 1
Child 2
Child 3
Company
Date 1
Date 2
State 1
State 2
Court
Individual 1
Statute 1
Statute 2
Individual 2
Trust Company

Dear :

This letter responds to your authorized representative's letter dated April 28, 2011, requesting income, estate, gift, and generation-skipping transfer (GST) tax rulings with respect to the proposed modifications of Trust 1.

The facts and representations submitted are summarized as follows:

On Date 1, a date prior to September 25, 1985, Grantor created Trust 1 for the benefit of Child 1 and his descendants. The current Trustees are Trust Company and Individual 1.

Pursuant to Trust 1, during the life of Child 1, the trustees in their discretion may distribute the income and principal of Trust 1 to or for the benefit of Child 1, his spouse, and his issue to provide for their care, comfort, support, maintenance, and education, and to provide for any illness, accident, emergency, disability or other unusual circumstances. Upon the death of Child 1, Child 1 may appoint the Trust 1 property by will to any one or more of Child 1's issue. If Child 1 does not exercise the limited power of appointment on his death, then until the termination date the trustees in their discretion may distribute the income and principal of Trust 1 to or for the benefit of Child 1's spouse (if Child 1 is married at the time of his death and his spouse survives him) and issue to provide for their care, comfort, support, maintenance, and education, and to provide for any illness, accident, emergency, disability or other unusual circumstances. Any income not distributed shall be accumulated and added to principal.

If at any time prior to the termination date, there are no living issue of Child 1, then the trustees, in their discretion, may distribute the income and principal to or for the benefit of Child 1's spouse and the issue of the Grantor to provide for their care, comfort, support, maintenance and education, and to provide for any illness, accident, emergency, disability or other unusual circumstance. If at any time prior to the termination date, there are no living issue of the Grantor, then the trustees, in their discretion, may distribute the income to the issue of Grantor's sister, in such amounts as the trustees determine for their care, comfort, support, maintenance, education and best interests, and to provide for any illness, accident, emergency, disability or other unusual circumstance. Any income not distributed shall be accumulated and added to principal.

Trust 1 will terminate 21 years after the last survivor of Grantor, Grantor's wife, Child 1, Child 2, Child 3, and 11 other individuals who were living when Trust 1 was created. On the termination date, the Trust 1 property will be divided and distributed outright in equal shares to the grandchildren of Child 1, with the issue of any deceased grandchild receiving by right of representation the share such grandchild would have received if living. If there are no grandchildren or more remote issue of Child 1 living on the termination date, then the Trust 1 property will be distributed one-half to Child 2's grandchildren and one-half to Child 3's grandchildren in equal shares. If only one of Child 1's brothers has grandchildren or more remote issue living on the termination date, then all of the Trust 1 property will be distributed to that family line.

Trust 1 provides that a trustee, or a successor trustee, may resign upon thirty days notice to the Grantor, if living, to Child 1 after the Grantor's death or to Child 1's guardian, or to each successor beneficiary or the legal guardian of a successor beneficiary if Child 1 is deceased. If Individual 1 dies, resigns or for any reason cannot continue to act as the Individual Trustee, then a successor Individual Trustee shall be appointed by Child 1, if living, otherwise by the other living children of the Grantor. If the Corporate Trustee resigns or for any other reason cannot continue to act as the Corporate Trustee, then a successor or substitute Corporate Trustee shall be appointed by Child 1, if living, otherwise by the other living children of the Grantor.

The primary asset of Trust 1 is common stock of Company. Trust 1 provides that the trustees may not sell, transfer, exchange, or dispose of Company stock without first offering to sell the stock to Company. If the trustees desire to sell Company stock, Company will have an option for thirty days to redeem such stock for a price per share equal to and on the basis of the net book value per share of Company.

On Date 2, Child 1 filed a petition with Court, a State 2 court, requesting that Court accept jurisdiction over Trust 1 so that the situs of Trust 1 is in State 2, and modify Trust 1 by approving the following proposed modifications of Trust 1:

1. A Distribution Adviser is named to make all decisions related to the distribution of the Trust 1 property to the beneficiaries. The Distribution Adviser shall direct the Trustees to distribute income and principal from time to time pursuant to the standards established in the trust instrument. If no Distribution Adviser is acting, the Trustees will make such decisions. The initial Distribution Adviser will be Individual 2.

2. An Investment Adviser is named to make all decisions related to the investment of the Trust 1 property. If no Investment Adviser is acting, the Trustees will make such decisions. The initial Investment Adviser will be Child 1.

3. A Trust Protector is named to make certain administrative changes to the trust agreement from time to time. The Trust Protector may modify the provisions relating to the identity, qualifications, succession, removal, and appointment of any fiduciary or Trust Protector. However, the Trust Protector may not modify the Prohibition on Appointment as Officeholder (see paragraph 6 below). The Trust Protector may modify the investment powers granted to the Trustees and the Investment Adviser. The Trust Protector may remove any trustee or the Investment

Adviser. The Trust Protector may not exercise any power that would cause the trust to extend beyond any applicable rule against perpetuities nor cause the Trust Protector to possess a general power of appointment. The initial Trust Protector will be Child 1.

4. The terminology used to describe the beneficiaries of Trust 1 is changed from "issue" to "descendants."

5. While the Trust 1 situs remains in State 2, at least one trustee must be a State 2 trust company.

6. Neither Grantor nor Grantor's wife may hold any office under this trust instrument. No descendant of Grantor, no spouse of any such descendant and no party that would be a related or subordinate party, within the meaning of § 672(c), as to the Grantor, the Grantor's wife, or any such descendant, may act as a trustee or as Distribution Adviser. (Prohibition on Appointment as Officeholder).

7. State 2 law will govern the administration of Trust 1, while State 1 law will continue to govern the validity, construction, and duration of Trust 1.

8. For purposes of determining the purchase price for Company's purchase of any Company stock from Trust 1, the definition of "book value" is clarified to be the value of the stock as of the month end immediately preceding the date notice of the offer to purchase such stock is given to Company.

9. Child 1, or if he fails to act, those persons in the oldest generation of living descendants of Child 1 who have reached age 25, or if none, or if they fail to act, those persons in the oldest generation of living descendants of the Grantor who have reached age 25, may appoint an individual or trust company to act in any vacant office of the trust.

The Trustees represent that Trust 1 has been irrevocable since its creation and that no property has been added to Trust 1 after September 25, 1985.

Trust 1 was created under State 1 law. Trust 1 does not specify that any particular state law is to govern the administration and construction of Trust 1. Initially a State 1 bank was the trustee of Trust 1. Currently, Trust 1 is being administered in State 2 by the Corporate Trustee, Trust Company, which is based in State 2. Statute 1 provides that, under State 2 law, the duration of a trust and time of vesting of interests in the trust property shall not change merely because the place of administration of the trust is changed from some other jurisdiction to State 2. Statute 2 provides that under the law of State 1, the use of the term "issue" means an individual's descendants.

You have requested the following rulings:

1. The change of situs of Trust 1 for administrative purposes from State 1 to State 2 will not cause Trust 1 to lose its exempt status from GST tax.

2. The proposed modifications of Trust 1 will not cause Trust 1 to lose its exempt status from GST tax.

3. The proposed modifications of Trust 1 will not cause any beneficiary to have made a gift for gift tax purposes.

4. The proposed modifications of Trust 1 will not subject any portion of Trust 1 to estate tax in the estate of any beneficiary.

5. The proposed modifications of Trust 1 will not cause Trust 1 or any beneficiary to realize or recognize any gain or loss under §§ 61 or 1001.

LAW AND ANALYSIS

Rulings 1 and 2

Section 2601 of the Internal Revenue Code imposes a tax on every GST made after October 26, 1986. A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term "taxable termination" means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that the term "taxable distribution" means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax of an interest in property to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a), 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 GST 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). Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died on September 25, 1985.

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 paragraph (b)(1), (2), or (3) of this section (hereinafter referred to as an exempt trust) 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)(1) 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, 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.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of this section, 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 transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a 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 modification. 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 to shift a beneficial interest in the trust.

In § 26.2601-1(b)(4)(i)(E), Example 4 provides as follows. In 1980, Grantor, who was domiciled in State X, executed an irrevocable trust for the benefit of Grantor's issue, naming a State X bank as trustee. Under the terms of the trust, the trust is to terminate, in all events, no later than 21 years after the death of the last to die of certain designated individuals living at the time the trust was executed. The provisions of the trust do not specify that any particular state law is to govern the administration and construction of the trust. In State X, the common law rule against perpetuities applies to trusts. In 2002, a State Y bank is named as sole trustee. The effect of changing trustees is that the situs of the trust changes to State Y, and the laws of State Y govern the administration and construction of the trust. State Y law contains no rule against perpetuities. In this case, however, in view of the terms of the trust instrument, the trust will terminate at the same time before and after the change in situs. Accordingly, the change in situs 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 transfer. Furthermore, the change in situs does not extend the time for vesting of any beneficial interest in the trust beyond that provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13. If, in this example, as a result of the change in situs, State Y law governed such that the time for vesting was extended beyond the period prescribed under the terms of the original trust instrument, the trust would not retain exempt status.

In § 26.2601-1(b)(4)(i)(E), Example 10 considers the following situation. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and 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. In addition, 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. Therefore, the trust will not be subject to the provisions of chapter 13.

In this case, Grantor created Trust 1 in State 1 and the trust agreement does not specify that any particular state law is to govern Trust 1. Initially, a State 1 bank was the trustee of Trust 1. Currently, Trust Company, which is based in State 2, is the Corporate Trustee of Trust 1. Child 1 petitioned Court, a State 2 court, requesting that Court accept jurisdiction over Trust 1 so that the situs of Trust 1 is in State 2. In addition, the proposed modifications provide that State 2 law will govern the administration of Trust 1, while State 1 law will continue to govern the validity, construction, and duration of Trust 1. The proposed change in situs and governing law will not change the termination date of Trust 1. Thus, the proposed change in situs will not shift any beneficial interest in Trust 1 and will not extend the time for vesting of any beneficial interest in Trust 1. Accordingly, based upon the facts submitted and representations made, we conclude that the change in situs of Trust 1 for administrative purposes from State 1 to State 2 will not cause Trust 1 to lose its exempt status from GST tax.

The proposed modifications of Trust 1 to add a Distribution Adviser, an Investment Advisor, a Trust Protector, and to require that while Trust 1 situs remains in State 2, at least one trustee must be a State 2 trust company, are all administrative in nature and under § 26.2601-1(b)(4)(i)(D)(2), will not be considered to shift a beneficial interest to a lower generation in the trust. See Example 10 of § 26.2601-1(b)(4)(i)(E). Further, the proposed modification to clarify the definition of "book value" is administrative in nature and is considered not to shift any beneficial interest to a lower generation in the trust. Finally, the proposed modification of Trust 1 to change the term "issue" to "descendants" is consistent with applicable state law and does not result in a shift in any beneficial interest to a lower generation nor does it extend the time for vesting of any beneficial interest in Trust 1. Accordingly, based upon the facts submitted and the representation made, we conclude that the proposed modifications of of Trust 1 will not cause Trust 1 to lose its exempt status from GST tax.

Ruling 3

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual.

Section 2511(a) provides that the gift tax applies 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 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 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 to be a gift, and is included in computing the amount of gifts made during the calendar year.

In this case, the beneficiaries of Trust 1 will have the same interests after the proposed modifications that they had prior to the modifications. Because the beneficial interests of the beneficiaries are substantially the same, no transfer of property will be deemed to occur as a result of the modifications. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed modifications of Trust 1 will not cause any beneficiary to have made a gift for gift tax purposes.

Ruling 4

Section 2001 provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2041(a)(2) provides for the inclusion in the gross estate of a decedent any property with respect to which the decedent possesses, at the time of his death, a general power of appointment created after October 21, 1942.

Section 2041(a)(3) provides for the inclusion in the gross estate of a decedent any property with respect to which the decedent by will exercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

Section 2041(b)(1)(A) provides that the term "general power of appointment" means a power that is exercisable in favor of the decedent, decedent's estate, decedent's creditors, or the creditors of decedent's estate; except that 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 deemed a general power of appointment.

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides that a power of appointment is not a general power of appointment if by its terms it is either (a) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate, or (b) expressly not exercisable in favor of the decedent or his creditors, or the creditors of decedent's estate.

In Rev. Rul. 95-58, 1995-2 C.B. 191, the Service ruled that a decedent/grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or corporate successor trustee that is not related or subordinate to the decedent within the meaning of § 672(c), is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus is not included in the decedent's gross estate under § 2036 or 2038.

Section 672(c) defines the term "related or subordinate party" to mean any nonadverse party who is (1) the grantor's spouse if living with the grantor; or (2) any one of the following: the grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

In this case, Child 1, in his capacity as a beneficiary of Trust 1, has two powers. First, Child 1 has a testamentary limited power of appointment over Trust 1 that may be exercised only in favor of Child 1's descendants. This limited power of appointment exists in the original trust instrument. This limited power of appointment will not cause Trust 1 to be included in Child 1's gross estate. Second, Child 1 has the power to appoint successor fiduciaries (the trustees) and officeholders of Trust 1. These offices include the Investment Adviser, Distribution Adviser, and Trust Protector. In the original trust instrument, Child 1, as beneficiary, had the power to remove and replace the trustees. Pursuant to the modifications, these powers are expanded to include all officeholders of the trust. Notwithstanding Child 1's new rights and powers, the Grantor, Grantor's wife, any descendants of the Grantor, any spouses of any descendants of the Grantor, and any subordinate party as to the Grantor, the Grantor's wife and any such descendants may not act as a trustee or Distribution Adviser of Trust 1. Thus, Child 1 is not permitted to act as a trustee or Distribution Adviser of Trust 1. Further, Child 1 may not appoint anyone related or subordinate to him as a trustee or Distribution Adviser. Accordingly, this power will not cause Trust 1 to be included in Child 1's gross estate. See Rev. Rul. 95-58.

Child 1 will have new rights and powers as the Investment Adviser and Trust Protector of Trust 1. As Investment Adviser, Child 1 will make all decisions related to the investment of the trust property. As Trust Protector, Child 1 may modify the provisions relating to the identity, qualifications, succession, removal, and appointment of any fiduciary or protector. The Trust Protector may modify the investment powers granted to the Trustees and Investment Adviser. The Trust Protector may remove any trustee or Investment Adviser. The Trust Protector may not exercise any power that would cause the trust to extend beyond any applicable rule against perpetuities nor cause the protector to possess a general power of appointment.

Although Child 1, as Trust Protector, will have the power to modify provisions relating to the succession, removal, and appointment of any fiduciary or officeholder of the trust, the modifications specify that no Trust Protector may modify the Prohibition on Appointment as Officeholder provision. Thus, Child 1 (or any other descendant of the Grantor) cannot act as a trustee or Distribution Adviser of the trust. Similarly, the Trustees and Distribution Adviser appointed by Child 1 may not be a related or subordinate party to Child 1. Thus, the powers of the Trustees and Distribution Adviser will not be attributed to Child 1 (or any other descendant of the Grantor). Thus, Child 1 and any beneficiary who may obtain such rights and powers pursuant to the modifications, will not be treated as having general powers of appointment by virtue of such powers. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed modifications of Trust 1 will not subject any portion of Trust 1 to estate tax in the estate of any beneficiary of Trust 1.

Ruling 5

Section 61(a) defines gross income as “all income from whatever source derived.” Under § 61(a)(3), gross income includes “[g]ains derived from dealings in property.” Under § 61(a)(15), income from an interest in a trust is included in gross income.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent is treated as income or as loss sustained.

In Cottage Savings Ass’n v. Commissioner, 499 U.S. 554 (1991), a financial institution exchanges its interest in one group of residential mortgage loans for another lender’s interest in a different group of residential mortgage loans. The two groups of mortgages were considered “substantially identical” by the agency that regulated the financial institution. The Supreme Court concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are “materially different.” Id. at 560-61. 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” so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 565. The Court held that mortgage loans made to different obligors and secured by difference homes embodied distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Id. at 566.

In this case, the beneficiaries will have the same beneficial interests in Trust 1 after the modifications as they had prior to the modifications to the trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed modifications of Trust 1 will not cause Trust 1 or any beneficiary to realize or recognize any gain or loss under §§ 61 or 1001.

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, 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.

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) 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