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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-102617-00
Date: December 19, 2000

Re:

LEGEND:

Trust A =

Trust B =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

B =
C =
D =
E =
F =
G =
H =
I =

Date 1 =
Date 2 =
Date 3 =

State =
$x =

Dear :

This is in response to your letter dated November 20, 2000, and prior correspondence, requesting a ruling concerning the federal gift, generation-skipping transfer, and income tax consequences of the proposed merger of Trust A and Trust B.

The facts and representations submitted are summarized as follows: Trust A, an irrevocable trust, was established by B and C on Date 1, for the primary benefit of B's and C's three sons, D, E, and F. Trust B, an irrevocable trust, was established by B and C on Date 2, for the primary benefit of B's and C's three sons, D, E, and F. B was the initial trustee of Trust A and Trust B.

Under the terms of Article 1.1 of Trust A, the trustee is to divide the trust property into three separate trusts (Trust 1, Trust 2, and Trust 3). Trust 1 is to be held for the primary benefit of D, Trust 2 is to be held for the primary benefit of E, and Trust 3 is to be held for the primary benefit of F. Under the terms of Article 1.1 of Trust B, the trustee is to divide the trust property into three separate trusts (Trust 4, Trust 5, and Trust 6). Trust 4 is to be held for the primary benefit of D, Trust 5 is to be held for the primary benefit of E, and Trust 6 is to be held for the primary benefit of F.

The terms of Trust A are summarized as follows:

Under Article 1.3, while either of B and C is serving as trustee, all of the net income of each trust is to be distributed at least quarterly to the primary beneficiary of each of Trust 1, Trust 2, and Trust 3. Article 1.4 provides that when neither of B and C is serving as trustee of a trust created under Trust A, the trustee shall distribute to the beneficiary of the trust, or any descendant of the beneficiary, such amounts of income and principal of such trust as will be necessary, considering other funds available to the beneficiary, to provide for the health, support, maintenance, and education of the beneficiary. In addition, any trustee other than B and/or C or a beneficiary may distribute to the beneficiary and the beneficiary's descendants all or any part of the net income of the beneficiary's trust, without reference to any standard and without regard to other sources of funds.

Article 1.6 provides that each trust created under Trust for the benefit of a son of B and C is to last for the son's lifetime. When a beneficiary other than a son of B and C attains age 30, or upon the death of the survivor of B and C, whichever occurs later, the trustee is to distribute the remaining trust income and principal to the beneficiary outright and such trust will then terminate.

Under Article 1.7, each beneficiary possesses a special testamentary power of appointment to appoint the trust property to any persons other than the beneficiary himself or herself, his or her creditors, his or her estate, or the creditors of his or her estate.

If a beneficiary dies prior to termination of his or her trust, Article 1.8 provides that all remaining unappointed income and principal is to be divided into shares among the then living descendants of the deceased beneficiary. Each share is then to be held as a separate trust for the benefit of such descendant under the provisions of Article 1 of Trust A.

Under Article 2.1, if B, who is the initial trustee of Trust 1, Trust 2, and Trust 3, dies, resigns or ceases to act, certain named individuals are appointed trustee. After B's death, each beneficiary of a trust who is a son of B and C and is over the age of 30 may elect to serve as a cotrustee of his trust. If at that time, the beneficiary has attained the age of 35, the beneficiary may elect to be the sole trustee of his trust. It is represented that each of D, E, and F has attained the age of 35.

Under Article 2.6, B, C, and the other named successor trustees are not to be compensated for serving as trustee. However, every other trustee that serves is entitled to fair and reasonable compensation for services.

Article 3.1 provides that Trust A is irrevocable and that B and C have no power to alter, amend, revoke or terminate any of the provisions of Trust A.

Article 3.2, provides that Trust 1, Trust 2, and Trust 3, unless they terminate earlier according to the terms of Trust A, will all terminate one day less than twenty-one years after the date of death of the last to survive of B and C and the descendants of B and C who are living at the time of the execution of Trust A.

Article 4 specifies the powers of the trustee. The trustee has the power to retain property transferred by B and C to Trust A, to exchange, sell or lease trust property, to borrow money, to invest and reinvest trust property and, to make any distribution required or permitted to be made to any beneficiary under the terms of Trust A.

Article 5.6 provides that Trust A was executed in State, and all questions pertaining to its validity, construction, and administration are to be determined in accordance with the laws of the State.

The provisions of Trust B are substantially identical to the terms of Trust A except for the following:

1. Under the terms of both Trust A and Trust B, B is the initial trustee of the trust. However, Trust A and Trust B differ with respect to the named individual successor trustees.

2. Under Trust A, B and C, and the other named successor trustees are not to be compensated for serving as trustee, but every other trustee that serves is entitled to fair and reasonable compensation for services rendered. Trust B provides that an

individual is not to be compensated for serving as trustee, but every corporate trustee is entitled to receive fair and reasonable compensation for services rendered.

3. Trust B contains the same trustee powers as those specified in Trust A. However, Trust B contains certain additional trustee powers: to invest and reinvest trust assets in a common trust fund, to execute lease, pooling or unitization agreements, to employ investment advisors, and to employ a bank or trust company to serve as custodian or agent.

The trustees of Trusts 1 - 6 propose to merge the trusts created under Trust A into the trusts created under Trust B. The purpose of the mergers is to reduce expenses and other costs of administration, improve management efficiency, and enhance investment opportunities. Under State law, the terms of an irrevocable trust may be modified if the settlor of the trust is still alive and the settlor and all of the beneficiaries of the trust consent to the modification. Sayers v. Baker, 171 S.W.2d 547 (Tex. Civ. App.- Eastland 1943, no writ). It has been represented that B, C, and the beneficiaries of each of the trusts to be merged have consented to the plan of merger.

Three merger agreements have been proposed. Under the agreements, each of which are identical, Trust 1 will be merged into Trust 4, Trust 2 will be merged into Trust 5, and Trust 3 will be merged into Trust 6. The current co-trustees of each pair of trusts to be merged are the same: the co-trustees of Trust 1 and Trust 4 are F and H; the co-trustees of Trust 2 and Trust 5 are D and G; and the current co-trustees of Trusts 3 and 6 are E and I. The trustees of the merged trusts will remain the same and the terms of Trust B will govern the surviving trusts, which shall be continued to be named as Trust 4, Trust 5, and Trust 6. The merger agreements also provide that no changes to the terms of the governing trust agreement (Trust B) will be made as a result of the merger.

It is represented that no additions have been made to Trusts 1, 2, 3, 4, and 6 after September 25, 1985. In 1997, an addition was made to Trust 5. It is represented that, on Date 3, each of B and C allocated a portion of their generation-skipping transfer (GST) tax exemption available under § 2631(a) of the Internal Revenue Code to the chapter 13 portion of Trust 5. The amount allocated by B and C was the smallest amount of GST exemption necessary to produce a zero inclusion ratio with respect to the property transferred in 1997. The trustee represents that the amount is $x. As a result of the allocations made by B and C, it is represented that Trust 5 currently has a zero inclusion ratio as that term is defined under § 2642(a).

It is also represented by D, E, and F that if any of D, E, and/or F exercises his testamentary power of appointment, he will not exercise the power in any way that would violate the perpetuities provision of Section 3.2 of each of Trust A and Trust B.

The following rulings are requested.

1. Trusts 1, 2, 3, 4, 5, and 6 are currently exempt from the GST tax under § 2601.

2. The proposed mergers of Trust 1 into Trust 4, Trust 2 into Trust 5, and Trust 3 into Trust 6 will not affect the grandfathered status of the trusts and will not cause any distributions from the merged trusts or distributions upon termination of the merged trusts to become subject to the GST tax provided there are not post-merger additions to the merged trusts.

3. The special power of appointment provided to the beneficiary of each of Trusts 1, 2, 3, 4, 5, and 6, under Article 1.7 of each trust to appoint the trust property to any persons other than the beneficiary himself or herself, his or her creditors, his or her estate, or the creditors of his or her estate, and the exercise of such powers as represented will not affect the grandfathered status of any trust.

4. The proposed mergers will not constitute taxable gifts under § 2511.

5. No gain or loss will be recognized for federal income tax purposes under §1001 or any other applicable provisions of the Internal Revenue Code upon the merger of Trust 1 into Trust 4, Trust 2 into Trust 5, and Trust 3 into Trust 6.

6. The assets of the merged trusts will have the same basis and holding period under §§ 1015 and 1223 before and after the proposed mergers.

Rulings #'s 1 and 2

Section 2601 imposes a tax on every generation-skipping transfer.

Section 26.2601-1(b)(1)(i) of the Generation-skipping Transfer Tax Regulations provides that the tax does not apply to any generation-skipping transfer under a trust (as defined in section 2652(a)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata portion of any GST under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii) provides that, except as provided in section 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust.

Under § 26.2601-1(b)(1)(ii)(B), a trust is not an irrevocable trust to the extent that, on September 25, 1985, the settlor held a power with respect to such trust that would have caused the value of the trust to be included in the settlor's gross estate for Federal estate tax purposes by reason of § 2038 (without regard to powers relinquished before September 25, 1985) if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(1)(ii)(C) provides that a policy of insurance on an individual's life that is treated as a trust under § 2652(b) is not considered an irrevocable trust to the extent that, on September 25, 1985, the insured possessed any incident of ownership (as defined in § 20.2042-1(c) of the Estate Tax Regulations, and without regard to any incidents of ownership relinquished before September 25, 1985), that would have caused the value of the trust, (i.e., the insurance proceeds) to be included in the insured's gross estate for Federal estate tax purposes by reason of § 2042, if the insured had died on September 25, 1985.

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 26.2611-1 provides that a generation-skipping transfer is an event that is either a direct skip, a taxable distribution, or a taxable termination. The determination as to whether an event is a GST is made by reference to the most recent transfer subject to the estate or gift tax.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual is allowed a GST tax exemption of $1,000,000 (adjusted for inflation under § 2631(c)) that may be allocated by the individual (or the individual's executor) to any property with respect to which the individual is the transferor. An allocation, once made, is irrevocable.

Section 2642(a)(1) provides generally, that the inclusion ratio with respect to any property transferred in a generation-skipping transfer shall be the excess (if any) of 1 over–

(A) except as provided in subparagraph (B), the applicable fraction determined for the trust from which the transfer was made, or

(B) in the case of a direct skip, the applicable fraction determined for such skip.

Section 2642(a)(2) provides that for purposes of § 2642(a)(1), the applicable fraction is a fraction–

(A) the numerator of which is the amount of the GST exemption allocated to the trust (or in the case of a direct skip), allocated to the property transferred in such skip), and

(B) the denominator of which is–

(i) the value of the property transferred to the trust (or involved in the direct skip), reduced by

(ii) the sum of–

(I) any Federal estate tax or State death tax actually recovered from the trust attributable to such property, and

(II) any charitable deduction allowed under §§ 2055 or 2522 with respect to such property.

Under § 26.2601-1(b)(1)(iv)(A), if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from chapter 13 under § 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to chapter 13 (the non-chapter 13 portion) and a portion subject to chapter 13 (the chapter 13 portion), each with a separate inclusion ratio (as defined in § 2642(a)). The non-chapter 13 portion represents the value of the assets of the trust as it existed on September 25, 1985. The applicable fraction (as defined in § 2642(a)(2)) for the non-chapter 13 portion is deemed to be 1 and the inclusion ratio is zero. The chapter 13 portion of the trust represents the value of all additions made to the trust after September 25, 1985. The inclusion ratio for the chapter 13 portion is determined under § 2642(a)(1).

In this case, Trusts 1, 2, 3, 4, and 6 were irrevocable on September 25, 1985, and there have been no additions to them since that date. With respect to Trust 5, an addition was made after September 25, 1985. Under § 26.2601-1(b)(1)(iv)(A), a pro rata portion of the Trust 5 is subject to the provisions of chapter 13, and is deemed to consist of two portions. The portion of the trust that is attributable to the additions made after September 25, 1985, is subject to chapter 13 and this portion has a separate inclusion ratio determined under § 2642. It is represented that, on Date 3, each of B and C allocated a portion of their GST tax exemption available under § 2631(a) to the chapter 13 portion of Trust 5. The amount allocated by B and C was the smallest amount of GST exemption necessary to produce a zero inclusion ratio with respect to the property transferred in 1997. The trustee represents that the amount is $x. The allocation is effective as of Date 3, and as a result of the allocation, the applicable fraction for this portion of Trust 5 is deemed to be one and the inclusion ratio, under § 2642(a)(1), is zero.

The non-chapter 13 portion represents the value of the assets of Trust 5 as it existed on September 25, 1985, and any increase or decrease in the value of the assets attributable to the assets. The applicable fraction for this portion is deemed to be one and therefore, the inclusion ratio, under § 2642(a), for this portion of Trust 5 is zero. Section 26.2601-1(b)(1)(iv)(A).

Based on the facts submitted and the representations made, we conclude that Trusts 1, 2, 3, 4, 5 and 6, are exempt from the tax imposed under chapter 13.

In addition, the trustees of Trusts 1 - 6 propose to merge the trusts to reduce expenses and other costs of administration, improve management efficiency, and enhance investment opportunities. Trust 1 will be merged into Trust 4, Trust 2 will be merged into Trust 5, and Trust 3 will be merged into Trust 6. The trustees of the merged trusts will remain the same and the terms of Trust B shall be the terms governing the surviving trusts. The terms of Trust B are substantially similar to the terms of Trust A.

Generally, an amendment to an exempt (irrevocable) trust that modifies or otherwise changes the quality, value, or timing of any powers, or beneficial interests, rights or expectancies originally provided under the terms of the trust will cause the trust to lose its exemption from GST tax.

Under the proposed mergers, the interests of the all of the beneficiaries will remain the same and the timing of the termination of the trusts will remain the same. In addition, the value of the income or corpus interest of each beneficiary will not change as a result of the merger. Accordingly, the proposed mergers of Trust 1 into 4, Trust 2 into Trust 5, and Trust 3 into Trust 6 will not change the quality, value, or timing of any powers; beneficial interests, rights, or expectancies originally provided for under the terms of the original trusts.

Based on the facts submitted and the representations made we conclude that the proposed mergers of Trust 1 into Trust 4, Trust 2 into Trust 5, and Trust 3 into Trust 6 will not affect the grandfathered status of the trusts and will not cause any distributions from the merged trusts or distributions upon termination of the merged trusts to become subject to the GST tax provided there are not post-merger additions to the merged trusts.

Ruling # 3

Section 2041(b)(1) provides that the term “general power of appointment” means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Section 20.2041-1(c)(1)(b) of the Estate Tax Regulations provides that a power is not a general power of appointment if by its terms it is expressly not exercisable in favor of the decedent or his or her creditors or the creditors of his or her estate.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided in § 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12.

Section 26.2601-1(b)(1)(v)(B) provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) is not treated as an addition to a trust if–

(1) Such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under § 26.2601-1(b)(1); and

(2) In the case of an exercise, the power of appointment is not exercised in a manner that may postpone or suspend the vesting of absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of this paragraph (b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of the creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power is exercised.

In the present case, each beneficiary possesses a special testamentary power of appointment to appoint the trust property, "to any person or persons other than himself or herself, his or her creditors, his or her estate, or the creditors of his or her estate."

It is represented by D, E, and F that, after the proposed mergers, if any of D, E, and/or F exercises his testamentary power of appointment, he will not exercise the power in any way that would violate the perpetuities provision of Section 3.2 of each of Trust A and Trust B.

Based on the representations made by D, E, and F, and provided that any future beneficiary of a merged trust who will possess the special testamentary power of appointment under Article 1.7 does not exercise the power in any way that would violate the perpetuities provision under Section 3.2, we conclude that the special power of appointment provided to the beneficiary of each of Trusts 1, 2, 3, 4, 5, and 6, to appoint the trust property to any persons other than the beneficiary himself or herself, his or her creditors, his or her estate, or the creditors of his or her estate, and the exercise of such powers by the beneficiaries of the merged trusts will not affect the grandfathered status of any merged trust.

Ruling # 4

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during the calendar year by and individual, resident or nonresident.

Section 2511(a) provides that the tax imposed by § 2501 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(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 to be a gift, and is included in computing the amount of gifts made during the calendar year.

Based on the facts submitted and the representations made, we conclude that after the merger of Trust 1 into Trust 4, Trust 2 into Trust 5, and Trust 3 into Trust 6, the merged trusts will have the same beneficiaries as they had before the mergers. In addition, the same assets will be held for the same beneficiaries. Therefore, the interest of each beneficiary will remain the same. Accordingly, the proposed mergers will not result in a gift for federal gift tax purposes under § 2511.

Ruling # 5

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 over the amount realized. 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 that, generally, the gain or loss realized from a conversion of property into cash, or from an exchange of property for other property differing materially either in kind or extent, is treated as income or as loss sustained.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Association 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 this case, the merger of the trusts into the surviving trusts will not constitute a sale or other disposition for purposes of § 1001. The interests of the beneficiaries before and after the mergers remain the same because each set of merged trusts has the same beneficiaries and substantially similar terms. The exchanged properties are not materially different because they do not embody legal entitlements that are different in kind or confer different rights and powers.

We conclude that neither the merger nor the distribution of assets to the surviving trusts will result in recognition of gain or loss to any trust or the beneficiary of any trust.

Ruling # 6

Section 1015(b) provides that if property is acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by gift, bequest, or devise), the basis 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 on the transfer under the law applicable in the year in which the transfer is made.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by 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 in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Because the proposed mergers of the Trusts 1 and 4, Trusts 2 and 5, and Trusts 3 and 6, will not result in the realization of gain or loss under § 1001, or income under § 61, the basis of the assets held in the merged trusts will be the same as the basis of those assets prior to the merger.

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

As noted above, the basis of the assets held in the merged trusts will be the same as the basis of those assets prior to the mergers. Based on the information submitted and the representations made, we conclude that the assets distributed from Trusts 1 - 6 into the merged trusts will have the same basis and holding periods under §§ 1015 and 1223 before and after the proposed mergers.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
JAMES F. HOGAN
Assistant to the Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy of letter for section 6110 purposes

cc: