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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-132133-01
Date:
June 05, 2002

Re:

Legend:
Trustor A =
Trustor B =
Trust =

Trust A =
Trust B =
Trust C =
Trust A-1 =
Trust B-1 =
Trust C-1 =
Child A =
Child B =
Child C =
Date 1 =
Date 2 =
Date 3 =
Date 4 =

Dear :

This is in response to your letter, dated June 1, 2001, in which a ruling was requested concerning the income, estate, gift, and generation-skipping transfer (GST) tax consequences of a proposed merger of two trusts.

Trustor A and Trustor B created a revocable trust, Trust, on Date 1. The Trust was amended on Date 2. Trustor A died in on Date 3 and under Part 2.3 of his will, he bequeathed the residue of his estate to Trust. Upon the death of Trustor A, Trust provides that a surviving spouse's trust is to be created to hold Trustor B's share of community property and other assets of Trustor B. Under the terms of Trust, the

balance of the Trust assets transferred to the Trust by Trustor A passed to an irrevocable Family Trust. Under the terms of the Family Trust, Trustor B is the sole beneficiary during her lifetime. Upon the death of Trustor B, the Family Trust assets are to be divided equally with one share held in separate trust for each surviving child and one share held in trust for each deceased child with surviving issue. Trustor B died in , Date 4. Trustor B was survived by Child A, Child B, and Child C. Accordingly, the Family Trust was divided into Trust A, Trust B, and Trust C, each trust benefiting Child A, Child B, and Child C, respectively.

Under the terms of Trust A, Trust B, and Trust C, the trustee is to pay the trust income at least quarterly and distribute principal if necessary or advisable for the health, support, education, and maintenance of such child. Each child has a testamentary special power of appointment over such child's trust and may appoint the remaining trust estate to one or more of Trustors' issue or the spouse of a deceased issue. Upon the death of a child, the child's remaining unappointed trust estate passes either outright or in trust to the child's issue, per stirpes.

The executor for Trustor A's estate did not allocate any of Trustor A's GST exemption to Family Trust. It is represented that at Trustor A's death, Trustor A had $1 million GST exemption available and that the assets passing to Family Trust were less than $1 million in value. It is also represented that Trustor A made no other bequests that would be direct skips for purposes of § 2632 and made no other transfers to nonexempt trusts to which GST exemption would be allocated under § 2632. Under § 26.2632-1(d)(c), Trustor A's GST exemption is automatically allocated on the due date for filing Trustor A's federal estate tax return to the assets passing to the Family Trust. As a result of the allocation to Family Trust, Trust A, Trust B, and Trust C each have a zero inclusion ratio. It is represented that no additions have been made to the Family Trust, since initial funding, or to Trust A, Trust B, and Trust C.

At the time of Trustor B's death, virtually all of her assets were held in the surviving spouse's trust. Under the terms of the surviving spouse's trust, the trust assets are to be divided and held under terms identical to the terms that govern the Family Trust. The surviving spouse's trust was divided equally with one share held in separate trust for each surviving child. Surviving spouse's trust was divided into Trust A-1, Trust B-1, and Trust C-1, each trust benefiting Child A, Child B, and Child C, respectively.

The executor of Trustor B's estate did not allocate any of Trustor B's GST exemption to Trust A-1, Trust B-1, or Trust C-1. It is represented that at Trustor B's death, Trustor B had $ 1,060,000 GST exemption available and that the assets passing to Trust A-1, Trust B-1, and Trust C-1 were less than $ 1,060,000 in value. It is also represented that Trustor B made no other bequests that would be treated as direct skips under § 2632 and made no other transfers to nonexempt trusts to which GST exemption would be allocated to under § 2632. Under § 26.2632-1(d)(2), Trustor B's GST exemption is automatically allocated pro rata on the due date for filing Trustor B's federal estate tax return to the assets passing to Trust A-1, Trust B-1, and Trust C-1. As a result of the allocation of the GST exemption, Trust A-1, Trust B-1 and Trust C-1

each have a zero inclusion ratio. It is represented that no additions have been made to these trusts since the trusts were initially funded.

All trusts, whether created under the Family Trust or under the terms of the surviving spouse's trust, must terminate 21 years after the death of the last to die of Trustor A, Trustor B, and their issue who were living on the death of the first Trustor to die.

As a result of the foregoing, each child now is the beneficiary of two separate trusts with identical provisions. In order to save administrative expenses, the trustees seek to merge Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1.

You have requested the following rulings:

1. The proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will not cause Trust A, Trust A-1, Trust B, Trust B-1, Trust C, or Trust C-1 to recognize gain or loss under §§ 61 and 1001?

2. Pursuant to § 1015, the basis for each asset held in trust after the merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will be the same as the basis of those assets prior to the merger.

3. Pursuant to § 1223(2), the holding period for each asset held in Trust A-1, Trust B-1, and Trust C-1 after the merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will include the holding period for each asset held in Trust A, Trust B, and Trust C prior to the merger.

4. The proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will not cause any constructive or actual additions to Trust A-1, Trust B-1 or Trust C-1 and, after the merger, Trust A-1, Trust B-1, and Trust C-1 will not lose their exempt status under § 2601.

5. The proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will not be generation-skipping transfers and will not be subject to GST tax under § 2601 and will not cause any distributions from Trust A to Trust A-1, Trust B to Trust B-1, or Trust C to Trust C-1, upon the merger, to become subject to GST tax (provided there are no post-merger additions to the trusts).

6. Child A, Child B, and Child C's exercise of a special power of appointment provided under the terms of the successor trusts, Trust A-1, Trust B-1, and Trust C-1, will not cause any distributions from the successor trusts or distributions upon termination of the successor trusts to be subject to the GST tax.

7. The proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will not cause Child A, Child B, or Child C to have made a taxable gift under chapter 12.

8. The proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will not cause the interest that Child A, Child B, and Child C has in the respective successor trust to be included in such child's gross estate under §§ 2033, 2036, 2037, 2038, and 2041, except for the accrued but unpaid net income at such child's death.

Ruling Request 1

Section 61 of the Internal Revenue Code provides that gross income includes all income from whatever source derived. Section 61(a)(3) specifically includes gains derived from dealings in property.

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(c) provides that, except as otherwise provided in Subtitle A, the entire amount of gain or loss determined under § 1001 on the sale or other exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides, as a general rule, that 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. For purposes of § 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional interest. Such an exchange is a disposition under § 1001(a).

An exchange of property results in the realization of gain only if the properties exchanged materially differ. Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565.

In the present ruling request the taxpayers represent and the underlying documents support that the terms and provisions of the trusts being merged are identical. The current beneficiaries as well as remainder beneficiaries will possess the same income and remainder interests before and after the merger of the trusts. Consequently, the interests of the beneficiaries after the merger will not materially differ from their interests under Trust. Accordingly, the proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will not cause the trusts to recognize gain or loss from the sale or other disposition of property under § 61 or 1001.

Ruling Requests 2 and 3

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 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 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 a transfer in trust by a 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 a transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

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 the property was held by any other person, if 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.

Accordingly, we conclude that the basis of the assets in the successor trusts will be same as the basis of those assets in Trust A, Trust A-1, Trust B, Trust B-1, Trust C, and Trust C-1 prior to the merger. In addition, we conclude under § 1223(2) the holding period for each asset held in Trust A-1, Trust B-1, and Trust C-1 after the merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will include the holding period for each asset in Trust A, Trust B, and Trust C prior to the merger.

Ruling Requests 4 and 5

Section 2601 imposes a tax on every generation-skipping transfer made by a transferor to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986.

Section 2602 provides that the amount of tax imposed by § 2601 is the taxable amount multiplied by the applicable rate. Section 2641 provides that the applicable rate is the product of the maximum Federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2642(a) provides, in part, that the inclusion ratio with respect to any property transferred in a generation-skipping transfer will be equal to the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. The applicable fraction, generally, is a fraction the numerator of which is the amount of the GST exemption allocated to the trust, and the denominator of which is the value of the property transferred to the trust.

Section 2631 provides that for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of $1 million (adjusted for inflation to $1,060,000 for the year 2001) which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 26.2632-1(d)(2) of the Generation-Skipping Transfer Tax Regulations generally provides that a decedent's unused GST exemption is automatically allocated on the due date for filing the Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date. Unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for purposes of chapter 11 (chapter 11 value), first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.

Section 2652 provides that the transferor for generation-skipping transfer tax purposes is the decedent for purposes of chapter 11 and the donor for purposes of chapter 12.

Section 2654(b) provides that the portions of a trust attributable to transfers from different transferors are treated as separate trusts.

Section 26.2642-4(a)(2) provides that if separate trusts created by one transferor are consolidated, a single applicable fraction for the consolidated trust is determined. The numerator of the redetermined applicable fraction is the sum of the nontax portions of each trust immediately prior to the consolidation.

In the present case, Trust A, Trust B, and Trust C are identical to Trust A-1, Trust B-1, and Trust C-1, respectively, and each trust has an inclusion ratio of zero. Trustor A is the transferor for generation-skipping transfer purposes with respect to Trust A, Trust B, and Trust C. Trustor B is the transferor for generation-skipping transfer purposes with respect to Trust A-1, Trust B-1, and Trust C-1. See § 2652. After the merger, the portion of each successor trust attributable to Trustor A will be treated as a separate trust from the portion of the successor trust that is attributable to Trustor B for purposes of chapter 13. See § 26.2654-1(a)(2). The portion of each successor trust attributable to Trustor A will have an inclusion ratio of zero following the merger. The portion of each successor trust attributable to Trustor B will also have an inclusion ratio of zero following the merger. See § 26.2642-4(a)(2). Accordingly, the proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will not: (i) cause any constructive or actual additions to the successor trusts, Trust A-1, Trust B-1, and Trust C-1, (ii) will not be generation-skipping transfers, (iii) will not be subject to GST tax under § 2601, (iv) will not cause any distributions from Trust A to Trust A-1, Trust B to Trust B-1, or Trust C to Trust C-1, upon the merger, to be subject

to GST tax (provided there are no post-merger additions), and (v) each successor trust will be exempt from GST tax.

Ruling Request 6

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any 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 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, inclusive.

Section 2041(b)(1) defines the term "general power of appointment" as a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Section 2652 provides that the transferor for generation-skipping transfer tax purposes is the decedent for purposes of chapter 11 and the donor for purposes of chapter 12.

Section 26.2652-1(a)(1) provides, in general, that the individual with respect to whom property was most recently subject to Federal estate or gift tax is the transferor of that property for purposes of chapter 13.

Section 26.2652-1(a)(2) provides that a transfer is subject to Federal estate tax if the value of the property is includible in the decedent's gross estate as determined under § 2031 or § 2103.

In the present case, Child A, Child B, and Child C possess a testamentary power of appointment to appoint any remaining trust estate in Trust A, Trust A-1, Trust B, Trust B-1, Trust C, and Trust C-1, respectively, to one or more of Trustors' issue or spouse of a deceased issue. Child A, Child B, and Child C may not appoint the trust estate to himself or herself, his/her estate, his/her creditors, or the creditors of his/her estate. Accordingly, the testamentary power of appointment is not a general power of appointment. If Child A, Child B, or Child C exercises his/her power at death or if the power lapses, because it is not a general power of appointment, the exercise or lapse of the power will not be treated as a transfer of property for purposes of § 2041. Child A, Child B, and Child C will not be treated as transferors for purposes of chapter 13. Thus, we conclude Child A, Child B, and Child C's exercise of a testamentary special power of appointment provided under the terms of the successor trusts, Trust A-1, Trust B-1, and Trust C-1, will not cause any distributions from the respective successor trust to be subject to the GST tax.

Ruling Request 7

Section 2501(a)(1) imposes a gift tax on the transfer of property by gift. 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.

In the present case, the interests of Child A, Child B, and Child C before and after the proposed merger are identical. Accordingly, the proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1, will not cause Child A, Child B, or Child C to have made a taxable gift under chapter 12.

Ruling Request 8

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

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 the decedent's death.

Section 2036(a) provides that the value of the decedent's gross estate includes the value of all property to the extent of any interest transferred by the decedent with respect to which the decedent has retained for life either an income interest in the property or the right to designate the persons who will possess or enjoy the property or have an interest in the income of the property.

Section 2038(a)(1) provides that, in the case of transfers after June 22, 1936, 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 an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of 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 when any such power is relinquished during the 3-year period ending 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 to the extent of any 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 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, inclusive.

Under the terms of Trust and after the merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1, the interest of Child A, Child B, and Child C will terminate at the child's death and the corpus will either pass outright or be held in further trust for the benefit of each child's issue. Accordingly, Child A, Child B, and Child C will not have an interest in the corpus of the respective trust at the time of such

child's death for purposes of § 2033. Child A, Child B, and Child C possess a testamentary special power of appointment to appoint the trust estate to one or more of the Trustors' issue, or the spouse of a deceased issue. Child A, Child B, and Child C do not possess a general power of appointment as defined under § 2041. Further, Child A, Child B, and Child C have not transferred property to the respective trust for purposes of § 2036, 2037, and 2038. Under the facts as presented, we conclude that the proposed merger of Trust A into Trust A-1, Trust B into Trust B-1, and Trust C into Trust C-1 will not cause the interest that Child A, Child B, and Child C has in the respective successor trust to be included in his/her gross estate under §§ 2033, 2036, 2037, 2038, and 2041.

The ruling contained in this letter is 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 the ruling, it is subject to verification on examination.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

The 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.

Sincerely yours,
Lorraine E. Gardner
Assistant to the Branch Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes