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Date:
June 23, 2006

LEGEND

Husband	=
Wife	=
Trust	=
Date 1	=
Child 1	=
Child 2	=
Child 3	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
Grandchild 4	=
Grandchild 5	=
Grandchild 6	=
Grandchild 7	=
Grandchild 8	=
Great-grandchild 1	=
Great-grandchild 2	=
Great-grandchild 3	=
State Statute A	=
State Statute B	=

Dear :

This is in response to your authorized representative's letter of June 22, 2005, requesting rulings regarding the application of the income, estate, gift, and generation-skipping transfer ("GST") tax consequences of a proposed transaction. This letter responds to that request.

The information submitted and the representations made are as follows: Husband and Wife created Trust on Date 1. The initial beneficiaries of Trust were Husband and Wife's three children, Child 1, Child 2, and Child 3. Child 1, Child 2, and Child 3 are now deceased. Child 1 was survived by four children, Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4, all of whom are currently alive. Child 2 was survived by four children, Grandchild 5, Grandchild 6, Grandchild 7, and Grandchild 8. Grandchild 5 and Grandchild 6 are currently alive. Grandchild 7 is deceased but survived by Great-grandchild 1. Grandchild 8 is deceased but survived by Great-grandchild 2 and Great-grandchild 3. Child 3 was not survived by any descendants.

Paragraph First of Trust provides, generally, that the Trustee shall distribute, at least quarter annually, all of the net income of the trust to Child 1, Child 2, and Child 3, in equal portions. In addition, the trustee is permitted to pay to Child 1, Child 2, and Child 3, so much of the principal of the trust as the trustee deems necessary to maintain Child 1, Child 2, and Child 3, in the degree of comfort and well-being to which they have become accustomed.

Paragraph First further provides that if any one or more of the children shall not be living at any time designated for payment of net income or application of principal, and if such deceased child is survived by issue, the portion such deceased child would have received, if living, shall be devoted by the trustee to the support, care, maintenance, and education of the issue of such deceased child. In addition, if any one or more of the children shall not be living at the time for distribution of principal and shall have died without surviving issue, then the share of principal for such deceased child shall be divided equally among the survivors of Child 1, Child 2, and Child 3.

Paragraph Fifth, as modified by two state court decrees, authorizes each current trustee to appoint one or more successor trustees, subject to certain requirements.

The current trustees of Trust are four of the six living grandchildren of Husband and Wife, Grandchild 1, Grandchild 2, Grandchild 5, and Grandchild 6.

The current beneficiaries of Trust are the six living grandchildren, Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, Grandchild 5, and Grandchild 6, and three of the great-grandchildren, Great-grandchild 1, Great-grandchild 2, and Great-grandchild 3, of Husband and Wife. Great-grandchild 1 replaced Grandchild 7, who is deceased, as a beneficiary of Trust. Great-grandchild 2 and Great-grandchild 3 replaced Grandchild 8, who is deceased, as a beneficiary of Trust.

The trustees of Trust have filed a petition to construe and vary the terms of Trust. Specifically, the petition requests that the court approve a division of Trust into nine separate shares (the "Separate Trusts"), with each Separate Trust to be held for the primary benefit of one of the nine current beneficiaries of Trust.

Under State Statute A, the trustees have the power on the division of Trust to allocate particular assets in proportionate or disproportionate shares, value the trust property for those purposes, and adjust for resulting differences in valuation. Pursuant to State Statute A, the trustees propose to allocate assets equal to one-eighth of the value of Trust's assets to each of the Separate Trusts for Granchild 1, Grandchild 2, Grandchild 3, Grandchild 4, Grandchild 5, Grandchild 6, and Great-grandchild 1. In addition, the trustees propose to allocate assets equal to one-sixteenth of the value of Trust's assets to each of the Separate Trusts for Great-grandchild 2 and Great-grandchild 3. The assets of Trust, which consist entirely of publicly traded securities, municipal bonds, and cash or cash equivalents, will be distributed to the Separate Trusts on a pro-rata basis.

Following the division, Paragraph First will be construed to provide that while the primary beneficiary is living, the trustee will have discretion to distribute trust income or principal to or for the support, care, maintenance, and education of the primary beneficiary. If the primary beneficiary dies before June 28, 2025, the termination date of Trust and each Separate Trust, the trustee will distribute the net trust income to the primary beneficiary's then living issue per stirpes, and the trustees will have the discretion to distribute principal to the primary beneficiary's then living issue per stirpes.

In addition, Paragraph Fifth will be construed (i) to provide for the appointment of trustees for each Separate Trust; (ii) to require that each trustee of a Separate Trust be a corporate trustee or a descendant of Husband and Wife; (iii) to require that there always be at least one trustee serving with respect to each Separate Trust who is not a current beneficiary of such trust; (iv) to direct that all decisions regarding discretionary distributions of income or principal be made by the trustee or trustees other than the current beneficiary; and (v) to set forth procedures for the appointment and removal of trustees.

The trustees and the beneficiaries of Trust have consented to the proposed division of Trust into the Separate Trusts and the proposed construction of Paragraph First and Paragraph Fifth in the manner set forth above.

Your authorized representative has requested the following rulings with respect to Trust:

1. The proposed construction and modification of Trust will not cause Trust or any of the separate trusts to lose their status as a trust that is exempt from the GST tax.

2. The proposed construction and modification of Trust will not result in any beneficiary of a Separate Trust having a general power of appointment under § 2041 of the Internal Revenue Code over any assets of such Separate Trust.

3. The proposed construction and modification of Trust will not result in any beneficiary of a Separate Trust possessing a general power of appointment under § 2514 over any assets of such Separate Trust.

4. The proposed division will not cause Trust, any of the Separate Trusts, or any of the beneficiaries to recognize any gain or loss from the sale or other disposition of property under § 61 or § 1001.

5. Pursuant to § 1015, the tax basis of the Separate Trusts in each property received in the proposed division will be the same as the tax basis of Trust in the property.

6. Pursuant to § 1223(2), the holding period of the Separate Trusts in each property received in the proposed division will include the holding period of Trust in the property.

RULING 1

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

Section 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 provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that 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).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii) (B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from the application of chapter 13 by § 1433(b)(2)(A) of the 1986 Act, 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.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the GST provisions, if: (1) the judicial action involves a bona fide issue; and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state.

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 paragraphs (b)(4)(i)(A), (B), or (C) of this subsection) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, but only if -- (1) the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and (2) the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(E), Example 3, provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of A and B, or per capita among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates. The court's construction resolves a bona fide issue regarding the proper interpretation of the instrument and is consistent with applicable state law as it would be interpreted by the highest court of the state. Therefore, the trust will not be subject to the provisions of chapter 13.

Section 26.2601-1(b)(4)(i)(E), Example 5, considers a situation where, prior to September 25, 1985, Grantor established an irrevocable trust for the benefit of Grantor's two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for the benefit of A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The example concludes that the division of the trust into 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 division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In the present case, Trust was irrevocable on September 25, 1985, and it is represented that no additions, actual or constructive, have been made to Trust after that date. The proposed division of Trust into the Separate Trusts (i) will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons holding the beneficial interests prior to the division, and (ii) will not extend the time for vesting of any beneficial interest beyond the period provided for under Trust. In addition, the proposed construction of Paragraph First and Paragraph Fifth following the division of Trust into the Separate Trusts is consistent with applicable local law and resolves bona fide issues regarding the interpretation of certain provisions of the trust instrument.

Based on the facts presented and the representations made, we conclude that the proposed construction and division of Trust will not affect the status of Trust or the Separate Trusts as exempt from the generation-skipping transfer tax.

RULINGS 2 and 3

Section 2001 imposes a tax 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 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 a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent the property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive. For purposes of § 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

Section 2041(b)(1) defines the term “general power of appointment" as a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate. However, under § 2042(b)(1)(A), a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not a general power of appointment.

Under § 20.2041-1(c)(2) of the Estate Tax Regulations, a power is limited by an ascertainable standard if the extent of the holder’s duty to exercise and not exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). The words “support” and “maintenance” are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

Section 2501(a)(1) provides, generally, that a tax is imposed for each calendar year on the transfer of property by gift by any individual, resident or nonresident.

Under section 2514(b), the exercise or release of a general power of appointment created after October 21, 1942, is a transfer of property by the individual possessing such power.

Under section 2514(c), a "general power of appointment" is defined as a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or creditors of his estate. However, under § 2514(c)(1), a power to consume, invade, or appropriate property for the benefit of the possessor that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor is not a general power of appointment.

Section 25.2514-1(c) of the Gift Tax Regulations contains rules similar to § 20.2041-1(c)(2), defining a general power of appointment for purposes of § 2514. Thus, the rules governing when a power of appointment is limited by an ascertainable standard under § 2041 also apply under § 2514. In addition, the term "power of appointment" has the same meaning for purposes of both the gift and estate tax. See Rev. Rul. 76-547, 1976-2 C.B. 302.

In Rev. Rul. 76-547, 1976 C.B. 302, the income beneficiary of a trust held the power as trustee to invade principal for the individual's own "care, maintenance, health and enjoyment." Under the revenue ruling, the word "enjoyment" is not sufficiently restrictive to limit the power to an ascertainable standard under § 2514. However, the revenue ruling raises no concerns about the word "care."

Although federal law controls in determining how the powers and rights possessed by an individual are taxed, state law prevails in determining the nature and extent of the powers and rights possessed by such persons. See Morgan v. Commissioner, 309 U.S. 78, 80 (1940). Thus, whether a trustee's power is limited by an ascertainable standard relating to health, education, support or maintenance is a matter of state law.

A review of State law in this case has revealed no law directly on point. Accordingly, under Commissioner v. Bosch, 387 U.S. 456 (1967), we must determine what the law of State, as it applies to Trust, is likely to be.

State Statute B provides that a person other than a settlor who is a beneficiary and trustee of a trust that confers on the trustee a power to make discretionary distributions for the trustee's personal benefit may exercise the power only in accordance relating to the trustee's individual health, education, support, or maintenance within the meaning of §§ 2041 and 2514. Although State Statute B was enacted after Trust was executed and does not appear to have a retroactive effect, the statute is instructive in the present case and suggests that the trustees' power to distribute income and principal is limited by an ascertainable standard.

In the present case, a trustee's power to invade the trust income and principal can only be exercised for the "support, care, maintenance, and education" of the respective beneficiaries. Under §§ 20.2041-1(c)(2) and 25.2514-1(c)(2), a power to distribute income or principal for the health, education, or support of the holder is not a general power of appointment. Further, under the regulations, the terms "support" and "maintenance" are treated as being synonymous. We believe that the term "care" is also synonymous with terms "support" and "maintenance." See Rev. Rul. 76-547. We further believe that such an interpretation is consistent with State law as it would be applied by the highest court of State. See State Statute B.

Based on the foregoing, we conclude that no beneficiary who is serving as a trustee of Trust currently possesses a general power of appointment because distributions of income and principal are limited by an ascertainable standard. We further conclude that the proposed construction and division will not result in any beneficiary who is serving as a trustee of a Separate Trust having a general power of appointment over any assets of such Separate Trust under § 2041 or § 2514.

RULING 4

Section 61(a)(3) provides that gross income 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, the entire amount of the gain or loss on the sale or exchange of property is 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 in either kind or in extent, is treated as income or as 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 property interest. Such an exchange of property is a disposition under § 1001(a). See § 1.1001-1.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that a partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests in order to extinguish their survivorship interests.

An exchange of property results in the realization of gain under § 1001 if the properties exchanged are materially different. Cottage Savings Association 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 this case, the Separate Trusts will be funded on a pro-rata basis. Accordingly, based on the information submitted and the representations made, we conclude that the proposed division of Trust into the Separate Trusts on a pro-rata basis will not cause the interests of the beneficiaries of the separate trusts to differ materially. The beneficiaries will hold essentially the same interests before and after the pro-rata division. Therefore, the proposed construction and division of Trust will not result in the realization of any gain or loss from a sale or other disposition of property under §§ 61 and 1001.

RULINGS 5 & 6

Section 1015(b) provides that if property is acquired by a transfer in trust (other than a transfer in trust by a gift, bequest, or devise), the basis shall be 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 such transfer.

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 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 such property was held by any other person, if under chapter 1 of Subtitle A 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 his hands as it would have in the hands of such other person. See also section 1.1223-1(b).

Based upon the information submitted and representations made, we conclude that because § 1001 does not apply to the proposed construction and division of Trust, under § 1015 the basis of the assets received by the Separate Trusts from Trust will be the same after the division and construction as the basis of those assets before the construction and division. Furthermore, pursuant to § 1223(2) the holding period of each asset in the Separate Trusts will include the holding period of that asset in the hands of Trust.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as 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.

This 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.

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

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 9
(Passthroughs & Special Industries)

Enclosures
Copy for 6110 purposes

cc: