Internal Revenue Service

Number: **201024018**
Release Date: 6/18/2010

Index Number: 2601.00-00, 2601.04-00, 2501.00-00, 1001.00-00, 1015.00-00, 1223.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:4
PLR-140145-09
Date:
March 02, 2010

Grantor =
Bank =
Trust 1 =
Trust 2 =
Trust 1 Sub-trusts =

Trust 2 Sub-trusts =

Date 1 =
Date 2 =
Date 3 =
Merger Agreement =

State 1 Court =

State 2 Court =
State 1 =
State 2 =
State 1 Law 1 =
State 1 Law 2 =
State 2 Law 1 =
State 2 Law 2 =
A =
B =
C =
D =
E =
F =
G =
H =
I =

Dear :

This responds to your letter dated September 1, 2009 requesting a ruling pertaining to the estate, gift, generation-skipping transfer, and income tax effects of a proposed merger of two irrevocable trusts (and respective sub-trusts) created prior to September 26, 1985.

The facts submitted and representations made are as follows. Grantor has five grandchildren, A, B, C, D, and E, all of whom are over the age of twenty-one. F is the daughter of Grantor and the mother of A, B, C, D, and E. G is the spouse of F and father of A, B, C, D, and E. H is the spouse of D. Grantor is deceased. A, B, C, D, and E are alive and each has three children. A has two grandchildren.

On Date 1, a date prior to September 26, 1985, Grantor created an irrevocable trust (Trust 1) for the benefit of A, B, C, D, and E that was immediately divided into five equal separate trusts, one for the benefit of each A, B, C, D, and E (Trust 1 Sub-trusts). F, G, and Bank are the trustees of the sub-trusts created for the benefit of A and C. G, B, and Bank are trustees of the sub-trust created for the benefit of B. G, H, and Bank are trustees of the sub-trust created for the benefit of D. G, E and Bank are trustees of the sub-trust created for the benefit of E.

On Date 2, a date prior to September 26, 1985, Grantor created another irrevocable trust (Trust 2) for the benefit of A, B, C, D, and E that was immediately divided into five equal separate trusts (Trust 2 Sub-trusts) one for the benefit of each A, B, C, D, and E. F, G, and Bank are trustees of the sub-trusts created for A, B, C, and E. G, H, and Bank are trustees of the sub-trust created for the benefit of D. The trustees of the Trust 1 Sub-trusts and the Trust 2 Sub-trusts are collectively referred to as “Trustees.”

Under the terms of Articles I, II, and III of Trust 1, the trustees of the Trust 1 Sub-trusts must accumulate income and add it to principal until the grandchild for whose benefit such sub-trust is held reaches age twenty-one, at which time, the trustees may distribute the income to the beneficiary. Notwithstanding the previous sentence, the trustees may withhold the income and distribute it to a descendant of the grandchild or add it to principal. The trustees have the discretionary authority to distribute principal for a grandchild's or the grandchild's descendant's maintenance and education, accident, illness or other emergencies, to enable such persons to purchase, build or improve a home, to establish a business or profession or to enter into any other financial transaction that the trustees deem to be in the grandchild's or the grandchild's descendant's best interests; provided, however, if any beneficiary is the trustee of the trust established for his benefit, the distribution powers are vested exclusively in the other trustees. The trustees may also terminate the trust and distribute the trust estate to the grandchild if at any time the trustees are of the opinion that the continuance of the trust is neither necessary nor desirable in the interests of the grandchild.

Upon death, each grandchild has the power to appoint his share outright or in trust to any living descendants of Grantor (except to himself, his estate, his creditors, or creditors of his estate), or if there are no living descendants of Grantor, then to any individual or entity. If a grandchild fails to appoint the trust estate, then the trustees must distribute the trust estate in equal shares to the grandchild's living descendants, per stirpes, or if the grandchild has no living descendants, to the living descendants of F; provided, however, if any portion of the trust estate becomes distributable to a grandchild for whose benefit a trust share exists, such portion shall be added to the grandchild's existing trust.

Under Article IV, if a descendant of the grandchild becomes entitled to a fractional share of the trust estate before reaching age thirty, the trustees are authorized to hold such amounts in trust for the benefit of such descendant. The trustees must accumulate income and add it to principal. The trustees have discretion to distribute principal for such beneficiary's maintenance and education. The trust will terminate on the earliest to occur of: (i) the death of the beneficiary, (ii) the beneficiary reaching age thirty, or (iii) the twenty-first anniversary of the death of the last to die of the descendants of Grantor's father living on Date 1. Upon termination, the trustees will distribute the trust estate outright to the beneficiary. If the trust terminates due to the death of the beneficiary, the trustees will distribute the trust estate equally to the living children of the beneficiary, or if there are no living children of the beneficiary, then to the beneficiary's intestate heirs under State 1 law.

Article VI provides that any individual trustee may appoint an additional or successor trustee; provided, however, no more than three individuals may serve as trustee of Trust 1 at any time. Any corporate trustee may be removed, but such removal will not take effect until a successor corporate trustee is appointed to serve.

Under the terms of Articles I, II, and III of Trust 2, the trustees have discretion to distribute principal for the maintenance and education of the grandchild or his descendant, for accident, illness, or other emergencies of the grandchild or his descendant, to enable the grandchild or his descendant to purchase, build or improve a home, to establish a business or profession, or for any other purpose the trustees deem worthwhile and in the best interests of the grandchild or his descendant. The trustees may distribute income to the beneficiary or his descendants or may accumulate income and add it to principal. Furthermore, the trustees may terminate the trust by distributing the principal to the grandchild if at any time the trustees believe the continuance of the trust is neither necessary nor desirable in the interests of the grandchild.

Upon death, each grandchild has the power to appoint his share outright or in trust to any living descendants of Grantor (except to himself, his estate, his creditors, or creditors of his estate), or if there are no living descendants of Grantor, then to any individual or entity. If a grandchild fails to appoint the trust estate, then the trustees must continue to hold the trust estate in one trust for the benefit of the grandchild's living descendants, per stirpes. The trustees have authority to distribute the income in equal shares to the living descendants, per stirpes, or may accumulate income and add it to principal. The trustees also have discretion to distribute principal to the descendants for the same purposes as set forth above for a grandchild's trust. The trust estate will terminate on the death of the last to die of the descendants. Upon termination, the trustees will then divide and distribute the remaining trust estate into the number of equal shares necessary to provide one such share with respect to each trust originally created for each grandchild. Notwithstanding the above, all trusts will terminate on the twenty-first anniversary of the death of the last to die of the descendants of Grantor who were living on Date 1, and the trustees will distribute the trust estate to the persons in equal shares, per stirpes, for whose primary benefit the trust is held.

Article IV of Trust 2 provides that in the event any property becomes distributable to a person under the age of thirty, the trustees are authorized to retain such property in trust for the benefit of such person. The trustees may distribute principal for the maintenance and education of such person, and must accumulate income and add it to principal. The trust will terminate upon the earlier to occur of the death of such person or such person reaching age thirty. Upon termination, the trustees shall distribute the principal to such person, or if the trust terminates due to the person's death, shall distribute the principal in equal shares to the person's living children, or if the person has no living children, in equal shares to the living descendants, per stirpes, of the most immediate ancestor of such person who is Grantor or any descendant of Grantor who has living descendants.

Finally, Article VI of Trust 2 states that if any portion of the trust estate is not disposed of pursuant to any other provision of the trust document, then the trustees must distribute the trust estate to I.

Article VIII of Trust 2 provides that the individual trustees, or if no individual trustees are serving, then the majority of Grantor's living children over the age of eighteen, or if none, the majority of Grantor's living grandchildren over the age of eighteen, may appoint successor trustees of the trusts. Notwithstanding the previous sentence, Grantor may not be appointed as trustee, not more than one corporation and three individual trustees may serve as trustees of the trusts at any one time, and in the event that a successor trustee must be appointed after a corporate trustee is removed, then if any one or more of the persons appointing the successor trustee is also a beneficiary of such trust, then any trustee appointed to replace the removed trustee may not be a person who would be a related or subordinate party with respect to such beneficiary (as defined under § 672 of the Code). Furthermore, any person authorized to appoint a successor trustee is authorized to remove a corporate trustee. Only F may remove individual trustees.

State 1 Law 1 provides that a trustee who has the absolute discretion to invade the principal of a trust for the benefit of "one or more proper object of the exercise of the power," may exercise such discretion by appointing all or part of the principal of the trust in favor of a trustee of another trust, provided that the exercise of such discretion (A) does not reduce any fixed income interest of any income beneficiary of the trust, (B) is in favor of the proper objects of the exercise of the power, and (C) does not violate the limitations of State 1 Law 2.

State 2 Law 1 provides that interested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust, provided that the matters agreed to do not violate a material purpose of the trust and include terms and conditions that could be properly approved by a court. State 2 Law 2 provides that after notice to the beneficiaries, a trustee may combine two or more trusts into a single trust, if the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes of the trust. Two or more trusts may be combined into a single trust if the interests of each beneficiary in the trust resulting from the combination are substantially the same as the combined interests of the beneficiary in the trusts prior to the combination.

Trustees represent that on Date 3, pursuant to State 1 Law 1, the parties agreed to administrative modifications to Trust 2. One of the modified terms authorizes the trustees to merge the assets of a trust estate into a single trust estate, provided that in all respects deemed material by the trustees, the trust estates to be combined are held on the same terms and conditions and for the benefit of the same beneficiaries.

Also on Date 3, pursuant to State 1 Law 1 and State 2 Law 2, the Trustees executed Merger Agreement, which proposes to merge Trust 1 and Trust 2, effectively merging the Trust 1 Sub-trust created for the benefit of A, B, C, D, and E into the respective Trust 2 Sub-trust created for such beneficiary. The purpose of the proposed merger is

for administrative convenience and greater efficiency of management and investment of the trust property. Currently, ten sub-trusts exist, and after the proposed mergers, five sub-trusts will exist. The proposed merger will allow each merged trust to be governed by one trust document, which will reduce the cost of administrative expenses such as tax compliance, accounting costs, and management fees. State 1 Court approved Merger Agreement and State 2 Court approved both the modifications to Trust 2 and the merger of the trusts. However, each court conditioned its approval on the receipt of a favorable ruling by the Internal Revenue Service that the proposed mergers will not subject Trust 1 or Trust 2 to the GST tax.

Under section 1 of the Merger Agreement, the provisions of Trust 2 will govern the merged trust except for the following provisions.

(1) Upon the termination of a merged trust for the benefit of a grandchild, in the event the grandchild has not exercised his power of appointment granted with respect thereto, the fractional portion of the merged trust attributable to Trust 1 shall be distributed according to the terms of Trust 1 as if the merger had not occurred, and the fractional portion of the merged trust attributable to Trust 2 shall be distributed according to the terms of Trust 2 as if the merger had not occurred.

(2) In the event any property passing to a beneficiary under the age of thirty is retained by the trustee in trust for such person, then in the event of the death of the beneficiary before receiving all trust assets, if the beneficiary has no living children, the fractional portion of the merged trust attributable to Trust 1 shall be distributed according to the terms of Trust 1 as if the merger had not occurred, and the fractional portion of the merged trust attributable to Trust 2 shall be distributed according to the terms of Trust 2 as if the merger had not occurred.

(3) If any merged trust has not terminated prior to the twenty-first anniversary of the death of the last to die of the descendants of Grantor's father living on Date 1, then the fractional portion of the merged trust attributable to Trust 1 shall terminate on such anniversary and the principal shall be distributed according to the terms of Trust 1 as if the merger had not occurred. Similarly, if any merged trust has not terminated prior to the twenty-first anniversary of the death of the last to die of the descendants of Grantor living on Date 1, then the fractional portion of the merged trust attributable to Trust 2 shall terminate on such anniversary and the trustees shall distribute the principal thereof to the person (or persons, in equal shares per stirpes) for whose benefit such trust is being held.

Trustees represent that no additions have been made to either Trust 1 or Trust 2 after September 25, 1985.

Requested Rulings

1. Trust 1 and Trust 2 (and the respective sub-trusts) are currently exempt from the GST tax under § 2601 Internal Revenue Code (Code).

2. The proposed merger of Trust 1 and Trust 2 (and the respective sub-trusts) will not cause any distributions from the merged trusts or distributions upon termination of the merged trusts to become subject to GST tax provided there are no post-merger additions to the merged trusts.

3. The proposed mergers will not result in a transfer by any of the beneficiaries that is subject to gift tax under § 2501.

4. No gain or loss will be recognized under § 1001 upon the proposed merger.

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

Ruling 1

Section 2601 of the Code imposes a tax on each generation-skipping transfer.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means with respect to any generation-skipping transfer, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(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).

Trusts A and B were in existence and funded prior to September 26, 1985. Trustees represent that no additions have been made to the principal of either trust after September 25, 1985. Accordingly, based on the facts presented and representations made, we conclude that Trust 1 and Trust 2 (and the respective sub-trusts) are exempt from the GST tax under § 2601.

Ruling 2

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under §§ 26.2601-1(b)(1), (2) or (3) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy §§ 2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the 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. Furthermore, 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 a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), Example 6, considers a situation where the grantor, in 1980, establishes an irrevocable trust for Grantor's child and the child's issue. In 1983, Grantor's spouse also established a separate irrevocable trust for the benefit of the same child and issue. The terms of the spouse's trust and Grantor's trust are identical. In 2002, the appropriate local court approved the merger of the two trusts into one trust to save administrative costs and enhance the management of the investments. The merger of the two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the merger. In addition, the merger does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the example concludes that the trust that resulted from the merger will not be subject to the provisions of chapter 13.

The instant case involves facts that are similar to Example 6 in § 26.2601-1(b)(4)(i)(E) except that certain dispositive provisions, remainder beneficiaries, and perpetuities periods differ in Trust 1 and Trust 2. These differences, however, are accounted for in Merger Agreement, which provides that to the extent the trust provisions differ the fractional portion of the principal of the merged trust attributable to each original trust will be administered in accordance with the original trust documents. The rules in § 26.2601-1(b)(4)(i) apply in the case of trusts that are exempt from GST tax because the trusts were in existence and irrevocable prior to September 26, 1985.

Based on the facts presented and the representations made, we conclude that the merger of Trust 1 and Trust 2, as described above, will not shift any beneficial interest in the trusts 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. In addition, the consolidation of trusts will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in Trust 1 or Trust 2.

Accordingly, based on the information submitted and the representations made, we conclude that the proposed merger of Trust 1 and Trust 2 (and the respective sub-trusts) will not affect the grandfathered status of these trusts and will not cause any distributions from the merged trust or distributions upon termination of the merged trust to become subject to GST tax provided there are no post-merger additions to the merged trust.

Ruling 3

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by an individual, resident or nonresident. Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 2512(a) provides that, if a gift is made in property, the value thereof at the date of the gift will be considered the amount of the gift. Section 2512(b) states that where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration received shall be deemed a gift.

Based on the facts submitted and the representations made, the beneficial interests of the trust beneficiaries will not change as a result of the proposed merger of Trust 1 and Trust 2 as described above. Accordingly, based upon the facts provided and the representations made, we rule that the proposed merger of Trust 1 and Trust 2 will not result in a transfer by any of the beneficiaries that is subject to federal gift tax under § 2501.

Ruling 4

Section 61(a) of the Code defines gross income as "all income from whatever source derived." Under section 61(a)(3), gross income includes "[g]ains 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 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 of the Code, 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.

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). In Cottage Savings, the Supreme Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Id. at 566. 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' to the Internal Revenue Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent." Id. at 565.

The income and principal distribution provisions of Trust 1 and Trust 2 are substantially identical. The two trusts differ in minor ways. The merger agreement recognizes these minor differences and provides that, should the differences between the two trusts arise, the trusts will be construed in accordance with their original terms. With this provision, the legal entitlements of the beneficiaries are not affected by the merger. The beneficiaries' interests in the merged trust will not differ in kind or extent from what they enjoyed under Trust 1 and Trust 2. The proposed merger of Trust 1 and Trust 2 is not an exchange of properties that are materially different from one another.

Based on the facts presented and the representations made, we conclude that the proposed merger of Trust 1 and Trust 2 will not result in the recognition of gain or loss to either the merged trust or any beneficiary thereof under §§ 61 and 1001.

Ruling 5

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

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

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

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

Section 1223(2) provides that in determining the period for which the taxpayer has held property, however acquired, there shall be included the period for which such property was held by any other person, if under Chapter 1 of the Code such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person.

In this case, neither § 1001 nor § 61 applies to the proposed transaction.
Thus, based upon the facts provided and the representations made, we rule that the assets of each merged trust will have the same basis under § 1015 and holding period under §1223 both before and after the proposed merger.

Furthermore, 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 ruling(s) 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) 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 representative.

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.

Sincerely,

James F. Hogan
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: Copy for § 6110 purposes

cc: