

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-143227-02

Date:

JANUARY 29, 2003

In Re:

Legend

Wife =

Husband =

Son =

Trust 1 =

Wife's Trust Agreement =

Trust 2 =

Husband's Trust Agreement =

Trust 3 =

Irrevocable Trust Agreement =

Date 1 =

Date 2 =

State =

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Dear _____ :

This responds to a letter dated June 25, 2002, and subsequent correspondence, requesting rulings regarding the income, gift, and generation-skipping transfer (GST) tax consequences of the proposed consolidation of certain trusts.

FACTS

The facts submitted and representations made are as follows. Wife died before Husband, on Date 1. Trust 1 was established upon the Date 2 death of Husband under Wife's Trust Agreement, a revocable trust agreement. Trust 2 was established upon the Date 2 death of Husband under Husband's Trust Agreement, a revocable trust agreement. Trust 3 was established upon the death of Husband under Irrevocable Trust Agreement executed by Husband and Wife as settlors.

The dispositive provisions of Trusts 1, 2, and 3 are identical. The trustee of each trust must distribute, at least annually, 80 percent of the income of the trust to the son of Wife and Husband (Son) or, unless the principal of the trust is appointed by Son during his life or at his death under a special power of appointment granted him, per stirpes to the issue of Son. The trustee must distribute principal for the proper health, education, maintenance, and support of Son or of Son's issue, unless the principal of the trust is appointed by Son during his life or at his death under the special power of appointment granted him.

Each of the three trusts contains the following termination provision:

Subject to the possible exercise of that power of appointment [granted to Son or the issue of Son, if Son is deceased], the trusts established hereunder shall terminate on the later of (a) twenty-one (21) years after the death of the last survivor of such of the issue of Settlor who are living at Settlor's death and beneficiaries of the trust to be terminated, or (b) 90 years after Settlor's death. The foregoing alternate conditions shall be applied using the [State] Uniform Statutory Rule Against Perpetuities law and rules of construction, as amended. However, if the Internal Revenue Service or state law hereafter limits the generation-skipping tax exemption available to this trust to a shorter period of perpetuities limitation than [State] law permits, the shorter limitations period shall apply so to preserve the limitation. Upon termination, the entire principal and income shall be distributed per stirpes to the issue of [Son].

Son is currently serving as trustee of Trusts 1, 2, and 3.

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For administrative convenience, the trustee proposes to consolidate Trusts 2 and 3 into Trust 1 (the consolidated trust). The consolidated trust will be administered under the terms of Trust 1. Trust 1 will receive all of the assets and liabilities of Trusts 2 and 3.

As a result of the termination provisions in the trust instruments, the eventual termination dates of Trusts 1, 2, and 3 may differ. Therefore, at the time the assets of Trusts 2 and 3 are merged into Trust 1, the value of each of Trust 1, Trust 2, and Trust 3 will be established in order to comprise a proportionate percentage of the entire combined trust's initial value. Upon the date of consolidation, the value of each of the three trusts will be established and recorded by the trustee. Thus, should separation of the consolidated trust ever become necessary, the amount to be separated will be determined as follows. The date of separation value of the consolidated trust will be multiplied by a fraction, the numerator of which will be the date of consolidation fair market value of the applicable original trust, and the denominator of which will be the date of consolidation fair market value of the consolidated trust.

The trust instruments governing Trusts 1, 2, and 3 expressly permit consolidation of each trust with other trusts created by Husband or Wife with the same beneficiaries, trustee, and dispositive provisions. You represent that, under the law of State, the trustee is not required to seek court approval to consolidate the trusts.

You represent that the assets of the three trusts consist of cash, marketable securities and real estate. Trusts 1, 2, and 3 became irrevocable after September 25, 1985. You represent that each of these three trusts has an inclusion ratio of zero due to the following allocations of Husband's and Wife's GST exemptions. During their lives, Husband and Wife each allocated GST exemption on Forms 709, United States Gift (& Generation-Skipping Transfer) Tax Return, to their transfers to Trust 3. On Wife's Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, Wife's executors allocated Wife's GST exemption to the reverse qualified terminable interest trust and the credit shelter trust which funded Trust 1 at Husband's death. Husband's executors allocated Husband's GST exemption to Trust 2 on Husband's Form 706. There have been no other additions or contributions to any of the trusts which would result in any of the trusts having an inclusion ratio other than zero.

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You have requested the following rulings:

1. The consolidation of Trusts 2 and 3 into Trust 1 will not subject Trusts 1, 2 or 3 or any distributions from Trusts 1, 2 or 3, to the GST tax.
2. The consolidation of Trusts 2 and 3 into Trust 1 will not constitute an actual or constructive addition to any of the trusts for purposes of the GST tax.
3. Following the consolidation of Trusts 2 and 3 into Trust 1, Trust 1, will be exempt from the GST tax.
4. The consolidation of Trusts 2 and 3 into Trust 1 will not cause any beneficiary of a trust or any beneficiary of the consolidated trust to have made a taxable gift for federal gift tax purposes.
5. The consolidation of the trusts will not cause any trust, including the consolidated trust, to recognize any gain or loss from the sale or other disposition of property under § 61 or § 1001.
6. Pursuant to § 1015, the basis of the consolidated trust in each asset received from a trust will be the same as the transferring trust's basis in such asset.
7. Pursuant to § 1223(2), the holding period of each asset transferred to Trust 5 will include the holding period for which the property was held by the transferring trust.

LAW AND ANALYSIS

Generation-Skipping Transfer Tax Ruling Requests Nos. 1, 2, and 3

Section 2601 of the Internal Revenue Code imposes a tax on each generation-skipping transfer which includes under § 2611(a) a taxable distribution, a taxable termination, and a direct skip.

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 the tax imposed by § 2601 is (1) the taxable amount (determined under subchapter C), multiplied by (2) the applicable rate (determined under subchapter E).

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Section 2641 provides that the term “applicable rate” means, with respect to any generation-skipping transfer, the product of (1) the maximum Federal estate tax rate, and (2) the inclusion ratio with respect to the transfer.

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

Section 2642(a) provides that the inclusion ratio is the excess, if any, of 1 over the applicable fraction determined for the trust from which the transfer is made, or in the case of a direct skip, the applicable fraction determined for the skip. The applicable fraction is a fraction in which the numerator 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 the skip, and the denominator is the value of the property transferred to the trust or transferred in the direct skip, reduced by any Federal estate tax or State death tax actually recovered from the trust attributable to the property and any charitable deduction allowed under §§ 2055 and 2522 with respect to the property.

Section 26.2654-1(a)(2)(i) of the Generation-Skipping Transfer Tax Regulations provides that, if there is more than one transferor with respect to a trust, the portions of the trust attributable to the different transferors are treated as separate trusts for purposes of chapter 13.

It is represented that Trusts 1, 2, and 3 each have an inclusion ratio of zero due to allocations of Wife’s and Husband’s GST exemptions to the respective trusts. There have been no other additions or contributions to any of the trusts. As a result, the inclusion ratio of each trust prior to the consolidation is zero. Therefore, subsequent to the consolidation, the portion of the consolidated trust attributable to Wife and the portion of the consolidated trust attributable to Husband will be treated as separate trusts for purposes of chapter 13 and each portion will have a zero inclusion ratio for purposes of § 2601.

Therefore, based on the facts submitted and representations made, we conclude:

1. The consolidation of Trusts 2 and 3 into Trust 1 will not subject Trusts 1, 2 or 3 or any distributions from Trusts 1, 2 or 3, to the GST tax.
2. The consolidation of Trusts 2 and 3 into Trust 1 will not constitute an actual or constructive addition to any of the trusts for purposes of the GST tax.

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3. Following the consolidation of Trusts 2 and 3 into Trust 1, Trust 1, will be exempt from the GST tax.

Gift Tax Ruling Request No. 4

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 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(a) provides that, if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

In this case, the interest of each beneficiary will remain the same after the proposed consolidation of Trusts 1, 2, and 3 as it was prior to the proposed transaction. Accordingly, based on the facts submitted and the representations made, we conclude that the consolidation of Trusts 2 and 3 into Trust 1 will not cause any beneficiary of a trust or any beneficiary of the consolidated trust to have made a taxable gift for federal gift tax purposes.

Income Tax Ruling Requests Nos. 5, 6, and 7

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that gain from the sale or other disposition of property is the excess of the amount realized therefrom over the adjusted basis provided in § 1001 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 exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations generally provides 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 property interest. Such an exchange of property is a disposition under § 1001(a). See § 1.1001-1.

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An exchange of property results in a realization event under § 1001(a) if the properties exchanged are materially different. Cottage Savings Ass'n v. Commissioner, 499 U.S. 566 (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.

Section 1015(b) provides 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 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 under Chapter 1 of the Code such property has, for the purposes 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.

Based on the information submitted and the representations made, the trusts are to be combined for administrative convenience and efficiency. Each beneficiary is entitled to the same income and remainder interests in the assets of the trusts both before and after the proposed consolidation. Thus, the interests of the beneficiaries in Trust 1, Trust 2, and Trust 3 will not differ materially from their interests in the consolidated trust (Trust 1), and there will be no sale or other disposition of property as a result of the consolidation. Accordingly, we conclude:

5. The consolidation of the trusts will not cause any trust, including the consolidated trust, to recognize any gain or loss from the sale or other disposition of property under § 61 or § 1001.

6. Pursuant to § 1015, the basis of the consolidated trust in each asset received from a trust will be the same as the transferring trust's basis in such asset.

7. Pursuant to § 1223(2), the holding period of each asset transferred to Trust 5 will include the holding period for which the property was held by the transferring trust.

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 rulings contained in this letter are based upon information and representations submitted by the trustee and accompanied by a penalty of perjury

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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.

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,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

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