

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200532042**

Release Date: 8/12/2005

Index Number: 61.00.00-00, 1001.00-00,  
2601.00-00

Person To Contact:

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Refer Reply To:

CC:PSI:B04 – PLR-169991-03

Date: APRIL 20, 2005

In Re:

**Legend:**

Husband =

Date 1 =

Wife =

Daughter =

Daughter's Spouse =

Grandchild 1

Grandchild 2

Husband's Will =

Trust 1 =

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Date 2 =

Wife's Will =

Trust 2 =

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Date 3 =  
Husband's Brother =  
Foundation =  
Charity 1 =  
Charity 2 =

Bank 1 =  
Bank 2 =  
Great Grandchild 1 =  
Great Grandchild 2 =  
Great Grandchild 3 =  
Great Grandchild 4 =  
Great Grandchild 5 =  
State =

Date 4 =  
Compromise Agreement =

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Date 5 =  
Agreement =  
Bank 3 =

Individual =  
Date 6 =

Date 7 =  
Court =

Date 8 =  
State's Unitrust Statute =

Dear \_\_\_\_\_ :

This is in response to a letter dated December 2, 2004, and other correspondence, requesting rulings regarding the income and generation-skipping transfer (GST) tax consequences of a modification of a trust under a Compromise Agreement and other proposed modifications of the trust.

## Facts

The facts submitted and representations made are as follows. Husband died testate on Date 1 prior to September 25, 1985, survived by Wife, Daughter, Daughter's Spouse, Grandchild 1, and Grandchild 2, the two children of Daughter and Daughter's Spouse.

Husband's Will provided that the residue of his estate was to be placed in two trusts, "Trust Fund A," over which Wife held a testamentary general power of appointment, and "Trust Fund B" (currently operating as Trust 1). Wife died testate on Date 2 prior to September 25, 1985, survived by Daughter, Daughter's Spouse, Grandchild 1, and Grandchild 2. In Wife's Will, Wife bequeathed her residuary estate to Trust 2, a revocable trust created by Wife during her lifetime. In addition, Wife exercised her power of appointment over Trust Fund A by appointing the Trust Fund A corpus to Trust 2. No additions have been made to Trusts 1 and 2 after September 25, 1985.

Item VII. of Husband's Will provides the terms of Trust 1. Upon Husband's death, the trustees were to pay nominal monthly annuities to five specified household employees under specified conditions. The balance of the net income of Trust 1 ("Net Income") was to be distributed one-half to Wife, one-fourth to Daughter, and one-fourth in equal shares to Grandchild 1 and Grandchild 2.

Item VII.1.A.(1) of Husband's Will provides for the distribution of Wife's one-half share of the Net Income after Wife's death as follows:

(1) Should my wife [Wife] predecease me or die during the term of the trust and leave surviving her my daughter [Daughter] and any grandchild or grandchildren or the descendants of any deceased grandchild or grandchildren of mine, the one-half (1/2) of the balance of the net income which would have been payable to my wife shall be distributed one-fourth (1/4) to my daughter and one-fourth (1/4) to or for the benefit of my grandchildren, or their descendants, per stirpes.

Item VII.1.B. provides for the payment of the one-fourth share of Net Income Daughter became entitled to receive at Husband's death as follows:

The Trustee shall currently at the end of each quarter pay to my daughter [Daughter], if she survives me, one-fourth (1/4) of the balance of net income from this trust for and during the term of her natural life.

Item VII.1.B. (2) provides for the payment, after Daughter's death, of that one-fourth share of Net Income as follows:

(2) Should my daughter [Daughter] predecease me or die during the term of this trust and leave surviving her a grandchild or grandchildren, or the descendants of any deceased grandchild or grandchildren of mine, then my Trustee is directed to pay to or for the benefit of my grandchildren or their descendants, per stirpes, the one-fourth (1/4) of the balance of net income which would have been distributable to my daughter [Daughter].

Item VII.1.C.(4) provides that, if any of Husband's grandchildren predecease Husband or die during the term of Trust 1 and leave surviving issue, then the one-fourth share of Net Income that would have been distributable to Husband's grandchildren will be paid in equal shares, per stirpes and not per capita, to or for the benefit of Husband's surviving grandchildren and the descendants of any deceased grandchild of Husband.

Item VII.1.C.(5) provides that if any of Husband's grandchildren survive Wife and Daughter but die during the term of Trust 1 leaving surviving issue, then upon the death of any such grandchild of Husband, all of the Net Income of Trust 1 will be paid in equal shares, per stirpes and not per capita, to or for the benefit of Husband's surviving grandchildren and the descendants of any deceased grandchild of Husband, but not for longer than 21 years.

Item VII.1.C.(6) provides that if any of Husband's grandchildren survive Wife and Daughter but die during the term of Trust 1 leaving no surviving issue, then the Net Income of Trust 1 will be paid to Daughter's Spouse, if he is then living, for his life and at his death will be paid to Husband's Brother, if he is then living, for his life.

Item VII.2. provides for the termination and distribution of Trust 1 as follows:

2. The trust herein created shall continue in full force and effect not longer than during the lifetime of [Wife]; [Daughter]; [Daughter's Spouse]; [Husband's Brother]; and any grandchild or grandchildren of [Husband] living at the time of [Husband's] death, plus twenty-one (21) years. Upon the death of the last survivor of [Wife]; [Daughter]; [Daughter's Spouse]; [Husband's Brother]; and any grandchild or grandchildren of [Husband] living at the time of [Husband's] death, this trust shall terminate and the title to all of the trust property in this [Trust 1] thereupon shall vest immediately in fee simple in the persons then entitled to receive the income therefrom and in the proportions in which they are entitled to such income, and thereupon the Trustee shall immediately pay over and deliver the trust property to the persons entitled thereto.

Item VII.2. further provides that if [Daughter] dies without surviving issue, or if all of Daughter's issue die before Trust 1 terminates, then when Trust 1 terminates, the trustee of Trust 1 will set aside all of the assets of Trust 1 to be used to establish

Foundation. One-half of the income of Foundation is to be paid to Charity 1 and one-half to Charity 2.

Item VII.3. provides that if any person entitled to share in the Net Income of Trust 1 requires hospitalization or any kind of unusually expensive medical attention and if, in the trustee's opinion, the beneficiary is not financially able to pay the expense, then the trustee in its uncontrolled discretion shall pay from income or principal amounts that may be necessary to provide proper medical care and hospitalization.

Bank 1 was named as the original trustee of Trust 1. Each successor trustee must be a trust company or bank with trust powers, subject to the supervision of a federal agency or instrumentality, having unimpaired and paid up capital of not less than \$1 million.

Daughter died on Date 3, survived by Daughter's Spouse, Grandchild 1 and Grandchild 2. At Daughter's death, a question arose regarding the proper disposition of the one-fourth share of Net Income Daughter acquired under Item VII.1.A.(1) at Wife's death. Neither Item VII.1.A. nor Item VII.1.B provide for the disposition of that interest. Item VII.1.B provides that the one-fourth share of Net Income that passed directly to Daughter upon Husband's death was payable "for and during the term of [Daughter's] natural life." That one-fourth interest clearly passed, under Item VII.1.B.(2), to Grandchild 1 and Grandchild 2 and their descendants upon Daughter's death. However, Item VII.1.A.(1) does not limit the duration of Daughter's one-fourth interest in Wife's share of Net Income; and Item VII.1.A. contains no provision concerning the disposition at Daughter's death of Daughter's interest, under Item VII.1.A.(1), in Wife's share of Net Income.

On Date 4, after September 25, 1985, Compromise Agreement was executed regarding the disposition of the one-fourth share of Net Income Daughter acquired under Item VII.1.A.(1) at Wife's death and the underlying principal of that one-fourth share (referred to as the "Disputed Share"). Compromise Agreement was signed by Bank 2 (a successor in interest of Bank 1), as trustee of Trust 1 and executor of Husband's Will; Daughter's Spouse; Grandchild 1, individually and as parent of Great Grandchild 1, then a minor; Grandchild 2, individually and as parent of Great Grandchild 2, Great Grandchild 3, Great Grandchild 4, and Great Grandchild 5, then minors. The parties did not seek judicial approval of the agreement nor were guardians ad litem appointed for the minor and unborn descendants of the parties to the agreement. Foundation had not been established. Charity 1 and Charity 2 were not parties to the agreement. Neither Foundation nor the two charities were represented by any party to the agreement.

Under the Compromise Agreement, after Daughter's death, Daughter's Spouse is to receive the disputed one-fourth interest in the Net Income of Trust 1 during his life. At his death, this one-fourth interest in the Net Income of Trust 1 will be distributed to

Grandchild 1 and Grandchild 2, or their surviving descendants, per stirpes, for and during their natural lives and until Trust 1 terminates. On termination of Trust 1, the principal of the Disputed Share is to be distributed, under Item VII.2. of Husband's Will.

In accordance with the Compromise Agreement, since Daughter's death, one-fourth of the Net Income of Trust has been distributed to Daughter's Spouse. The other three-fourths of the Net Income has been paid, in accordance with the terms of Trust 1, in equal shares, to Grandson 1 and Grandson 2.

Husband's Brother predeceased Daughter. Daughter's Spouse, Grandchild 1, and Grandchild 2 are still living. Grandchild 1's one child, Great Grandchild 1, is now an adult. Grandchild 2 now has two adult children, Great Grandchild 2 and Great Grandchild 3, and two children who are still minors, Great Grandchild 4 and Great Grandchild 5.

On Date 5, Agreement was executed. Agreement incorporates by reference, and clarifies, the terms of Compromise Agreement. Agreement states that under Compromise Agreement the Net Income of the Disputed Share is to be paid to Daughter's Spouse for life, and at his death is to be paid in equal shares to Grandchild 1 and Grandchild 2 or their surviving issue, per stirpes, until Trust 1 terminates. Upon termination of Trust 1, the corpus of the Disputed Share is to be distributed as provided in Article VII. 2. of Husband's Will. Agreement was signed by Bank 3 (a successor in interest of Bank 1), as the trustee of Trust 1; Daughter's Spouse, Grandchild 1 and Grandchild 2, as the current income beneficiaries of Trust 1; Great Grandchild 1, Great Grandchild 2 and Great Grandchild 3, as the adult contingent income and remainder beneficiaries of Trust 1; Individual, as guardian ad litem for the minor, unborn, and not-yet-adopted contingent income and remainder beneficiaries of Trust 1; and Charity 1 and Charity 2.

Further, Agreement makes three modifications to Trust 1. First, under Agreement as amended by the parties (the "Amendment"), the right of the income beneficiaries to receive the trust Net Income will be converted, pursuant to State's Unitrust Statute, into the right to receive proportionate shares of a unitrust amount, the Total Annual Return Amount. The Total Annual Return Amount is computed by multiplying: (A) a fraction, the numerator of which is the sum of the fair market values of the trust corpus on the first business day of the current calendar year and on the first business days of the immediately preceding two calendar years (less any trust liabilities for such preceding years, including any undistributed amounts of income attributable to such preceding years) and the denominator of which will be three; by (B) 4.25 percent. However, for the first two calendar years, the Total Annual Return Amount will be 4.25 percent of the fair market value of the trust corpus on the first business day of the current calendar year.

Second, under Agreement, the provision designating Foundation as the final contingent remainder beneficiary will be changed to provide that the corpus will be paid directly to Charity 1 and Charity 2.

Third, Agreement creates an investment advisory committee that will approve or reject the trustee's recommendations regarding investment decisions. The trustee must notify the committee of a proposed action and the committee must respond within a specified time. If the committee does not respond, the trustee may proceed with the proposed action. However, the trustee may sell assets without being subject to these notification and approval requirements to the extent necessary to pay the Total Annual Return Amount, authorized trustee fees, and other reasonable trust expenses. The committee can also direct the trustee to buy, sell, exchange, or retain assets but the trustee need not follow these directions. The initial committee will be comprised of Daughter's Spouse, Grandchild 1 and Grandchild 2.

On or about Date 6, Bank 3, as trustee, filed a petition with the Court requesting the Court to issue an order granting approval of Compromise Agreement and the modifications to Trust 1 under Agreement (before the Amendment), conditioned upon the trustee's receipt of a favorable private letter ruling from the Internal Revenue Service. Each of the parties to the Agreement received notice of the petition and consented to the request. On Date 7, Court issued the requested order.

On Date 8, Court issued an order restating the conditional Date 7 order and clarifying it by adding the following:

[Compromise Agreement] was entered into to correct a scrivener's error resulting in ambiguity in [Trust 1], and is hereby approved retroactively to [Date 4], and all actions heretofore taken by the parties thereto in connection therewith are hereby approved and ratified . . .

It is represented that Bank 3, as trustee, will file a petition with the Court requesting the Court to issue an order granting approval of the modification to Trust 1 under the Amendment to Agreement. Each of the parties to the Agreement and the Amendment will receive notice of the petition and consent to the request.

The taxpayers have requested the following rulings:

1. Compromise Agreement will not cause Trust 1 to lose its status as a trust that is exempt from the generation-skipping transfer (GST) tax by reason of § 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.

2. Compromise Agreement will not cause any portion of the property comprising the Disputed Share to be included in the gross estate of any party to Compromise

Agreement for federal estate tax purposes under §§ 2033 or 2036 of the Internal Revenue Code except to the extent of property that is distributed to that party and remaining in that party's estate at the party's date of death.

3. The proposed modifications to Trust 1 under Agreement and the Amendment will not cause Trust 1 to lose its status as a trust that is exempt from the GST tax by reason of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i).
4. The proposed modifications to Trust 1 under Agreement and the Amendment will not cause the beneficiaries of Trust 1 or the trust to realize gain or loss or income under §§ 61 or 1001.
5. Ruling Requests #1 and 3:

Section 2601 imposes a tax on each 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. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under §§ 2038 or 2042, if the settlor had died on September 25, 1985.

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 generally applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Unless noted otherwise, 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 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. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount



of a GST transfer or the creation of a new GST transfer. 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 to shift a beneficial interest in the trust. In addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of § 1.643(b)-1 of the Income Tax Regulations. Section 1.643(b)-1 provides that for purposes of determining the meaning of the term income as used in various Internal Revenue Code sections relating to the income taxation of trusts, an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year. Under the regulation, a state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust.

Section 26.2601-1(b)(4)(i)(E), Example 7, involves a trust that is irrevocable on or before September 25, 1985, under which trust income is to be distributed equally to A, B, and C, who are skip persons assigned to the same generation. The trust is amended to increase A's share of trust income. The example concludes that the modification does not shift a beneficial interest to a lower generation beneficiary, because the modification does not increase the amount of a GST transfer under the original trust or create the possibility that new GST transfers not contemplated in the original trust may be made. In addition, 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. Accordingly, the trust as modified will not be subject to chapter 13. The example concludes, however, that under the facts presented the modification increasing A's share of trust income is a transfer by B and C to A for federal gift tax purposes.

Section 26.2601-1(b)(4)(E), Example 11, considers a situation where a trust administered under the laws of State X, that is otherwise exempt from the GST tax, provides that trust income is payable to A for life and, upon A's death, the remainder is to pass to A's issue, per stirpes. In 2002, the State X amends its income and principal statute to define income as a unitrust amount of 4% of the fair market value of the trust assets valued annually. For a trust established prior to 2002, the statute provides that the new definition of income will apply only if all the beneficiaries who have an interest in the trust consent to the change within two years after the effective date of the statute. The statute provides specific procedures to establish the consent of the beneficiaries. A and A's issue consent to the change in the definition of income within the time period,

and in accordance with the procedures, prescribed by the state statute. The example concludes that administration of the trust, in accordance with the state statute defining income to be a 4% unitrust amount, will not be considered to shift any beneficial interest in the trust. Therefore, the trust will not be subject to the provisions of chapter 13 of the Internal Revenue Code. Further, the example states that, under these facts, no trust beneficiary will be treated as having made a gift for federal gift tax purposes, and neither the trust nor any trust beneficiary will be treated as having made a taxable exchange for federal income tax purposes. Finally, the example states that the conclusions in this example would be the same if the beneficiaries' consent was not required, or, if the change in administration of the trust occurred because the situs of the trust was changed to State X from a state whose statute does not define income as a unitrust amount or if the situs was changed to such a state from State X.

In the present case, Trust 1 was irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, were made to Trust 1 after that date.

The modification of Trust 1 under Compromise Agreement, pursuant to which the income from the Disputed Share will be paid to Daughter's Spouse during his lifetime, did not shift a beneficial interest in Trust 1 to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest before the execution of Compromise Agreement. In addition, the modification did not extend the time for vesting of any beneficial interest in Trust 1 beyond the period provided for in Trust 1. After the execution of Compromise Agreement, Trust 1 terminates on the same date on which the trust would have terminated before Compromise Agreement was executed, and all interests in Trust 1 vest on the same date as they would have before Compromise Agreement was executed. Accordingly, based on the facts submitted and the representations made, we conclude that Compromise Agreement did not cause Trust 1 to lose its status as a trust that is exempt from the generation-skipping transfer (GST) tax by reason of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i). See § 26.2601-1(b)(4)(i)(E), Example 7.

Regarding the modification under Agreement converting the annual distribution to be made to the trust beneficiaries from Net Income to a unitrust amount, State's Unitrust Statute generally authorizes the conversion of an "income trust" (a trust that describes the amount to be distributed to a beneficiary by referring to the trust's income) to a "total return unitrust," generally, a trust that pays out a unitrust amount computed as a percentage of the fair market value of the trust. The unitrust rate, that is, the percentage of the fair market value of the trust to be distributed, must be no less than 3 percent and no more than 5 percent. In the present case, the trustee, the beneficiaries, and the guardian ad litem for minor, unborn, and not-yet-adopted contingent income and remainder beneficiaries of the trust have agreed in writing to the conversion of the trust from an income trust into a 4.25 percent unitrust. Further, the trustee will petition the appropriate state probate court for approval of this conversion. In the instant case,

State's Unitrust Statute meets the requirements of §1.643(b)-1. Therefore, in accordance with § 26.2601-1(b)(4)(i)(D), the conversion and administration of the trust pursuant to State's Unitrust Statute, as described above, 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. See § 26.2601-1(b)(4)(i)(E), Example 11.

Finally, the proposed modification substituting Charity 1 and Charity 2 for Foundation as contingent remainder beneficiaries does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation 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. The modification creating an investment advisory committee is administrative in nature.

Accordingly, based on the facts submitted and the representations made and provided the proposed conversion meets the requirements of State's Unitrust Statute, we conclude that the proposed modifications to Trust 1 under Agreement and the Amendment will not cause Trust 1 to lose its status as a trust that is exempt from GST tax by reason of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i).

#### Ruling Request #2:

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the decedent's interest therein at the time of his death.

Section 20.2033-1(a) of the Estate Tax Regulations provides, in general, that the gross estate of a decedent who was a citizen or resident of the United States at the time of his death includes the value of all property, whether real or personal, tangible or intangible, and wherever situated, beneficially owned by the decedent at the time of his death.

Section 2036(a) requires the inclusion in the gross estate of property to the extent of any interest of which the decedent has made a lifetime transfer under which he has retained for his life, or for any period not ascertainable without reference to his death or for any period that does not in fact end before his death the possession or enjoyment of, or the right to the income from, the property, or the right either alone or in conjunction with any other person, to designate the person or persons who shall possess or enjoy the property or the income therefrom.

Based on the facts submitted and the representations made, we conclude that Compromise Agreement will not cause any portion of the property comprising the Disputed Share to be included in the gross estate of any party to Compromise Agreement for federal estate tax purposes under §§ 2033 or 2036 except to the extent of property that is distributed to that party and remaining in that party's estate at the party's date of death.

Ruling Request #4:

Section 61(a)(3) provides that gross income includes gains derived from dealings in property. Under §1.61-1(a) of the Income Tax Regulations, gross income means all income from whatever source derived, unless excluded by law. Gross income includes income realized in any form, whether in money, property, or services.

Under §1001(a), gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in §1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized. Under §1.1001-1(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 kind or in extent, is treated as income or loss sustained.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under §1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under §1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that 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.

Section 1.1001-1(c)(1) provides that a loss is not ordinarily sustained prior to the sale or other disposition of the property for the reason that until such sale or other disposition occurs there remains the possibility that the taxpayer may recover or recoup some of the adjusted basis of the property. Until some identifiable event fixes the actual sustaining of a loss and the amount thereof, it is not taken into account.

The proposed modifications under Agreement to substitute Charity 1 and Charity 2 as remote contingent remainder beneficiaries in place of Foundation and to create an investment advisory committee will not be treated as a taxable exchange for federal income tax purposes by either the trust or the beneficiaries.

The third proposed modification under Agreement and the Amendment will convert, pursuant to State's Unitrust Statute, the income beneficiaries' income interests into the right to receive their proportionate shares of a unitrust amount. As discussed above, under State's Unitrust Statute, a trustee may convert an income trust to a unitrust without court approval if the unitrust percentage is no less than 3 percent nor more than 5 percent if the rate is agreed upon in writing by the trustee and the beneficiaries. Here, the trustee and beneficiaries have agreed in writing to the conversion of the trust from an income trust into a 4.25 percent unitrust, and this agreement will be presented to the appropriate state probate court for approval. In Example 11 of § 26.2601-1(b)(4)(i)(E), an income trust was converted to a unitrust under a state statute authorizing such conversions. The example concludes that "neither the trust nor any trust beneficiary will be treated as having made a taxable exchange for federal income tax purposes."

Accordingly, based on the facts submitted and the representations made and provided the proposed conversion meets the requirements of State's Unitrust Statute, we conclude that no gain or loss will recognized under § 61 or §1001 by Trust 1, or any beneficiary of Trust 1 as a result of the proposed modifications.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the Compromise Agreement or the proposed modifications of Trust 1 under the cited provisions or under any other provisions of the Code. Specifically, we are not ruling regarding the gift tax consequences of the Compromise Agreement.

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,

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George Masnik, Chief  
Branch 4  
Office of Associate Chief Counsel  
(Passthroughs and Special  
Industries)

Enclosure  
Copy for section 6110 purposes

cc: