

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
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Date:  
December 04, 2024

RE:

Legend

Date 1 =  
Date 2 =  
Date 3 =  
Settlor =  
Trust =

X =  
Agreement =

Grandchild =

A =  
B =  
C =  
D =  
E =  
F =  
Corporate Trustee =  
Special Representative =  
Valuation Company =  
State =  
Statute 1 =

Statute 2 =  
 Statute 3 =  
 Statute 4 =  
 Court =

Dear :

This letter responds to your personal representative's letter of June 6, 2024, and subsequent correspondence, in which rulings are requested on the income, gift and generation-skipping transfer (GST) tax consequences of a court-approved termination of Trust.

The facts and representations submitted are as follows:

On Date 1, a date prior to September 25, 1985, Settlor created an irrevocable trust, Trust, for the benefit of Grandchild. Under the terms of Trust, the co-trustees are required to pay to Grandchild an annual annuity of \$x. No other distributions are permitted during Grandchild's lifetime. Upon Grandchild's death, the \$x annuity shall be divided and paid *per stirpes* to Grandchild's lineal issue. Grandchild has two living adult children, A and B (Current Remaindermen) and four living minor grandchildren, C, D, E, and F (Successor Remaindermen). None of Grandchild's lineal issue has a predeceased child with living issue. Trust shall terminate upon the last to die of ten individuals, including Grandchild. Upon termination of Trust, all trust property is required to be distributed *per stirpes* to the lineal issue of Grandchild, outright and free of Trust. The Current Remaindermen and the Corporate Trustee are currently serving as co-trustees of Trust.

Statute 1 provides, in relevant part, that if all parties agree to a resolution of a matter [defined under Statute 2], then the agreement shall be evidenced by a written agreement signed by all parties. Subject to the provisions of Statute 3, the written agreement shall be binding and conclusive on all persons interested in the estate, trust, nonprobate asset, other property passing at death, or custodial property. Statute 2 defines "matter" to include the determination of any question arising in the administration of an estate or trust.

Statute 3 provides, in relevant part, that within thirty days of execution of the agreement by all parties, the special representative may note a hearing for presentation of the written agreement to a court of competent jurisdiction. At such hearing the court shall review the agreement on behalf of the parties represented by the special representative. The court shall determine whether or not the interests of the represented parties have been adequately represented and protected, and an order declaring the court's determination shall be entered. If the court determines that such interests have not

been adequately represented and protected, the agreement shall be declared of no effect.

Statute 4 provides, in relevant part, that any party, or a party's legal representative, may file the written agreement or a memorandum summarizing the written agreement with the court having jurisdiction over the estate or trust. On filing the agreement or memorandum, the agreement will be deemed approved by the court and is equivalent to a final court order binding on all persons interested in the estate, trust, nonprobate asset, other property passing at death, or custodial property.

On Date 2, Grandchild, the Current Remaindermen, the Corporate Trustee, and a special representative (Special Representative) appointed by Court representing the minor and unborn Trust beneficiaries, entered into Agreement under Statute 1, providing for the termination of Trust, contingent upon receiving a favorable letter ruling from the Internal Revenue Service (IRS). Under Section 6 of Agreement, Trust shall terminate 60 days after a favorable private letter ruling from the IRS is issued and Trust property will be distributed to the beneficiaries in accordance with the actuarial value of each beneficiary's interest in Trust (Proposed Distribution), as to be determined by Valuation Company. Agreement further provides that co-trustees may make non-pro rata distributions of Trust property to satisfy the Proposed Distribution. On Date 3, pursuant to Statute 3, Court discharged the Special Representative and approved Agreement.

It is represented that Trust was irrevocable prior to September 25, 1985, and that no additions, actual or constructive, have been made to Trust.

The co-trustees request the following rulings:

1. The termination of Trust and the Proposed Distribution will not cause Trust, or any distributions from Trust, to become subject to GST tax under § 2601.
2. The termination of Trust and the Proposed Distribution will not cause Trust, or any of the beneficiaries of Trust to be treated as having made taxable gifts under § 2501.
3. The termination of Trust and the Proposed Distribution are treated as a sale of Grandchild's and the Successor Remaindermen's interests in Trust to the Current Remaindermen. This will cause Grandchild and the Successor Remaindermen to recognize long-term capital gain on the Proposed Distribution they receive. To the extent the Current Remaindermen exchange property, including property deemed received from Trust, for Grandchild's and the Successor Remaindermen's interests in Trust, the Current Remaindermen will recognize capital gain or loss on the property exchanged. For purposes of calculating such gain or loss, the amount realized by the Current Remaindermen will be equal to the fair market value of the property transferred to Grandchild and the Successor Remaindermen as the Proposed Distribution.

Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every GST, which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the regulations, the tax does not apply to a 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)(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 will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus (unless specifically noted), 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 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 § 26.2601-1(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. 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 or the creation of a new GST.

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

Based on the facts submitted and the representations made, we conclude that the termination of Trust and the Proposed Distribution will neither cause a beneficial interest to be shifted to a beneficiary who occupies a generation lower than the beneficiaries who held the interests prior to the termination, nor extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original Trust, as long as the actuarial values of the trust accurately represent the actuarial value of each

beneficiary's interest. Accordingly, we rule that the court-approved termination of Trust and the Proposed Distribution will not cause Trust, or any distributions from Trust, to become subject to GST tax under § 2601.

### Ruling 2

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any 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 the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed a gift that is included in computing the amount of gifts made during the calendar year.

In the present case, the beneficial interests, rights, and expectancies of the beneficiaries will be substantially the same, both before and after the termination and the Proposed Distribution, as long as the actuarial values of the trust accurately represent the actuarial value of each beneficiary's interest. Thus, assuming the actuarial values accurately represent each beneficiary's interest, we conclude that no transfer of property will be deemed to occur as a result of the termination and the Proposed Distribution. Accordingly, based on the facts submitted and the representations made, we conclude that the termination of Trust and the Proposed Distribution will not cause Trust, or any of the beneficiaries of Trust to be treated as having made taxable gifts under § 2501.

### Ruling 3

Section 61(a)(3) provides that gross income includes gains derived from dealings in property, and under § 61(a)(14), income from an interest in an estate or trust.

Section 1001(a) provides that the 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 § 1011 for determining loss over the amount realized.

Section 1001(b) states 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 1001(e)(1) provides that in determining gain or loss from the sale or disposition of a term interest in property, that portion of the adjusted basis of the interest which is determined pursuant to § 1015 (to the extent that the adjusted basis is a portion of the entire adjusted basis of the property) shall be disregarded. Under § 1001(e)(2), the term “term interest in property” includes an income interest in a trust but does not include a remainder interest. Section 1001(e)(3) provides that § 1001(e)(1) does not apply to a sale or other disposition which is a part of a transaction in which the entire interest in property is transferred to any person or persons. See § 1.1001-1(f) of the Income Tax Regulations.

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 1015(b) provides that if property is acquired by a transfer in trust (other than by 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 the transfer.

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

Section 1.1015-1(b) provides that property acquired by gift has a uniform basis, and that the proportionate parts of that basis represented by the interests of the life tenant and remainder interest holder are determined under rules provided in § 1.1014-5.

Section 1222(3) provides that the term “long-term capital gain” means gain from the sale or exchange of a capital asset held for more than one year.

Section 1221(a) defines the term “capital asset” as property held by the taxpayer with certain listed exceptions not applicable here.

Section 1223(2) provides that in determining the period for which a taxpayer has held property however acquired there shall be included the period for which the property was held by any other person, if the property has the same basis in the taxpayer’s hands as it would have in the hands of that other person.

Rev. Rul. 72-243, 1972-1 C.B. 233, provides that the proceeds received by the life tenant of a trust, in consideration for the transfer of the life tenant’s entire interest in the trust to the holder of the remainder interest, are treated as an amount realized from the

sale or exchange of a capital asset under § 1222. The right to income for life from a trust estate is a right in the estate itself. See *McAllister v. Commissioner*, 157 F.2d 235 (2d Cir. 1946), *cert. denied*, 330 U.S. 826 (1947).

Although the proposed transaction takes the form of a distribution of Trust's property in accordance with the actuarial value of the respective interests of Grandchild, the Current Remaindermen, and the Successor Remaindermen, in substance it is a sale of Grandchild's and the Successor Remaindermen's interests to the Current Remaindermen, and an exchange by the Current Remaindermen of their interests with the other beneficiaries. *Frank Lyon Co. v. U.S.*, 435 U.S. 561, 582 (1978) (substance and economic realities of sale-lease transaction supported taxpayer's deductions for depreciation, interest and related expenses). Accordingly, the amounts received by Grandchild as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Rev. Rul. 72-243. Because Grandchild's basis in the income interest of Trust is a portion of the entire basis of the property under § 1015(b), and because the disposition of her term interest is not part of a transaction in which the entire interest in Trust is transferred to a third party, her adjusted basis in her interest in Trust is disregarded under § 1001(e). Grandchild's holding period in the life interest in Trust exceeds one year. Accordingly, based on the facts submitted and the representations made, the entire amount realized by Grandchild as a result of the early termination of Trust will be long-term capital gain under § 1222(3).

Similarly, the amounts received as the Proposed Distribution by the Successor Remaindermen as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. *Cf. Helvering v. Gambrill*, 313 U.S. 11, 15 (1941), 1941-1 C.B. 364 (The phrase "property held by the taxpayer" under a prior law holding period rule relating to capital gains and losses includes not only full ownership, but also any interest owned whether vested, contingent, or conditional). The amounts realized will be the fair market value of the Proposed Distribution received by the Successor Remaindermen. Their holding periods in their interests in Trust also exceed one year. Accordingly, under § 1222(3), the gain determined under § 1001(a) for the Successor Remaindermen as a result of the early termination of Trust will be long-term capital gain.

In addition, to the extent that the Current Remaindermen exchange property, including property deemed received from Trust, for the interests of Grandchild and the Successor Remaindermen, the Current Remaindermen will recognize gain or loss on the property exchanged. § 1.1001-1(a). Accordingly, based on the facts submitted and the representations made, for purposes of determining gain or loss in connection with the Proposed Distribution, the amount realized by the Current Remaindermen on the exchange of property for Trust interests held by Grandchild and the Successor Remaindermen will be equal to the fair market value of the Proposed Distribution made to Grandchild and to the Successor Remaindermen. See § 1.1001-1(a).

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 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.

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.

Sincerely,

*Melissa C. Liquerman*

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Melissa C. Liquerman  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure:

Copy for § 6110 purposes

cc: