Decanting: Amending Trusts Without The Court

Presentation by:

Michael L. Graham

The Graham Law Firm, PC

Dallas, Texas

For:

Tulsa Estate Planning Council

Tulsa, Oklahoma

May 18, 2011

Index

1. Mindmap of Decanting Today Concepts
2. Excerpts from *100 Years is a Long Time – New Concepts and Practical Planning Ideas,* Graham and Christensen
3. Rev. Proc. 2011-3
4. PLR 200736002
5. Table of State Decanting Statutes – As of 2009 by US Trust
6. Tax Effects of Decanting – Obtaining and Preserving the Benefits, Zeydel and Blattmachr, Journal of Taxation, November 2009
7. Various Alaska and Arizona Trust Statutes relating to Decanting and Trust Situs

Decanting Today

- Reasons to Decant
  - changed circumstances
  - modifying administrative provisions
  - altering who is trustee, how appointed
  - extending termination date
  - Converting to and from a grantor trust
  - reducing liability
  - Converting to supplemental needs trust
  - correcting drafting error
- Rule Against Perpetuities
  - 2041(a)(3)
  - State Law
  - Extension of time, relate back
- Change of Situs to As
  - Can Can Foreign Trustee Serve as Trustee?
- Texas Draft of Decanting
- Common Law Basis
  - Florida: Phipps v. Palm Beach Trust Company, 142 Fla. 782, 196 So. 299 (1940)
  - General Rule: Power Vested in a Trustee to create an estate in fee includes power to create or appoint any estate less than a fee unless clearly indicated otherwise
  - Nevertheless, Fla. adopted a decanting statute
  - Special POA: Is it Held in fiduciary or non-fiduciary capacity
- Requirement of unlimted power to distribute
  - What if document has HEMS Standard
  - AS, AZ, other statutes
    - Standard may not change (AS)
    - Same or more restrictive (AZ)
  - Current right to distribute
    - Some states address
- Income tax issues
  - PLR 200736002
    - Entire trust v. Partial decanting
    - New Tax ID Number
    - May be academic, cap gain distributed on year of termination
- Gift tax issues
  - Notice, opportunity to object?
    - inclusion of SPOA
- GST Tax
  - Grandfather if pre-86 trust
    - Reg. 26.2601-1(b)(4)(i)(A)
  - Post 86 Trust
    - Effect of Decanting Not Covered in Regs or other authority
    - No guidance language in PLRs - encouraging
- Adding and Subtracting Beneficiaries
- Rev. Proc. 2011-3
  - No further rulings on decanting
  - Does not distinguish between those under State Law and those under the Document

100 YEARS IS A LONG TIME—NEW CONCEPTS AND PRACTICAL PLANNING IDEAS

Presentation by Michael L. Graham, The Graham Law Firm, P.C., Dallas, Texas

Paper prepared by

Henry Christensen III, McDermott, Will and Emery, New York, New York

Michael L. Graham, The Graham Law Firm, P.C., Dallas Texas*

This Paper Reprinted from Presentation by Authors at 2007 Annual Meeting of the American College of Trust and Estate Counsel (ACTEC)

© Copyright Michael Lynn Graham and Henry Christensen III

*Messrs. Graham and Christensen would like to acknowledge with gratitude the valuable assistance of Mr. Christensen's associates, Stacey Delich-Gould and Nina McIntyre, in preparing the attached materials

ISSUES IN THE MODIFICATION OR REVOCATION OF LONG-TERM IRREVOCABLE TRUSTS

BY HENRY CHRISTENSEN III

BACKGROUND. By their very nature, irrevocable trusts are generally considered to be irrevocable. They are irrevocable first and foremost because that is what the grantor wanted if she or he is dead. (If she or he is alive, she or he probably would like to retain a power to amend during life, subject to the tax constraint below. As Jim Casner said years ago, "There is no such thing as an independent Trustee as long as the grantor is alive.") And as an important separate point, tax planning is often important in the creation of a trust, because a transfer is likely to be incomplete for all tax purposes if the grantor can amend or revoke it, and may be incomplete for income tax purposes if the Trustee can amend it.

The Problem: Irrevocable trusts are, by their nature, difficult to amend or revoke, but a time may come when it is in everyone's interest that the trust be amended. Reasons may include:

- The trust deed may have been poorly drafted, e.g. the deed fails to include a necessary tax provision, or simply does not reflect what the grantor intended; or
- Changes to the tax law occur that may necessitate trust modification; or
- Changes in family dynamics may occur, e.g. unanticipated problems with heirs or their families after the creation of the trust making planned distributions imprudent; or
- Simply put, the grantor needs the money back.

The Solution: Courts in the US and the UK and the IRS have moved towards a purposive interpretation of trust instruments and have embraced their equitable powers to permit changes to, or terminations of, trusts under certain circumstances. Trusts may be drafted with sufficient flexibility to permit adaptive changes, for example by providing for a trust protector or powers of appointment. The Uniform Trust Code (the "UTC"), the Restatement (Second and Third) of Trusts, and statutory law in many US states have made a marked shift towards permitting flexibility in interpretation and application of trust instrument restrictions.

US Law.

For more than a century, American law strictly limited the ability of a court to modify or terminate trust instruments. Absent a violation of law or public policy, the courts were previously forbidden from interfering with the material purpose of a trust. In recent years, there has been a shift towards courts addressing the current needs of beneficiaries by modifying or terminating a trust, rather than respecting without question the original wishes of the trust grantor. Many argue that a principal reason that change is necessary is due to the abolition of the Rule Against Perpetuities. Since non-charitable trusts may now exist forever, it is necessary to make the grantor's original scheme easier to undo or modify. See, Mary Louise Fellows, *In Search of Donative Intent*, 73 Iowa L. Rev. 61 (1988).

Under the Restatement (Second) of Trusts, a court was permitted to direct a trustee to deviate from the terms of the instrument when "owing to circumstances not known to the settlor and not anticipated by him, compliance would defeat or substantially impair the accomplishment of the purpose of the trust, but not "merely because such deviation would be more advantageous

NY12525:{00054569.DOC;3}398687.12

to the beneficiaries." The Second Restatement codified the so-called "equitable deviation doctrine," which gave courts flexibility to modify in light of changed circumstances when needed to accomplish the purposes of the trust. The equitable deviation doctrine applied only to modify administrative provisions of a trust.

Over time, state codes have started to enunciate a balancing test for the courts to apply when deciding if modification or termination is appropriate. For example, the California Probate Code of 1986 applies an expanded equitable deviation doctrine which allows courts to balance the grantor's intent against the reasons for modification. This applies to permit alteration of both administrative and dispositive trust provisions. Cal. Prob.Code § 15403 (b).

The UTC takes a different approach and permits modification or termination of a trust if (1) there is consent of all beneficiaries and the alteration is not inconsistent with trust purposes, or (2) because of changed circumstances not anticipated by the grantor, the continuation of the trust under its terms would substantially impair the accomplishment of the purpose of the trust. This is not nearly as expansive as the California provision and is more deferential to the grantor's intent. Uniform Trust Code § 412.

The Restatement (Third) of Trusts, like the California Probate Code, has embraced both general modification reforms: a balancing test and the equitable deviation doctrine. (Please see below for a more detailed description of provisions).

An issue which will need to be addressed in the future is whether a grantor may prevent subsequent modifications or termination by the court by language in the trust instrument. For example, can a grantor recite a list of the issues he or she has taken into account in drafting a trust, so that a court cannot later modify the trust on one of those grounds? Can a grantor simply "opt out" and forbid later amendment?

The increasing trend of courts permitting modification to trusts has been bolstered by legislative efforts in many states and through the UTC and Restatements.

- **New York EPTL Section 7-1.9. Revocation of Trusts.** This section permits the creator of a trust, while he or she is living, to revoke or amend the whole or part of a trust instrument with written consent of all persons beneficially interested in a trust.
- **Alaska Statutes Section 13.36.360. Modification or Termination of Irrevocable Trust by Consent.** Alaska permits courts, upon petition of a trustee, grantor or beneficiary, to modify or terminate an irrevocable trust if all the beneficiaries consent, and if the continuation of the trust on the existing terms of the trust is not necessary to further a material purpose of the trust. If a beneficiary does not consent to the modification or termination of the trust, the court may still approve the modification or termination if it determines: (1) if all the beneficiaries had consented, the trust could have been modified or terminated; and (2) the rights of the beneficiary who does not consent will be adequately protected or not significantly impaired. The court may go beyond what a grantor would have wished to allow all of the beneficiaries to terminate a trust, even if the grantor directed otherwise.
- **California Probate Code Section 15409.** Provides a broad umbrella under which a court may modify the administrative or dispositive provisions of a trust, or may terminate a trust, if "owing to circumstances not known to the settlor and not anticipated by the settlor, the continuation of the trust under its terms would defeat or substantially limit the

accomplishment of the purposes of the trust." This provision also provides that a court may order a trustee "to do acts that are not authorized or are forbidden by the trust instrument." This provision could help when changes in tax law threaten to defeat the testator's tax-minimization intent.

- In order to take advantage of this provision, a trustee or beneficiary must petition the court, and the court must be convinced that there are "circumstances not known and not anticipated by the settlor" that would defeat or impair the trust's purpose. Consent of other beneficiaries or trustees is not required.
- Under California Probate Code Section 15403, if all the beneficiaries of an irrevocable trust consent, they may compel such modification or termination of the trust, unless the court finds that a material purpose remains for continuation of the trust and that purpose outweighs reasons advanced for termination or modification. In such circumstance, any minor beneficiaries must be represented by a guardian ad litem.

Uniform Trust Code

- **Uniform Trust Code, Section 411. Modification or Termination of Noncharitable Irrevocable Trust by Consent.**
  - The UTC provides that a non-charitable irrevocable trust may be modified or terminated upon consent of the grantor and all beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust. This is the same as New York's EPTL § 7-1.9.

  But the UTC goes further:

  - A non-charitable irrevocable trust also may be terminated without the consent of the grantor upon consent of all beneficiaries, if the court finds that continuance of the trust is not necessary to achieve any material purpose of the trust. Such a trust may be modified upon consent of all beneficiaries if the court finds that the modification is not inconsistent with a material purpose of the trust. Here, a recitation by the grantor of his or her purposes in creating the trust could be helpful.
  - Finally, if there is not unanimous consent of the beneficiaries to the proposed modification or termination of the trust, the modification or termination may be approved by the court if: (1) if all the beneficiaries had consented, the trust could have been modified or terminated; and (2) the interests of the beneficiary who does not consent will be adequately protected.
- **Uniform Trust Code, Section 412. Modification or Termination Because of Unanticipated Circumstances or Inability to Administer Trust Effectively.** UTC 412 provides that a court may modify the administrative or dispositive terms of a trust or terminate the trust if, because of circumstances not anticipated by the grantor, modification or termination will further the purposes of the trust. To the extent practicable, the modification must be made in accordance with the grantor's probable intention. The court can also modify the administrative terms of a trust if continuation of

NY12525:{00054569.DOC;3}398687.12

the trust on its existing terms would be impracticable or wasteful or impair the trust's administration.

- **Uniform Trust Code, Section 416. Modification to Achieve Grantor's Tax Objectives.** To achieve the grantor's tax objectives, the court may modify the terms of a trust in a manner that is not contrary to the grantor's probable intention. The court may provide that the modification has retroactive effect.

Restatement (Third) on Trusts.

- **Third Restatement.** Section 65 of the Third Restatement permits all the beneficiaries of a trust to join in their consent and compel the modification or termination of a trust. If such termination or modification is inconsistent with the material purpose of the trust, then the grantor can grant approval for such termination or modification. After the grantor's death, the beneficiaries may petition the court and make such termination or modification with authorization of the court, if the court makes a determination that the reasons for termination or modification outweigh the trust's material purpose.

IRS Permits Changes to Irrevocable Trusts to Correct Scrivener's Error

- The IRS has opined that it will permit changes to irrevocable trusts where there has been a mistake due to scrivener's error.
- **PLR 200535007:** IRS held that a NIMCRUT could be reformed to include a provision that post-contribution realized gains could be allocated to trust income. This provision had been omitted inadvertently due to scrivener's error. Trustee had administered trust believing that trust contained such a provision. Court permitted irrevocable trust to be amended and for amendment to take effect from date of trust's inception. IRS held that the judicial reformation was not a prohibited act of self-dealing and that the trust still qualified as a CRUT.

Work-Around Options for Modifying Irrevocable Trusts and US Tax Law Issues.

- Another way to "modify" the content of an irrevocable trust which has become outdated or less than optimal due to changed circumstances is to create a new trust and move the assets of the first trust to a second trust which contains the more optimal provisions. As such, a new trust with preferable dispositive, administrative or situs provisions can receive the assets of the suboptimal irrevocable trust. This adds flexibility to an irrevocable trust without requiring court authorization.
- The strategy, in the past, had the potential to cause unfavorable tax results. The IRS has opined in a recent series of rulings that modification of irrevocable trusts through an appointment or decanting to a new trust shall be looked upon more favorably.
    - **Life Insurance Trusts**—PLRs 200514001 and 200514002: Sale of life insurance policies between one grantor trust and another having the same grantor is not recognized as a sale for federal income tax purposes because the sale was "between" same taxpayer. "Transfer-for-value" rule causing life insurance proceeds to be includible in gross estate does not apply.
    - **Charitable Remainder Trusts (CRTs)**

- PLR 200543061: Taxpayer and spouse were receiving unitrust of 5% of CRT's fair market assets until death, however, charitable remainder beneficiaries needed immediate financial assistance to carry out their charitable mission. All parties agreed that it was in common interest to terminate the trust and distribute assets to non-charitable and charitable beneficiaries. State law permitted early termination of CRT when all beneficiaries consented (and none were under a legal disability), although trust instrument did not provide for termination. Key issue was whether early termination would allocate greater allocation of trust assets to income beneficiaries and less to charitable remainder. The trust's proposed allocation was found to be reasonable so long as income beneficiaries had no knowledge of medical condition or other circumstance which would cause them to have a life expectancy shorter than actuarial tables. The trust termination was treated as a sale or exchange between the income and remainder beneficiaries, resulting in taxable transaction for income beneficiaries, however, there was no self-dealing under section 4941 resulting from the sale or exchange since the charitable remainder beneficiary was a public charity, not a private foundation.
- PLR 200539008: IRS permitted divorced couple that had established CRT to divide CRT into two separate trusts. The two new trusts were permitted to continue as qualified CRTs, and no gain or loss was recognized under IRC 1041, nor was split subject to gift tax under IRC 2516.
- PLR 200535006: decedent's son disclaimed a portion of his interest in a trust. The trust was then divided into two trusts, and one trust was reformed with new provisions so that it qualified as a CRT. After reformation and assuming son made a qualified disclaimer under IRC 2518, the IRS held that the qualified reformation was made, and the taxpayer met strict requirements of IRC 2055(e) (3). The decedent's estate was permitted to take a charitable deduction equal to the present value of the trust's remainder interest.

Giving A Protector Discretion To Amend The Trust.

- One alternative may be to empower a protector to make substantive amendments to a trust, as long as they don't risk loss of the marital or charitable deduction, or making a gift incomplete. Such a power is in many ways similar to a "variance" power given to the Trustees of community trusts, so as to avoid the necessity of judicial <u>cy pres</u> proceedings. For example, in a community trust, such as the New York Community Trust (NYCT), there is a distribution committee and a trustee bank named by the trust donor who jointly administer each trust as fiduciaries. The trustee bank and distribution committee are governed in their administration of each trust by the terms of the donor's will or deed of trust. Under NYCT policies, a donor can create one of three types of funds. He may designate a particular beneficiary or beneficiaries to receive trust income, he may designate a particular area to which trust income will be devoted; or he may leave the decision of how to distribute trust income entirely to the discretion of the distribution

committee. The donor's designations will be "respected and observed" unless "circumstances have so changed since the execution of the instrument ... as to render unnecessary, undesirable, impractical or impossible a literal compliance with the terms of such instrument." From the NYCT Trust Resolution. The ability of the NYCT to depart from the terms set by the donor in limited, specified circumstances is sometimes referred to as the "variance power". Community trusts argue that such powers provide much greater flexibility than standard perpetual charitable trusts.

UK Law.

Under the English approach to trust modification, courts have broad powers to modify or terminate trusts at the petition of beneficiaries.

- *Hastings-Bass* Decision:
  - Factual Background: Trustees of a trust had made an advance of a cash sum to another trust settlement which conferred a life interest on the primary beneficiary of the original trust settlement, with remainders to his children. The remainder interests were void for perpetuity, and the question before the court was whether the whole transfer, including the life interest, had failed.
  - Holding: Where a trustee is given discretion as to some matter under which he acts in good faith, the court shall not interfere with his action notwithstanding that it does not have the full effect which he intended, unless: (1) what the trustee has achieved is unauthorized by the power conferred on him, or (2) it is clear that the trustee would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account. *In re Hastings-Bass, Deceased [1974] 2 All E.R. 193 [Court of Appeal], [1975] Ch. 25, at 41.* As such, "[w]here a trustee acts under a discretion given to him by terms of a trust, the court will interfere with his actions if is it clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account." *Mettoy Pension Trustees Ltd v. Evans,* [1991] 1 WLR 1587, 1621.
- Building upon the principles set forth in *Hastings-Bass*, Simon Taube, QC, has opined that there are three broad categories of cases in which UK courts may/should intervene and set aside the decision of trustees:
  - Where the trustees act *ultra vires*, e.g. by making invalid appointments on grounds of voidness for excess, voidness in part, or excessive delegation;
  - Where there is a material procedural irregularity in trustees' action, e.g. by making appointments which are invalid on grounds of defect of form, lack of necessary consent, failure to consult or failure to exercise any discretion at all; and
  - Where the trustees act "unreasonably," in the sense used in *Associated Provincial Picture Houses v. Wednesbury Corporation [1948] 1 KB 223:* "a person entrusted with a discretion must, so to speak, direct himself properly in law. He must call his own attention to the matters which he is bound to consider. He

must exclude from his own consideration matters which are irrelevant to what he has to consider. If he does not obey those rules he may be ... acting 'unreasonably.'" Examples of such action might include:

- appointments which have been made with capriciousness or in bad faith;
- irrational exercises of power, or fraud on the power, such as failure to use a power for purposes it was conferred;
- decisions based on irrelevant considerations or failing to take account of relevant considerations.

- ***Abacus Trust Company (Isle of Man) Ltd. v. National Society for the Prevention of Cruelty to Children [2001] STC 1344 (Chancery Division).*** In this case, a trustee completed an appointment on April 3, 1998, failing to take account of previous advice he had received that the appointment should not be completed until after April 6, 1998. As a result, a significant capital gains tax liability arose. The court held in this case, applying the *Hastings-Bass* principle, that the appointment by the trustee was void *ab initio,* because the court was satisfied that had the trustee properly considered the tax advice it had received, it would not have made the appointment before April 6, 1998. The court based this decision on the fact that trustees are bound to take account of the fiscal consequences of their actions. Where it can be shown that proper consideration of the fiscal consequences would have lead to the appointment not going ahead, then the court should treat the appointment as void.

- **Under application of the *Hastings-Bass* rule, are trustee decisions void or voidable?** This is an important question going forward. If an appointment is made by the trustees and it is void, despite having been (to all outward appearances) arrived at and recorded in the proper manner, it may lead to great uncertainty. The matter might be raised many years afterwards, when the trust fund has been distributed (and taxes paid) on the assumption that the appointment was valid. In contrast, if the appointment is merely voidable, all the restrictions appropriate to the equitable remedy of rescission would come into play, such as delay and the acquisition of third-party rights.
  - ***Abacus Trust Company (Isle of Man) v. Barr*** [2003] 1 All ER 763 (Chancery Division) concludes that application of the *Hastings-Bass* rule renders a trustee's decision voidable, not void. In so deciding, Lightman, J. enunciated the rule that if it can be established that the trustees breached their fiduciary duty but, had they not done so, their decision might have been different, then the decision is voidable and may be set aside by the court. Thus, the voidability of a trustee decision depends on (1) whether the trustee breached a duty; and (2) whether the outcome of the decision would have been different if the duty had not been breached.
  - Note that successful completion of a *Hasting-Bass* proceeding requires a trustee to affirm that it made a mistake. And it is the trustee, not the grantor, who made the mistake.

- ***IRC v. Botnar.*** Can one create an irrevocable trust for others, but retain the possibility of future benefit for the grantor upon changes in circumstances? The *Botnar* case concerned the application of section 739 of the Income and Corporation Taxes Act 1988

("ICTA 1988") in the United Kingdom to income arising within offshore settlements. Section 739 applies where an individual transfers assets with the result that income becomes payable to a non-resident, but the transferor has a "power to enjoy" the income. In such a case, the income will be treated as the income of the transferor -- effectively, a grantor trust. In *Botnar*, the taxpayer had transferred shares in a company owning a United Kingdom automobile distributorship to a Liechtenstein settlement. Although he and his wife were expressly excluded from benefiting under the terms of the settlement, the trustees had the power to transfer the whole or part of the trust fund to other settlements which could possibly benefit the taxpayer. The court found that where it was possible for the whole or part of the trust fund to be resettled upon trusts under which the taxpayer or his wife could benefit, they had a "power to enjoy" the income of a person resident outside of the UK and thus would properly be taxed under section 739 ICTA 1988. *Commissioners of Inland Revenue v. Botnar, [1999] B.T.C. 267 (Court of Appeal).* Note the original beneficiaries of the *Botnar* settlement were all strangers, such that Inland Revenue could argue they couldn't have been the intended final beneficiaries. Nevertheless, leading counsel in England and Wales have applied the *Botnar* principle to a broader range of facts.

- **Drafting Suggestions to Avoid *Botnar* Pitfalls.** Critical to the decision in *Botnar* was that clause 3(c) of the original settlement permitted the trustees to resettle the funds on a trust with beneficiaries which had to include, but did not have to be limited to, at least one beneficiary of the original settlement. This made it possible for the taxpayer and his wife to benefit. **It is now imperative** that the draftsman ensures that any power to transfer funds to another settlement is bound by the excluded persons clause, such that it is impossible for the settlement funds to be transferred to another settlement under which a potential beneficiary could be the grantor, despite his exclusion under the transferor settlement, unless the grantor wishes to retain this flexibility.

- **Section 24 of Bermuda Trustee Act.** Section 24(1)(a) of the Bermuda Trustee Act permits the exercise of the power of advancement to apply to the whole of the presumptive share of a beneficiary (rather than one half). Under a 1999 Amendment to the Act, the statutory power of advancement may be used to create or advance onto further or separate discretionary trusts even allowing further delegation of discretion. The Trustee may at any time pay or apply capital of a trust to or for the benefit of a person entitled to capital "whether absolutely or contingently on his attaining any specified age or on the occurrence of any other event," and notwithstanding that the interest of the beneficiary is subject to being defeated by the exercise of a power of appointment or power of revocation. This power gives great flexibility to the trustees and to grantors and beneficiaries of Bermuda trusts. In addition, trustees may also use the power of advancement to essentially vary the terms of the trust by advancing trust capital to a new trust which postpones the vesting of the beneficiary's interest, or varies essential trust terms.

Drafting Recommendations:

Sample Trust Indenture Language Permitting Modification

- The Protector may amend any provision hereof other than any contained in this Article, except insofar [as such amendment shall affect the beneficial enjoyment of trust property.] [as such amendment might limit or curtail the interests of any charity hereunder for which a tax benefit was allowed].
- This Indenture and the trusts created hereunder shall be irrevocable; provided, however, that the Trustees, acting alone, are hereby authorized to amend the trust in any manner required for the sole purpose of insuring that the trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of Section 664(d)(2) of the Code.

Sample Decanting Provision

- **Trustees Can Create Trusts.** The discretionary power of the Trustees (excluding, however, any Interested Trustee) to distribute principal from the Descendants' Separate Trusts may be exercised in the same ways as a Non-Fiduciary Power under this Article, except that this shall not authorize the Trustees to restrict or curtail any beneficiary's interest in any mandatory payments (such as all or a fraction of the trust income) by an exercise that would not be authorized without this paragraph. If a power held in a fiduciary capacity is exercised to create another power (whether the power created is conferred in a fiduciary or individual capacity), then the power created shall not be exercisable in any manner which may postpone the vesting of any estate or interest in the appointed property or suspend the absolute ownership or power of alienation of the appointed property for a period ascertainable without regard to the date of the Grantor's death, except that the power created (the "second power") may be exercisable to postpone the vesting of an estate or interest in the appointed property without regard to the date of this Trust Agreement if the creation of the second power establishes the date upon which any applicable rule against perpetuities with respect to such second power is deemed to commence.

NY12525:{00054569.DOC;3}398687.12

MEASURING HOW LONG A TRUSTEE SHOULD HOLD SETTLOR DESIGNATED PERMISSIVE AND MANDATORY ASSETS

BY MICHAEL L. GRAHAM

BACKGROUND The terms of a trust may limit the trustee's investment authority in various ways. A restriction may require that certain investments or types of investments be retained or acquired for the trust estate. Unless in violation of public policy, such directions and restrictions are legally permissible and are binding on the trustee in managing the assets. Such authorizations or directions will often displace the normal duty of prudent investing. However, if, as a result of circumstances unknown to the settlor, compliance with the mandate would defeat or substantially impair the accomplishment of the trust purpose, it may be permissible, or even required, for the trustee to sell the mandated asset. Absent binding authorization from the grantor (a matter of state law) when successive interests are created in a trust in which unproductive or underproductive property is a substantial part, the trustee likely has *the duty* to sell the property and invest the proceeds in suitable trust investments.

Although courts generally give effect to the intention of the settlor or testator, they may order a sale of an unproductive or underproductive asset when there is a practical necessity for such a deviation. In some jurisdictions, the courts have found that a trustee directed to retain an investment by the trust instrument has the power to sell, by implication of law, when retention of the investment will lead to a serious impairment or destruction of a large part of the estate.

The Problem: Trustees may find themselves caught between a trust provision mandating that a particular asset be held and the legal duty (under common law and more recently the Uniform Prudent Investor Act and the Restatement (Third) of Trusts) to diversify trust assets. Often the settlor expects (or at least mandates) that the trustee retain a closely held asset under all circumstances. But what if the beneficiaries want the trustee to sell?

The Solution: Drafters will want to take both common law and statutory rules into account in drafting either permissive or mandatory investment provisions. With respect to family businesses, the prudent drafter will encourage settlors to consider and express their wishes as to acquisition and retention in the event that the business does not continue to prosper after his or her death. Through that effort, the drafter may be able to set forth permissible factors or standards for the trustee's consideration when deciding whether it is necessary to sell stock of the family business.

The Common Law Rule: ***In Re Pulitzer's Estate***, 139 Misc. 575, 259 N.Y.S. 87 (N.Y. Surr. 1931).

In Re Pulitzer's Estate sets forth the common law rule in New York that a trustee may sell an asset which a settlor intended to be held by the trust forever when there has been a change in circumstances.

- **Facts.** Joseph Pulitzer, the testator, had left the Press Publishing Company to his three sons in trust. The trust instrument required the sons and descendants to preserve, perfect and perpetuate one of the newspapers held by the publishing company, *The World*, and expressly prohibited the trustees from selling the stock of the Press Publishing Company. The trustees brought an action to sell certain assets of

the Press Publishing Company which had suffered significant financial losses for a number of years.

- **Holding:** The court held that the law assumes that a testator realized that securities bequeathed in trust may become so unproductive or diminished in value as to authorize their sale where extraordinary circumstances develop.
- New York courts have thus read an implied power of sale into trusts with language mandating that the trust hold a certain asset in some cases. The court in *Pulitzer* found that a court has the power "of equity, in emergencies, to protect the beneficiaries of a trust from serious loss, or a total destruction of a substantial asset of the corpus. The law, in the case of necessity, reads into the will an implied power of sale. The law also assumes that a testator had sufficient foresight to realize that securities bequeathed to a trustee may become so unproductive or so diminished in value as to authorize their sale where extraordinary circumstances develop, or crisis occurs." *In re Pulitzer's Estate*, 139 Misc. 575, 249 N.Y.S. 87 (N.Y.Surr. 1931).

Additional Support for the Common Law Right of Trustee to Dispose of "Mandatory" Assets of Trust

- ***Toronto General Trust Co. v. Chicago, B. & Q. R. Co.***, 64 Hun. 1, 18 N.Y.S. 593 (Sup. Ct. 1st Dept. 1892). A testator's will created a trust with income payable to the testator's widow. The express power to sell the stock conferred upon the trustee could not be exercised during the life of the widow, coming into existence only after the widow's death. In this case, the New York Court of Appeals sustained the trustees' sale of the securities during the widow's life because the securities were very speculative and subject to wide fluctuations in value. The court found an implied power to sell the securities during the widow's lifetime was justified by the prudence of a trustee in protecting the beneficiaries.
- ***Weld v. Weld***, 23 R.I. 311, 50 A. 490 (R.I. 1901). Where a will contained a prohibition against selling securities unless par was obtained for them and the estate was required to be kept together until the death of every individual who was named as an annuitant, the court relieved the trustee against the provision prohibiting sale by granting authority to dispose of perishable property or wasting assets.
- ***Stout v. Stout***, 192 Ky. 504, 233 S.W. 1057 (Ct. App. Ky. 1921). Where the principal asset of an estate was a whiskey barrel business which the trustees were directed to continue, the court permitted the trustees to sell the business which had become unprofitable because of national prohibition.

Permissive vs. Mandatory Language in the Trust Instrument

- **Permissive Language.** A trust term may specifically permit retention or expansion of the trust's holdings of particular property. Such a provision is typically included with respect to assets that may be of special interest to some or all of the beneficiaries or the settlor, even though this might otherwise be inconsistent with the normal standard of prudent diversification. If the language of a trust instrument is permissive only, i.e. the trust authorizes but does not require a particular investment, then such a permissive provision does not relieve the trustee of the fundamental duty to act with prudence. Restatement of the Law (Third) of Trusts, §228, Comment, pg. 106. It is

unclear "the degree to which the trustee may have to give special consideration to specifically authorized investments, as against simply omitting them from serious consideration." Restatement of the Law (Third) of Trusts, §228, Comment, pg. 106.

- **It is unclear what level of protection a "permissive" retention clause provides.**
  - *In re Will of Dumont,* 809 N.Y.S. 2d 360 (2006), *reversing* 2004 N.Y. Slip Op. 50647U; 2004 N.Y. Misc. LEXIS 896 (June 25, 2004). In this case a provision of a testamentary trust stated that "It is my desire and hope that said stock will be held by my said Executors and my said Trustee ... and neither my Executors nor my said Trustee shall dispose of such stock for the purpose of diversification of investment and neither they nor it shall be held liable for any diminution in value of such stock. ... The foregoing provision shall not prevent my said Executors or my said Trustee from disposing of all or part of the stock of Eastman Kodak Company in case there shall be some compelling reason other than diversification of investment for doing so." In this case, the lower court held that the clause authorizing retention of a single holding "cannot trump the application of prudence in the management of an estate." However, this decision was overturned on procedural grounds and the appellate court did not address the permissive language which purports to allow for the retention of assets regardless of a duty to diversify. Thus, an arguable rule emerges that if a retention clause is in conflict with a trustee's legal duty of prudence, the retention clause will lose.

- **Mandatory Language.** A trust provision may mandate that the trustee hold a certain asset. Such a provision is typically upheld by courts, though a trustee is not required to comply if it would be impossible or illegal. A mandatory provision can work to exculpate a trustee from liability for failure to diversify trust assets, however, it is not a complete bar to liability.
- The **difference between permissive and mandatory language** is significant in several ways. A trustee is not under a duty to make or retain investments that are made merely permissive pursuant to a trust provision. However, as noted above, the trustee may be under some duty to give special consideration to such assets. Restatement of the Law (Third) of Trusts, §228, Comment, pg. 106. This question would likely turn on the specific language of the trust provision in question. Thus, permissive language should be considered carefully by drafters. The fact that a certain investment is permitted does not relieve the trustee from his fundamental duty to act with prudence. The trustee is still under a duty to act with reasonable care, skill and caution in making investment decisions.
- **What is the effect of mandatory trust language on trustee liability for retaining an asset, if such retention is later found to have been detrimental or was against the beneficiary's wishes?**
  - Where a trustee is mandatorily required to retain investments, the trustee is protected from liability for a loss resulting from the retention where he acts

NY12525:{00054569.DOC;3}398687.12

pursuant to the will or trust and in accordance with the applicable rules of law (e.g. good faith, loyalty, reasonable care). Although a will or trust instrument orders the fiduciary to retain an otherwise inappropriate investment, the trustee must exercise a certain standard of diligence and skill in watching the investment and protecting the principal and income.

- In *Clark v. Clark*, 167 Ga. 1, 144 S.E. 787 (Ga. 1928), the court stated that where a testator gives a direction in his will to continue his investments already made, the trustees must follow such directions, and if they follow them in good faith, they will not be liable for any losses, unless they are negligent in failing to change an investment when it ought to be changed to save it, and that the direction to continue a certain investment does not relieve the trustees from the ordinary duty of watching it and of calling it in when there is imminent danger of its loss by a change of circumstances. Thus the rule emerges that mandatory retention language is not sufficient alone to exculpate a trustee from liability. The trustee must also demonstrate good faith and a lack of negligence in failing to change the investment when changed circumstances arise.
- *McCormick v. McCormick*, 129 Ill.Dec. 579, 180 Ill.App.3d 184, 536 N.E.2d 419 (1988). Plaintiff sought an accounting and damages for breach of fiduciary duty against his father and another as the trustees of his trust, against former trustees and against agents of the trustees. Among other acts of mismanagement, plaintiff alleged a wasting of trust assets by construction of a home for him, a failure to diversify trust assets and imprudence in financing the construction of the home. The court held that where the trustees had been given power to retain any part of the trust assets in non-income producing property, and where the trust provided that an investment made in good faith would be proper regardless of any risk or lack of diversification, the trustees were not liable for investing a substantial portion of the trust assets in the home.

- **What Language Could Work to Exonerate the Trustee From Liability?**
  - If language is to exonerate a trustee from liability for failure to diversify, the language must be precise and explicit as to the asset to be retained and should provide a specific statement that the trustee is exculpated from liability for continuing to hold such asset (for other drafting suggestions, see “Recommendations to Practitioners and Drafting Considerations” below). A general authorization (i.e., permissive rather than mandatory language) to retain investments does not ordinarily abrogate the trustee's duty with respect to diversification or the trustee's general duty to act with prudence in investment matters.
  - In *Wood v. U.S. Bank*, 828 N.E. 2d 1072 (Ohio App. 2005), the court held “that even if the trust document allows the trustee to ‘retain’ assets that would not normally be suitable, the trustee's duty to diversify remains unless there are special circumstances. Of course, a trustee's duty to diversify may be expanded, restricted, eliminated, or otherwise altered by the terms of the trust

[citing Ohio R. C. 1339.52(C)]. But this statement is true only if the instrument creating the trust clearly indicates an intention to abrogate the common-law, now statutory, duty to diversify." 828 N.E. 2d at 1074. The language in this case granted the trustee the power to "retain any securities in the same form as when received, including shares of a corporate trustee even though all such securities are not of the class of investments a trustee may be permitted by law to make and to hold cash uninvested as they deem advisable or proper." The Court noted, in a warning to estate planners and trustees, "The unfortunate wording of this sentence makes it unclear whether the 'advisable or proper' applied to the cash only, not the other assets. Grammatically, that is the meaning. Luckily, our holding makes it unnecessary to construe this language; but we caution that this type of fuzzy drafting can create problems." *Wood v. U.S. Bank*, 828 N.E. 2d at 1074-1075. "We hold that to abrogate the duty to diversify, the trust must contain specific language authorizing or directing the trustee to retain in a specific investment a larger percentage of the trust assets than would normally be prudent. There authorization to 'retain' here was not sufficient -- it only authorized the trustee to retain its own stock--something it could not otherwise do." 828 N.E. 2d at 1078. The Court did not have to reach the issue whether changes in the investment or the needs of the beneficiaries would have trumped even mandatory language.

- **Would Such Exculpatory Language Violate Public Policy,** e.g. N.Y. E.P.T.L. §11-1:7(a)(1)? In New York, a testator wishing to override the requirements of the prudent investor rules by the express terms of his will should recall that a testamentary trustee or executor must always act with reasonable care, diligence and prudence (required by Section 11-1.7 of the EPTL). Thus, the testator could mandate the retention of certain assets, but the trustee would likely still be under a duty to petition the court to sell such assets where circumstances change such that there is a serious impairment or destruction of a large part of the trust estate.

Restatement of the Law (Third) of Trusts

- Under the Restatement, a trustee is "under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust." Restatement of the Law (Third) of Trusts, §227. This standard is to be applied "to investments, not in isolation but in the context of the trust portfolio and as part of an overall investment strategy, which should incorporate risk and return objectives suitable to the trust." Restatement of the Law (Third) of Trusts, §227(a) (1992).
- The Restatement requires that "In investing the funds of the trust, the trustee ... has the powers expressly or impliedly granted by the terms of the trust and ... has a duty to the beneficiaries to conform to the terms of the trust directing or restricting investments by the trustee.
  - The Restatement thus addresses the significance of trust language directing the trust's investments. Directions in the trust instrument are "legally

permissible and are ordinarily binding on the trustee in managing the trust assets, thus often displacing the normal duty of prudence." However, the trustee may not be under a duty to "comply with a term of the trust if a court order directs or authorizes non-compliance when, as a result of circumstances not known or anticipated by the settlor, compliance would defeat or substantially impair the accomplishment of the purposes of the trust." In fact, the trustee may have a duty to apply to the court for permission to deviate from the trust terms. See Restatement of the Law (Third) of Trusts, §228, Comment, pg. 104-5.

The Uniform Prudent Investor Act (UPIA)

- UPIA §2 sets forth the standard of care for a trustee: A trustee "shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust." The UPIA does not mandate a singular approach to investment, rather the trustee must consider the particular needs of trust beneficiaries.
- The UPIA standard is objective rather than subjective UPIA §1, Comment (1994), and requires that a prudent trustee behaves as other trustees similarly situated would behave.
- The UPIA states that a trustee is required to diversify investments unless there is a prudent reason not to. UPIA §3. Some factors that might convince a trustee not to diversify can include language in the trust agreement directing the trustees not to do so, the particular situation of beneficiaries and the tax cost of selling an asset that dominates the portfolio. The UPIA §3, Comment states that "the wish to retain a family business is another situation in which the purposes of the trust sometimes override the conventional duty to diversify."
- The vast majority of U.S. states have adopted the UPIA. As of 1995, New York adopted the UPIA in McKinney's EPTL 11-2.3.

The Uniform Principal and Income Act (the Other UPIA)

- Many drafters will, as a routine matter, exempt a trustee from the diversification requirements of UPIA. However, such a decision can substantially limit flexibility otherwise granted to a trustee under the Other UPIA.
- Section 104 of the Uniform Principal and Income Act, which is intended to allow a trustee to select investment assets based upon prudent investor standards, grants the trustee the power to adjust between principal and income to the extent the trustee considers it necessary if (i) the trustee manages trusts assets as a prudent investor, (ii) the trust refers to the amount to be distributed to a beneficiary by referring to the trust's income, and (iii) that the trustee is unable to accomplish his duty of impartiality between successive interests without such adjustment.
- As noted above, this provision is a very powerful in allowing a trustee to balance the interests of the current and future beneficiaries, and this provision will be unavailable if the drafter has provided that the prudent investor standards are not available.

- Thus, it might be better (and this is only applicable if there the distribution requirements are tied to income) to express a desire that the closely held business be retained, but retain application of UPIA, so that the prudent investor standards apply.

Recommendations to Practitioners and Drafting Considerations

- Having determined that diversification is not required under a certain trust instrument, the trustee should communicate this conclusion to co-trustees and beneficiaries (current and remaindermen). It may be advisable for a trustee to obtain consent or indemnification from trust beneficiaries when there is one dominant asset in the portfolio, although, as with any contract with beneficiaries, the trustee should assure that the beneficiaries are in possession of all relevant facts. The trustee should make contact with all beneficiaries on a regular basis to reconfirm the trust's investment strategy.
- If the settlor desires to use mandatory language regarding trust investments, such as requiring the trust to hold a large percentage of stock in a family business, one option might be to permit a trustee to use derivatives to mitigate the effects of an investment portfolio that has an over-concentration of stock. See "Do Trustees Have an Absolute Duty to Diversify," available at: www.bnatax.com/tm/tmm0406_cline.rtf. If the trustee believes that such a technique is useful, he would be well advised to communicate the proposal to all beneficiaries before undertaking it and seek their approval or the approval of the court.
- Drafters should be cognizant of the fact that the Restatement and case law has limited the effectiveness of trustee exculpation clauses and investment direction clauses. Therefore, the drafter should recall that such provisions will be strictly construed by the courts.
- It is useful for a drafter to include an explanation of the reasoning why a settlor does not want the trustee to diversify investments. This explanation could be helpful to a court in deciding whether to exculpate a trustee from liability for a breach of the duty to diversify or to relieve a trustee from liability for his decision to sell assets in contravention of the terms of the trust instrument. See "Do Trustees Have an Absolute Duty to Diversify," available at: www.bnatax.com/tm/tmm0406_cline.rtf.
- Drafters should always undertake to draft an instrument with the assumption that any court reviewing the language will have a strong preference to find a duty to diversify.

To avoid the problem of pitting the settlor's mandate to hold a specific asset, for example a family business, against the prudent investor requirements, the estate planning documents can expressly override the normal prudent investor obligations of the trustee. The will or trust agreement could also direct the trustee to retain the ownership interest in the family business unless the trustee is directed in writing by specified beneficiaries or a board of advisors (discussed elsewhere herein) to sell it. Eric Manterfield recommends in his article "Planning Strategies for the Family Business Owner" (ALI-ABA 2006) that the generic retention of the family business interest not be mandated in the estate planning documents. Rather, he recommends that the language refer specifically to the holding by name, provide that the direction s to retention applies to any successor business and give to one or more of the beneficiaries the power to direct the trustee's continued retention of the investment. "Language

which merely gives the trustee the power to retain the original trust assets is probably not sufficient to relieve the trustee of this obligation to sell the business interest. The power to retain necessarily includes the power to sell. The wording should provide that the trustee must retain the business holding unless directed in writing by named beneficiaries to sell it. The trust instrument should go on to relieve the trustee of any liability which the trustee might have as a result of the retention of this investment." Manterfield, Eric, "Planning Strategies for the Family Business Owner," (ALI-ABA 2006).

Interesting Examples of Language

- Mixed "Permissive" Language Re land and Cattle Business

Land and Cattle Business

The Graham family has been in the real estate, cattle ranching, and oil and gas businesses for several generations, beginning with my father, Tom L. Graham. By way of a short description, the real estate portion has included both ownership of undeveloped ranch land and developed commercial office buildings. The cattle ranching has been both direct, through ownership and operation of the land and livestock, and indirect, through leasing land out to others for both ranching and hunting. The oil and gas business has, through the years, been as an operator, a working interest owner, a royalty interest owner, and through the leasing of family owned mineral interests for development. For ease of description, all such investments and the operation thereof, in whatever form or fashion, and however they have been done in the past and however they are accomplished in the future, are referred to as the "Land and Cattle Business."

The Land and Cattle Business has been conducted in several forms, including first through direct ownership, and then through an entity, Graham Land and Cattle Company, Ltd., a Texas limited partnership. In this Will, I leave my estate, and the portions of my wife's estate over which I was given certain powers of appointment, in trust for very long periods of time, in part to assure that Trustee, directly or indirectly, will be able to continue those businesses without a division of the assets (both the Land and Cattle Business assets and the financial assets which make the Land and Cattle Business possible) and without direct control passing to descendants who may disagree with me and with each other about the merits of the Land and Cattle Business. The Land and Cattle Business is part of the family heritage, and I intend, to the maximum extent possible, to provide that it can be continued.

I encourage Trustee to continue to invest in and operate, directly or indirectly, the Land and Cattle Business in the future, even though a higher rate of investment return, with less volatility and less uncompensated risk, could be obtained through alternative investments, such as stocks, bonds, and other financial instruments and strategies. I also specifically recognize that continuation of the Land and Cattle Business means that a portion or all of the income and/or appreciation from the assets other than those directly used in the Land and Cattle Business will be dedicated in many years to the support of the negative cash flow and/or profit of the Land and Cattle Business.

Accordingly, I specifically authorize Trustee to continue to own, and to invest and reinvest in, the Land and Cattle Business, directly or through entity form, and either (i) to be personally active in the management and operation thereof, engaging personnel to assist in that work, (ii) to engage independent persons or entities to conduct the Land and Cattle Business on behalf of Trustee, or (iii) any combination thereof. Trustee shall never have any liability for doing such,

even though investment in assets other than the Land and Cattle Business might have resulted in my descendants having more assets available for them, either in the short term or the long term.

- For provisions with respect to the operation of a closely held business held in trust, see Exhibit XX hereof
- For provisions with respect to the retention of, investment in, and beneficiary use of a residence for one or more beneficiaries, see Exhibit YY hereof.

Exhibit XX

The Closely-Held Business

A. **Authority to Operate.** The Trustees may operate "the Business" (as defined below) and retain any equity interests in the Business, even if these interests otherwise would be a speculative or inappropriate investment for a trust. This authority shall not supersede the right of the Grantor's to compel that certain trust assets be made productive. The Trustees may do all things related to the operation of the Business that the Grantor could have done if living, in a fiduciary capacity:

1. The Trustees may carry out the terms of any option or buy-sell agreements into which the Grantor may have entered.

2. The Trustees may sell or liquidate any of the Business interests at such price and on such terms as the Trustees may deem advisable.

3. The Trustees may arrange for and supervise the continued operations of the Business.

4. The Trustees may vote (in person or by proxy) as stockholder or otherwise and in any matter involving the Business on behalf of the Trust Fund.

5. The Trustees may grant, exercise, sell, or otherwise deal in any rights to subscribe to additional interests in the Business.

6. The Trustees may take any actions appropriate to cause the capital stock or securities in the Business to be registered for public sale under any state or Federal securities act; may enter into any underwriting agreements or other agreements necessary or advisable for this registration and sale; and may grant indemnities to underwriters and others in connection with such registration.

7. The Trustees may participate in any incorporation, dissolution, merger, reorganization or other change in the form of the Business and, where appropriate, deposit securities with any protective committees and participate in voting trusts.

8. The Trustees may delegate to others discretionary power to take any action with respect to the management and affairs of the Business that the Grantor could have taken as the owner of the Business.

9. The Trustees may invest additional capital in, subscribe to additional stock or securities of and loan money or credit to the Business from the Trust Fund.

10. The Trustees may accept as correct financial or other statements rendered by the Business as to its conditions and operations except when having actual notice to the contrary.

B. **Liabilities.** Any contractual and tort liabilities arising from the Business shall be satisfied first from its assets, and only secondarily from other assets of the Trust Fund. The Trustees shall have no liability to anyone for any loss arising from the operations, retention or sale of the Business.

C. **Compensation.** The Trustees shall be entitled to additional reasonable compensation for the performance of services with respect to the Business, which may be paid to the Trustees from the Business, the Trust Fund, or both, as the Trustees may deem advisable.

D. **Conflict of Interest Waived.** The Trustees may exercise the authorities granted under this Article even if the Trustees shall own personally an interest in the Business.

E. **The "Business" Defined.** The "Business" means any interest the Grantor, the Trust, or both, shall own at the Grantor's death, representing, in the aggregate, at least five percent (5%) of the total equity interests in any actively-conducted trade or business, whether incorporated or unincorporated. The "Business" shall also include, but not be limited to, any five percent (5%) or greater equity interests in any corporations, general and/or limited partnerships as well as membership interests in any limited liability company or other business enterprise formed, operated or beneficially owned by the Grantor prior to the Grantor's death, and shall also include the Grantor's interest in Graham Land and Cattle Company, LLP, or its successor-in-interest, if any or participated in (to the extent of five percent (5%) or more) by the Grantor prior to the Grantor's death, and shall also include the Grantor's interest in Graham Land and Cattle Company, LLP, or its successor-in-interest, if any. The "Business" does not include any interests that are regularly traded on an established exchange or over-the-counter.

Exhibit YY

Acquisition and Maintenance of Real Property

The Trustees may acquire, hold and maintain any residence (whether held as real property, condominium or cooperative apartment) for the use and benefit of any one or more of the beneficiaries of any trust whenever that action is consistent with the terms of that trust, and, if the Trustees shall determine that it would be in the best interests of the beneficiaries of that trust (and consistent with the terms of that trust) to maintain a residence for their use but that the residence owned by that Trust should not be used for such purposes, the Trustees may sell said residence and apply the net proceeds of sale to the purchase of such other residence or make such other arrangements as the Trustees shall deem suitable for the purpose. Any proceeds of sale not needed for reinvestment in a residence as provided above shall be added to the principal of that trust and thereafter held, administered and disposed of as a part thereof. The Trustees may pay all carrying charges of such residence, including, but not limited to, any taxes, assessments and maintenance thereon, and all expenses of the repair and operation thereof, including the employment of household employees (including independent contractors) and other expenses incident to the running of a household for the benefit of the beneficiaries of that trust. Without limiting the foregoing, the Trustees may permit any income beneficiary of any trust created hereunder to occupy any real property or use any personal property forming a part of that trust on such terms as the Trustees may determine, whether rent free or in consideration of payment of taxes, insurance, maintenance and ordinary repairs or otherwise. In the case of any trust created under this Agreement that qualifies for the marital deduction, such occupancy shall be rent free and any other condition shall be consistent with the intention that the have that degree of beneficial enjoyment of the trust property during life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust, so that the 's interest is a qualifying income interest for life for purposes of the marital deduction.

100 Years Is a Long Time- New Concepts

And Practical Planning Ideas

Table of Contents

Sections:

1. Issues in the Modification or Revocation of Long-Term irrevocable Trusts (Included)

2. Measuring How Long a Trustee Should Hold Settlor Designated Permissive and Mandatory Assets (Included)

3. The Use of trust Protectors or Boards of Advisors in Long-Term Irrevocable Trusts (Omitted)

4. Divining the Intent of the Trust Settlor (Omitted)

5. Encouraging Accomplishment and Discouraging Sloth in Trust Beneficiaries (Omitted)

6. A Perpetual Dynasty Trust Predicament: The Problem of Choosing Successor Trustee for the Long Future (Omitted)

7. Changing the Governing Law of a Trust for Non-Tax Reasons (Omitted)

REV. PROC. 2011-3, 2011-1 I.R.B. 111 (1/3/2011)

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 2011-3

TABLE OF CONTENTS

SECTION 1. PURPOSE AND NATURE OF CHANGES

SECTION 2. BACKGROUND AND SCOPE

SECTION 3. AREAS RULINGS WILL NOT BE ISSUED

SECTION 4. AREAS RULINGS WILL NOT ORDINARILY BE ISSUED

SECTION 5. AREAS UNDER STUDY WHERE RULINGS WILL NOT BE ISSUED

SECTION 6. AREAS COVERED BY AUTOMATIC APPROVAL PROCEDURES

SECTION 7. EFFECT ON OTHER REVENUE PROCEDURES

SECTION 8. EFFECTIVE DATE

SECTION 9. PAPERWORK REDUCTION ACT

DRAFTING INFORMATION

SECTION 1. PURPOSE AND NATURE OF CHANGES

.01 The purpose of this revenue procedure is to update Rev. Proc. 2010-3, 2010-1 C.B. 110, by providing a revised list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Corporate), the Associate Chief Counsel (Financial Institutions and Products), the Associate Chief Counsel (Income Tax and Accounting), the Associate Chief Counsel (Passthroughs and Special Industries), the Associate Chief Counsel (Procedure and Administration), and the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) relating to issues on which the Internal Revenue Service will not issue letter rulings or determination letters. For a list of areas under the jurisdiction of the Associate Chief Counsel (International) relating to international issues on which the Service will not issue letter rulings or determination letters, see Rev. Proc. 2011-7, this Bulletin. For a list of areas under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division relating to issues, plans or plan amendments on which the Service will not issue letter rulings and determination letters, see, respectively, section 8 of Rev. Proc. 2011-4, this Bulletin, and section 3.02 of Rev. Proc. 2011-6, this Bulletin.

.02 Changes.

(1) Section 3.01(48), regarding §§451 and 45 and Nonqualified Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations, has been modified.

(2) Section 3.01(60), regarding §1033 involuntary Conversions, has been modified.

(3) New section 4.01(45), regarding §1362(d)(3), has been added.

(4) Section 4.07(53), regarding §2601 and the generation-skipping transfer tax, has been modified.

(5) Old section 5.02, regarding §72 and "partial annuitization," has been deleted.

(6) New section 5.09, regarding §§661 and 662 and "decanting," has been added.

(7) New section 5.16, regarding §2501 and "decanting," has been added.

(8) New section 5.17, regarding §§2601 and 2663 and "decanting," has been added.

(9) Section 6.02, regarding §442, has been modified.

SECTION 2. BACKGROUND AND SCOPE OF APPLICATION

.01 Background.

Whenever appropriate in the interest of sound tax administration, it is the policy of the Service to answer inquiries of individuals and organizations regarding their status for tax purposes and the tax effects of their acts or transactions, prior to the filing of returns or reports that are required by the revenue laws.

There are, however, certain areas in which, because of the inherently factual nature of the problems involved, or for other reasons, the Service will not issue rulings or determination letters. These areas are set forth in four sections of this revenue procedure. Section 3 reflects those areas in which rulings and determinations will not be issued. Section 4 sets forth those areas in which they will not ordinarily be issued. "Not ordinarily" means that unique and compelling reasons must be demonstrated to justify the issuance of a ruling or determination letter. Those sections reflect a number of specific questions and problems as well as general areas. Section 5 lists specific areas for which the Service is temporarily not issuing rulings and determinations because those matters are under study. Finally, section 6 of this revenue procedure lists specific areas where the Service will not ordinarily issue rulings because the Service has provided automatic approval procedures for these matters.

See Rev. Proc. 2011-1, this Bulletin, particularly section 6 captioned "Under What Circumstances Does The Service Not Issue Letter Rulings Or Determination Letters?" for general instructions and other situations in which the Service will not or ordinarily will not issue letter rulings or determination letters.

With respect to the items listed, revenue rulings or revenue procedures may be published in the Internal Revenue Bulletin from time to time to provide general guidelines regarding the position of the Service.

Additions or deletions to this revenue procedure as well as restatements of items listed will be made by modification of this revenue procedure. Changes will be published as they occur throughout the year and will be incorporated annually in a new revenue procedure published as the third revenue procedure of the year. These lists should not be considered all-inclusive. Decisions not to rule on individual cases (as contrasted with those that present significant pattern issues) are not reported in this revenue procedure and will not be added to subsequent revisions.

.02 Scope of Application.

This revenue procedure does not preclude the submission of requests for technical advice to the National Office from other offices of the Service.

.03 No-Rule Issues Part of Larger Transactions.

If it is impossible for the Service to determine the tax consequences of a larger transaction without knowing the resolution of an issue on which the Service will not issue rulings and determinations under this revenue procedure involving a part of the transaction or a related transaction, the taxpayer must state in the request to the best of the taxpayer's knowledge and belief the tax consequences of the no-rule issue. The Service's ruling or determination letter will state that the Service did not consider, and no opinion is expressed upon, that issue. In appropriate cases the Service may decline to issue rulings or determinations on such larger transactions due to the relevance of the no-rule issue, despite the taxpayer's representation. See also section 4.02(2) of this revenue procedure.

SECTION 3. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED

.01 Specific questions and problems. (1) Section 61.—Gross Income Defined.—Whether amounts voluntarily deferred by a taxpayer under a deferred-compensation plan maintained by an organization described in §501 (other than a plan maintained by an eligible employer pursuant to the provisions of §457) are currently includible in the taxpayer's gross income.

(2) Section 61.—Gross Income Defined.—Whether a split-dollar life insurance arrangement is "materially modified" within the meaning of §1.61-22(j)(2) of the Income Tax Regulations. (Also §§83, 301, 1401, 2501, 3121, 3231, 3306, 3401, and 7872.)

(3) Sections 61, 451, and 1001.—Gross Income Defined; General Rule for Taxable Year of Inclusion; Determination of Amount and Recognition of Gain or Loss.—Whether, under authorization by an appropriate State agency to recover certain costs pursuant to State specified cost recovery

legislations, any investor-owned utility company realizes income upon: (i) the creation of an intangible property right; (ii) the transfer of that intangible property right; or (iii) the securitization of the intangible property right.

(4) Section 79.—Group-Term Life Insurance Purchased for Employees.—Whether a group insurance plan for 10 or more employees qualifies as group-term insurance, if the amount of insurance is not computed under a formula that would meet the requirements of §1.79-1(c)(2)(ii) of the regulations if the group consisted of fewer than 10 employees.

(5) Section 83.—Property Transferred in Connection with Performance of Services.—Whether a restriction constitutes a substantial risk of forfeiture, if the employee is a controlling shareholder. Also, whether a transfer has occurred, if the amount paid for the property involves a nonrecourse obligation.

(6) Section 83.—Property Transferred in Connection with Performance of Services.—Which corporation is entitled to the deduction under §83(h) in cases where a corporation undergoes a corporate division, if the facts are not similar to those described in Rev. Rul. 2002-1, 2002-1 C.B. 268.

(7) Section 101.—Certain Death Benefits.—Whether there has been a transfer for value for purposes of §101(a) in situations involving a grantor and a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§673 to 677.

(8) Sections 101, 761, and 7701.—Definitions.—Whether, in connection with the transfer of a life insurance policy to an unincorporated organization, (i) the organization will be treated as a partnership under §§761 and 7701, or (ii) the transfer of the life insurance policy to the organization will be exempt from the transfer for value rules of §101, when substantially all of the organization's assets consists or will consist of life insurance policies on the lives of the members.

(9) Section 102.—Gifts and Inheritances.— Whether a transfer is a gift within the meaning of §102(a).

(10) Section 105(h).—Amount Paid to Highly Compensated Individuals Under Discriminatory Self-Insured Medical Expense Reimbursement Plan.—Whether a self-insured medical reimbursement plan satisfies the requirements of §105(h) for a plan year.

(11) Section 107.—Rental Value of Parsonages.—Whether amounts distributed to a retired minister from a pension or annuity plan should be excludible from the minister's gross income as a parsonage allowance under §107.

(12) Section 107.—Rental Value of Parsonages.—Whether an individual is a "minister of the gospel" for Federal tax purposes. (Also §§1402(a)(8), (c)(4) and (e), 3121(b)(8)(A), and 3401(a)(9)).

(13) Section 115.—Income of States, Municipalities, Etc.—The results of transactions pursuant to a plan or arrangement created by State statute a primary objective of which is to enable participants to pay for the costs of a post-secondary education for themselves or a designated beneficiary, including: (i) whether the plan or arrangement, itself, is an entity separate from a State and, if so, how the plan or arrangement is treated for Federal tax purposes; and (ii) whether any contract under the plan or arrangement is a debt instrument and, if so, how interest or original issue discount attributable to the contract is treated for Federal tax purposes. (Also §§61, 163, 1275, 2501, and 7701.)

(14) Section 115.—Income of States, Municipalities, Etc.—Whether the income of membership organizations established by States exclusively to reimburse members for losses arising from workmen's compensation claims is excluded from gross income under §115.

(15) Section 117.—Qualified Scholarships.—Whether amounts paid to research fellows and research associates are scholarships or fellowships excluded from wages for FICA tax purposes.

(16) Section 117.—Qualified Scholarships.—Whether an employer-related scholarship or fellowship grant is excludible from the employee's gross income, if there is no intermediary private foundation distributing the grants, as there was in Rev. Proc. 76-47, 1976-2 C.B. 670.

(17) Section 119.—Meals or Lodging Furnished for the Convenience of the Employer.—Whether the

value of meals or lodging is excludible from gross income by an employee who is a controlling shareholder of the employer.

(18) Section 121.—Exclusion of Gain from Sale of Principal Residence.—Whether property qualifies as the taxpayer's principal residence.

(19) Section 125.—Cafeteria Plans.—Whether amounts used to provide group-term life insurance under §79, accident and health benefits under §§105 and 106, and dependent care assistance programs under §129 are includible in the gross income of participants and considered "wages" for purposes of §§3401, 3121, and 3306 when the benefits are offered through a cafeteria plan.

(20) Section 162.—Trade or Business Expenses.—Whether compensation is reasonable in amount.

(21) Section 163.—Interest.—The income tax consequences of transactions involving "shared appreciation mortgage" (SAM) loans in which a taxpayer, borrowing money to purchase real property, pays a fixed rate of interest on the mortgage loan below the prevailing market rate and will also pay the lender a percentage of the appreciation in value of the real property upon termination of the mortgage. This applies to all SAM arrangements where the loan proceeds are used for commercial or business activities, or where used to finance a personal residence, if the facts are not similar to those described in Rev. Rul. 83-51, 1983-1 C.B. 48. (Also §§61, 451, 461, 856, 1001, and 7701.)

(22) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a charitable contribution deduction under §170 is allowed for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in §170(c).

(23) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.

(24) Section 181.—Treatment of Certain Qualified Film and Television Productions.—The determination under §1.181-1T(a)(1) and (2) as to who is the owner of a qualified film or television production.

(25) Section 199.—Income Attributable to Domestic Production Activities.—The determination under §1.199-3(f)(1) as to who is the taxpayer that has the benefits and burdens of ownership under Federal income tax principles of any qualifying production property (as defined in §1.199-3(j)(1)), qualified film (as defined in §1.199-3(k)), or utilities (as defined in §1.199-3(l)) during the period in which a qualifying activity under §199 occurs.

(26) Section 213.—Medical, Dental, Etc., Expenses.—Whether a capital expenditure for an item that is ordinarily used for personal, living, or family purposes, such as a swimming pool, has as its primary purpose the medical care of the taxpayer or the taxpayer's spouse or dependent, or is related directly to such medical care.

(27) Section 264(b).—Certain Amounts Paid in Connection with Insurance Contracts.—Whether "substantially all" the premiums of a contract of insurance are paid within a period of 4 years from the date on which the contract is purchased. Also, whether an amount deposited is in payment of a "substantial number" of future premiums on such a contract.

(28) Section 264(c)(1).—Certain Amounts Paid in Connection with Insurance Contracts.—Whether §264(c)(1) applies.

(29) Section 269.—Acquisitions Made to Evade or Avoid Income Tax.—Whether an acquisition is within the meaning of §269.

(30) Section 274.—Disallowance of Certain Entertainment, Etc., Expenses.—Whether a taxpayer who is traveling away from home on business may, in lieu of substantiating the actual cost of meals, deduct a fixed per-day amount for meal expenses that differs from the amount authorized by the revenue procedure providing optional rules for substantiating the amount of travel expenses for the period in which the expense was paid or incurred.

(31) Section 302.—Distributions in Redemption of Stock.—Whether §302(b) applies when the consideration given in redemption by a corporation consists entirely or partly of its notes payable, and the shareholder's stock is held in escrow or as security for payment of the notes with the possibility that the stock may or will be returned to the shareholder in the future, upon the happening of specific defaults by the corporation.

(32) Section 302.—Distributions in Redemption of Stock.—Whether §302(b) applies when the consideration given in redemption by a corporation in exchange for a shareholder's stock consists entirely or partly of the corporation's promise to pay an amount based on, or contingent on, future earnings of the corporation, when the promise to pay is contingent on working capital being maintained at a certain level, or any other similar contingency.

(33) Section 302.—Distributions in Redemption of Stock.—Whether §302(b) applies to a redemption of stock, if after the redemption the distributing corporation uses property that is owned by the shareholder from whom the stock is redeemed and the payments by the corporation for the use of the property are dependent upon the corporation's future earnings or are subordinate to the claims of the corporation's general creditors. Payments for the use of property will not be considered to be dependent upon future earnings merely because they are based on a fixed percentage of receipts or sales.

(34) Section 302.—Distributions in Redemption of Stock.—Whether the acquisition or disposition of stock described in §302(c)(2)(B) has, or does not have, as one of its principal purposes the avoidance of Federal income taxes within the meaning of that section, unless the facts and circumstances are materially identical to those set forth in Rev. Rul. 85-19, 1985-1 C.B. 94; Rev. Rul. 79-67, 1979-1 C.B. 128; Rev. Rul. 77-293, 1977-2 C.B. 91; Rev. Rul. 57-387, 1957-2 C.B. 225; Rev. Rul. 56-584, 1956-2 C.B. 179; or Rev. Rul. 56-556, 1956-2 C.B. 177.

(35) Section 302(b)(4) and (e).—Redemption from Noncorporate Shareholder in Partial Liquidation; Partial Liquidation Defined.—The amount of working capital attributable to a business or portion of a business terminated that may be distributed in partial liquidation.

(36) Section 312.—Effect on Earnings and Profits.—The determination of the amount of earnings and profits of a corporation.

(37) Sections 331, 453, and 1239.—The Tax Effects of Installment Sales of Property Between Entities with Common Ownership.—The tax effects of a transaction in which there is a transfer of property by a corporation to a partnership or other non-corporate entity (or the transfer of stock to such entity followed by a liquidation of the corporation) when more than a nominal amount of the stock of such corporation and the capital or beneficial interests in the purchasing entity (that is, more than 20 percent in value) is owned by the same persons, and the consideration to be received by the selling corporation or the selling shareholders includes an installment obligation of the purchasing entity.

(38) Sections 332, 351, 368(a)(1)(A), (B), (C), (E) and (F), and 1036.—Complete Liquidations of Subsidiaries; Transfer to Corporation Controlled by Transferor; Definitions Relating to Corporate Reorganizations; and Stock for Stock of Same Corporation.—Whether a transaction qualifies under §332, §351 or §1036 for nonrecognition treatment, or whether it constitutes a corporate reorganization within the meaning of §368(a)(1)(A) (including a transaction that qualifies under §368(a)(1)(A) by reason of §368(a)(2)(D) or §368(a)(2)(E)), §368(a)(1)(B), §368(a)(1)(C), §368(a)(1)(E) or §368(a)(1)(F), and whether various consequences (such as nonrecognition and basis) result from the application of that section, unless the Service determines that there is a significant issue that must be resolved in order to decide those matters. If the Service determines that there is a significant issue, and to the extent the transaction is not described in another no-rule section, the Service will rule on the entire transaction, and not just the significant issue. However, the Service may rule on a significant issue in a transaction that occurs in the context of a §355 distribution without ruling on the entire transaction. See section 6.03 of Rev. Proc. 2011-1, this Bulletin.

Notwithstanding the preceding paragraph, the Service will rule on the application of §351 to a controlled corporation when the transaction is undertaken prior to the distribution of the stock of the controlled corporation in a transaction qualifying under §355.

SIGNIFICANT ISSUE: A significant issue is an issue of law that meets the three following tests: (1) the issue is not clearly and adequately addressed by a statute, regulation, decision of a court, tax treaty, revenue ruling, revenue procedure, notice, or other authority published in the Internal Revenue Bulletin; (2) the resolution of the issue is not essentially free from doubt; and (3) the issue is legally significant and germane to determining the major tax consequences of the transaction. An issue of law will be considered not clearly and adequately addressed by the authorities above, and its resolution will not be essentially free from doubt when, because of concern over a legal issue (as opposed to a factual issue), taxpayer's counsel is unable to render an unqualified opinion on what the tax consequences of the transaction will be.

OBTAINING A RULING: To obtain a ruling on a transaction involving a significant issue, the taxpayer

must in its ruling request explain the significance of the issue, set forth the authorities most closely related to the issue, and explain why the issue is not resolved by these authorities.

(39) Section 355.—Distribution of Stock and Securities of a Controlled Corporation.—Whether the distribution of the stock of a controlled corporation is being carried out for one or more corporate business purposes, whether the transaction is used principally as a device, and whether the distribution and an acquisition are part of a plan under §355(e). *See* Rev. Proc. 2003-48, 2003-2 C.B. 86. Notwithstanding the preceding sentence, the Service may issue a ruling regarding the effect of redemptions under §355(e) pending the issuance of temporary or final regulations regarding redemptions under §355(e) if an adverse ruling on such question would result in there being a direct or indirect acquisition by one or more persons of stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation that is part of a plan under §355(e).

(40) Section 351.—See section 3.01(38), above.

(41) Section 358.—Basis to Distributees.—The acceptability of an estimation procedure or the acceptability of a specific sampling procedure to determine the basis of stock acquired by an acquiring corporation in a reorganization described in §368(a)(1)(B).

(42) Section 368.—See section 3.01(38), above.

(43) Section 409A.—Inclusion in Gross Income of Deferred Compensation Under Nonqualified Deferred Compensation Plans.—— The income tax consequences of establishing, operating, or participating in a nonqualified deferred compensation plan within the meaning of §1.409A-1(a); whether a plan is described in §1.409A-1(a)(3)(iv) or (v); whether a plan is a bona fide vacation leave, sick leave or compensatory time plan described in §1.409A-1(a)(5); and whether a plan provides for the deferral of compensation under §1.409A-1(b).

(44) Section 424.—Substitution or Assumption of Incentive Stock Options.—Whether the substitution of a new Incentive Stock Option ("ISO") for an old ISO, or the assumption of an old ISO, by an employer by reason of a corporate transaction constitutes a modification which results in the issuance of a new option by reason of failing to satisfy the spread test requirement of §424(a)(1) or the ratio test requirement of §1.425-1(a)(4). The Service will continue to rule on the issue of whether the new ISO or the assumption of the old ISO gives the employee additional benefits not present under the old option within the meaning of §424(a)(2).

(45) Section 451.—See section 3.01(3), above.

(46) Section 451.—General Rule for Taxable Year of Inclusion.—The tax consequences of a nonqualified unfunded deferred-compensation arrangement with respect to a controlling shareholder-employee eligible to participate in the arrangement.

(47) Section 451.—General Rule for Taxable Year of Inclusion.—The tax consequences of nonqualified unfunded deferred-compensation arrangements where the arrangements fail to meet the requirements of Rev. Proc. 92-65, 1992-2 C.B. 428; and Rev. Proc. 71-19, 1971-1 C.B. 698.

(48) Sections 451 and 457.—General Rule for Taxable Year of Inclusion; Nonqualified Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations.—The tax consequences to unidentified independent contractors in nonqualified unfunded deferred compensation plans. This applies to plans established under §451 by employers in the private sector and to plans of State and local governments and tax-exempt organizations under §457. However, a ruling with respect to a specific independent contractor's participation in such a plan may be issued.

(49) Section 453.—See section 3.01(37), above.

(50) Section 457.—See section 3.01(48), above.

(51) Section 641.—Imposition of Tax.—Whether the period of administration or settlement of an estate or a trust (other than a trust described in §664) is reasonable or unduly prolonged.

(52) Section 642(c).—Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose.—Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.

(53) Section 664.—Charitable Remainder Trusts.—Whether the settlement of a charitable remainder trust upon the termination of the noncharitable interest is made within a reasonable period of time.

(54) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§673 to 677.

(55) Section 704(b)(2).—Partner's Distributive Share.—Whether the allocation to a partner under the partnership agreement of income, gain, loss, deduction, or credit (or an item thereof) has substantial economic effect.

(56) Section 704(e).—Family Partnerships.—Matters relating to the validity of a family partnership when capital is not a material income producing factor.

(57) Section 761.—See section 3.01(8), above.

(58) Section 856.—Definition of Real Estate Investment Trust.—Whether a corporation whose stock is "paired" with or "stapled" to stock of another corporation will qualify as a real estate investment trust under §856, if the activities of the corporations are integrated.

(59) Section 1001.—See section 3.01(3), above.

(60) Section 1033.—Involuntary Conversions.—Whether the replacement or proposed replacement of compulsorily or involuntarily converted property does or does not qualify under §1033(a), if the taxpayer has already filed a federal tax return for the taxable year in which the property was converted. The Service may issue a determination letter in this case. See section 12.01 of Rev. Proc. 2011-1, this Bulletin.

(61) Section 1036.—See section 3.01(38), above.

(62) Section 1221.—Capital Asset Defined.—Whether specialty stock allocated to an investment account by a registered specialist on a national securities exchange is a capital asset.

(63) Section 1239.—See section 3.01(37), above.

(64) Section 1551.—Disallowance of the Benefits of the Graduated Corporate Rates and Accumulated Earnings Credit.—Whether a transfer is within §1551.

(65) Section 2031.—Definition of Gross Estate.—Actuarial factors for valuing interests in the prospective gross estate of a living person.

(66) Section 2055.— Transfers for Public, Charitable, and Religious Uses.—Whether a charitable contribution deduction under §2055 is allowed for the transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in §2055(a).

(67) Section 2512.—Valuation of Gifts.—Actuarial factors for valuing prospective or hypothetical gifts of a donor.

(68) Section 2522.—Charitable and Similar Gifts.—Whether a charitable contribution deduction under §2522 is allowable for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in §2522(a).

(69) Section 2601.—Tax Imposed. Exceptions: Retention of Trust's Generation-Skipping Transfer Tax Exempt Status in the Case of Modifications, Etc.—Whether a trust exempt from generation-skipping transfer (GST) tax under §26.2601-1(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in §26.2601-1(b)(4)(i)(E).

(70) Sections 3121, 3306, and 3401.—Definitions.—For purposes of determining prospective employment status, whether an individual will be an employee or an independent contractor. A ruling with regard to prior employment status may be issued.

(71) Sections 3121, 3306, and 3401.—Definitions; Employment Taxes.—Who is the employer of an

"employee-owner" as defined in §269A(b)(2).

(72) Sections 3121, 3306, and 3401.—Definitions.—For purposes of determining employment classification pursuant to the filing of Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, whether a worker is a bona fide partner and, therefore, not an employee of the business is at issue.

(73) Section 4980B.—Failure to Satisfy Continuation Coverage Requirements of Group Health Plans.—Whether an action is "gross misconduct" within the meaning of §4980B(f)(3)(B). (See section 3.05 of Rev. Proc. 87-28, 1987-1 C.B. 770, 771.) (74) Section 6166—Estates consisting largely of an interest in a closely held business — Requests involving section 6166 where there is no decedent.

(75) Section 6901.—Transferee Liability.—Whether a taxpayer is liable for tax as a transferee.

(76) Section 7701.—Definitions.—The classification of an instrument that has certain voting and liquidation rights in an issuing corporation but whose dividend rights are determined by reference to the earnings of a segregated portion of the issuing corporation's assets, including assets held by a subsidiary.

(77) Section 7701.—See section 3.01(8), above.

(78) Section 7704.—Certain Publicly Traded Partnerships Treated as Corporations.—Whether interests in a partnership that are not traded on an established securities market (within the meaning of §7704(b) and §1.7704-1(b)) are readily tradable on a secondary market or the substantial equivalent thereof under §1.7704-1(c)(1) of the Procedure and Administration Regulations.

.02 General Areas.

(1) The results of transactions that lack a *bona fide* business purpose or have as their principal purpose the reduction of Federal taxes.

(2) A matter upon which a court decision adverse to the Government has been handed down and the question of following the decision or litigating further has not yet been resolved.

(3) A matter involving alternate plans of proposed transactions or involving hypothetical situations.

(4) Whether under Subtitle F (Procedure and Administration) reasonable cause, due diligence, good faith, clear and convincing evidence, or other similar terms that require a factual determination exist.

(5) Whether a proposed transaction would subject the taxpayer to a criminal penalty.

(6) A request that does not comply with the provisions of Rev. Proc. 2011-1, this Bulletin.

(7) Whether, under the common law rules applicable in determining the employer-employee relationship, a professional staffing corporation (loan-out corporation) or the subscriber is the employer of individuals, if: (i) the loan-out corporation hires employees of the subscriber and assigns the employees back to the subscriber, or (ii) the loan-out corporation assigns individuals to subscribers for more than a temporary period (1 year or longer).

(8) Questions that the Service determines, in its discretion, should not be answered in the general interests of tax administration.

(9) Any frivolous issue, as that term is defined in section 6.10 of Rev. Proc. 2011-1, this Bulletin.

SECTION 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED

.01 Specific questions and problems. (1) Sections 38, 39, 46, and 48.—General Business Credit; Carryback and Carryforward of Unused Credits; Amount of Credit; Energy Credit; Reforestation Credit.—Application of these sections where the formal ownership of property is in a party other than the taxpayer, except when title is held merely as security.

(2) Section 61.—Gross Income Defined.—Determination as to who is the true owner of property in cases involving the sale of securities, or participation interests therein, where the purchaser has the contractual right to cause the securities, or participation interests therein, to be purchased by either the seller or a third party.

(3) Sections 61 and 163.—Gross Income Defined; Interest.—Determinations as to who is the true

owner of property or the true borrower of money in cases in which the formal ownership of the property, or the liability for the indebtedness, is in another party.

(4) Sections 83 and 451.—Property Transferred in Connection with Performance of Services; General Rule for Taxable Year of Inclusion.—When compensation is realized by a person who, in connection with the performance of services, is granted a nonstatutory option without a readily ascertainable fair market value to purchase stock at a price that is less than the fair market value of the stock on the date the option is granted.

(5) Section 103.—Interest on State and Local Bonds.—Whether the interest on State or local bonds will be excludible from gross income under §103(a), if the proceeds of issues of bonds (other than advance refunding issues) are placed in escrow or otherwise not expended for a governmental purpose for an extended period of time even though the proceeds are invested at a yield that will not exceed the yield on the State or local bonds prior to their expenditure.

(6) Section 103.—Interest on State and Local Bonds.—Whether a State or local governmental obligation that does not meet the criteria of section 5 of Rev. Proc. 89-5, 1989-1 C.B. 774, is an "arbitrage bond" within the meaning of former §103(c)(2) solely by reason of the investment of the bond proceeds in acquired non-purpose obligations at a materially higher yield more than 3 years after issuance of the bonds or 5 years after issuance of the bonds in the case of construction issues described in former §1.103-13(a)(2)(ii)(E) or §1.148-2(e)(2)(ii).

(7) Section 141.—Private Activity Bond; Qualified Bond.—Whether State or local bonds will meet the "private business use test" and the "private security or payment test" under §141(b)(1) and (2) in situations in which the proceeds are used to finance certain output facilities and, pursuant to a contract to take, or take or pay for, a nongovernmental person purchases 30 percent or more of the actual output of the facility but 10 percent or less of the: (i) subparagraph (5) output of the facility as defined in §1.103-7(b)(5)(ii)(b) (issued under former §103(b)), or (ii) available output of the facility as defined in §1.141-7(b)(1). In similar situations, the Service will not ordinarily issue rulings or determination letters concerning questions arising under paragraphs (3), (4), and (5) of §141(b).

(8) Sections 142 and 144.—Exempt Facility Bond; Qualified Small Issue Bond.—Whether an issue of private activity bonds meets the requirements of §142 or §144(a), if the sum of—

(i) the portion of the proceeds used to finance a facility in which an owner (or related person) or a lessee (or a related person) is a user of the facility both after the bonds are issued and at any time before the bonds were issued, and

(ii) the portion used to pay issuance costs and non-qualified costs equals more than 5 percent of the net proceeds, as defined in §150(a)(3).

(9) Section 148.—Arbitrage.—Whether amounts received as proceeds from the sale of municipal bond financed property and pledged to the payment of debt service or pledged as collateral for the municipal bond issue are sinking fund proceeds within the meaning of former §1.103-13(g) (issued under former §103(c)) or replaced proceeds described in §148(a)(2) (or former §103(c)(2)(B)).

(10) Sections 162 and 262.—Trade or Business Expenses; Personal, Living, and Family Expenses.—Whether expenses are nondeductible commuting expenses, except for situations governed by Rev. Rul. 99-7, 1999-1 C.B. 361.

(11) Section 163.—See section 4.01(3), above.

(12) Section 167.—Depreciation.

(i) Useful lives of assets.

(ii) Depreciation rates.

(iii) Salvage value of assets.

(13) Sections 167 and 168.—Depreciation; Accelerated Cost Recovery System.—Application of those sections where the formal ownership of property is in a party other than the taxpayer except when title is held merely as security.

(14) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a transfer to a pooled income fund described in §642(c)(5) qualifies for a charitable contribution deduction under §170(f)(2)(A).

(15) Section 170(c).—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.

(16) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a transfer to a charitable remainder trust described in §664 that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under §170(f)(2)(A).

(17) Section 216.—Deduction of Taxes, Interest, and Business Depreciation by Cooperative Housing Corporation Tenant-Stockholder.—If a cooperative housing corporation (CHC), as defined in §216(b)(1), transfers an interest in real property to a corporation (not a CHC) in exchange for stock or securities of the transferee corporation, which engages in commercial activity with respect to the real property interest transferred, whether (i) the income of the transferee corporation derived from the commercial activity, and (ii) any cash or property (attributable to the real property interest transferred) distributed by the transferee corporation to the CHC will be considered as gross income of the CHC for the purpose of determining whether 80 percent or more of the gross income of the CHC is derived from tenant-stockholders within the meaning of §216(b)(1)(D).

(18) Section 262.—See section 4.01(10), above.

(19) Section 265(a)(2).—Expenses and Interest Relating to Tax-Exempt Income.—Whether indebtedness is incurred or continued to purchase or carry obligations the interest on which is wholly exempt from the taxes imposed by subtitle A.

(20) Section 302.—Distributions in Redemption of Stock.—The tax effect of the redemption of stock for notes, when the payments on the notes are to be made over a period in excess of 15 years from the date of issuance of such notes.

(21) Section 302(b)(4) and (e).—Redemption from Noncorporate Shareholder in Partial Liquidation; Partial Liquidation Defined.—Whether a distribution will qualify as a distribution in partial liquidation under §302(b)(4) and (e)(1)(A), unless it results in a 20 percent or greater reduction in (i) gross revenue, (ii) net fair market value of assets, and (iii) employees. (Partial liquidations that qualify as §302(e)(2) business terminations are not subject to this provision.)

(22) Sections 302(b)(4) and (e), 331, 332, and 346(a).—Effects on Recipients of Distributions in Corporate Liquidations.—The tax effect of the liquidation of a corporation preceded or followed by the transfer of all or a part of the business assets to another corporation (1) that is the alter ego of the liquidating corporation, and (2) which, directly or indirectly, is owned more than 20 percent in value by persons holding directly or indirectly more than 20 percent in value of the liquidating corporation's stock. For purposes of this section, ownership will be determined by application of the constructive ownership rules of §318(a) as modified by §304(c)(3).

(23) Section 306.—Dispositions of Certain Stock.—Whether the distribution or disposition or redemption of "section 306 stock" in a closely held corporation is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes within the meaning of §306(b)(4).

(24) Sections 331 and 332.—See section 4.01(22), above.

(25) Sections 331 and 346(a).—Gain or Loss to Shareholders in Corporate Liquidations.—The tax effect of the liquidation of a corporation by a series of distributions, when the distributions in liquidation are to be made over a period in excess of 3 years from the adoption of the plan of liquidation.

(26) Section 346(a).—See sections 4.01(22) and (25), above.

(27) Section 351.—Transfer to Corporation Controlled by Transferor.—Whether §351 applies to the transfer of an interest in real property by a cooperative housing corporation (as described in §216(b)(1)) to a corporation in exchange for stock or securities of the transferee corporation, if the transferee engages in commercial activity with respect to the real property interest transferred.

(28) Section 355.—Distribution of Stock and Securities of a Controlled Corporation.—Whether the active business requirement of §355(b) is met when, within the 5-year period described in §355(b)(2)(B), a distributing corporation acquired control of a controlled corporation as a result of the distributing corporation transferring cash or other liquid or inactive assets to the controlled corporation in a transaction in which gain or loss was not recognized as a result of the transfer meeting the

requirements of §351(a) or §368(a)(1)(D).

(29) Section 355.—Distribution of Stock and Securities of a Controlled Corporation.—Any issue under §355(e) other than whether a distribution and an acquisition are part of a plan (*i.e.*, any non-plan issue). Notwithstanding the preceding sentence, the Service generally will rule on a non-plan issue or issues (*e.g.*, whether a corporation constitutes a predecessor of distributing) if an adverse ruling on such non-plan issue or issues would result in there being a direct or indirect acquisition by one or more persons of stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation that is part of a plan under §355(e).

(30) Section 441(i).—Taxable Year of Personal Service Corporations.—Whether the principal activity of the taxpayer during the testing period for the taxable year is the performance of personal services within the meaning of §1.441-3(c)(1)(iii).

(31) Section 448(d)(2)(A).—Limitation on Use of Cash Method of Accounting; Qualified Personal Service Corporation.—Whether 95 percent or more of the time spent by employees of the corporation, serving in their capacity as such, is devoted to the performance of services within the meaning of §1.448-1T(e)(4)(i).

(32) Section 451.—General Rule for Taxable Year of Inclusion.—The tax consequences of a nonqualified deferred compensation arrangement using a grantor trust where the trust fails to meet the requirements of Rev. Proc. 92-64, 1992-2 C.B. 422.

(33) Section 451.—See section 4.01(4), above.

(34) Section 451.—General Rule for Taxable Year of Inclusion—The income tax consequences as a result of being a beneficiary of a trust that an Indian tribe (as defined in 25 U.S.C. §2703(5)) establishes to receive and invest *per capita* payments for its members who are minors or legal incompetents under the Indian Gaming Regulatory Act (25 U.S.C. §§2701–2721), if the trust meets the requirements of section 5.02 of Rev. Proc. 2003-14, 2003-1 C.B. 319.

(35) Section 584.—Common Trust Funds.—Whether a common trust fund plan meets the requirements of §584. (For §584 plan drafting guidance, see Rev. Proc. 92-51, 1992-1 C.B. 988.)

(36) Section 642.—Special Rules for Credits and Deductions; Pooled Income Fund.—Whether a pooled income fund satisfies the requirements described in §642(c)(5).

(37) Section 664.—Charitable Remainder Trusts.—Whether a charitable remainder trust that provides for annuity or uni-trust payments for one or two measuring lives or for annuity or unitrust payments for a term of years satisfies the requirements described in §664.

(38) Section 664.—Charitable Remainder Trusts.—Whether a trust that will calculate the unitrust amount under §664(d)(3) qualifies as a §664 charitable remainder trust when a grantor, a trustee, a beneficiary, or a person related or subordinate to a grantor, a trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under §643(b) and income for Federal income tax purposes for the benefit of the unitrust recipient.

(39) Section 664.—Charitable Remainder Trusts.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, causes the trust to have ceased to qualify as a charitable remainder trust within the meaning of §664.

(40) Sections 671 to 679.—Grantors and Others Treated as Substantial Owners.—In a nonqualified, unfunded deferred compensation arrangement described in Rev. Proc. 92-64, the tax consequences of the use of a trust, other than the model trust described in that revenue procedure.

(41) Sections 671 to 679.—Grantors and Others Treated as Substantial Owners—Whether an Indian tribe (as defined in 25 U.S.C. §2703(5)) that establishes a trust to receive and invest *per capita* payments for its members who are minors or legal incompetents under the Indian Gaming Regulatory Act (25 U.S.C. §§2701–2721) is the grantor and owner of the trust, if the trust meets the requirements of section 5.02 of Rev. Proc. 2003-14, 2003-1 C.B. 319.

(42) Section 1001.—Determination of Amount of and Recognition of Gain or Loss.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of

the value of the trust assets, is treated as a sale or other disposition by the beneficiaries of their interests in the trust.

(43) Section 1221.—Capital Asset Defined.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, is treated as a sale or exchange of a capital asset by the beneficiaries.

(44) Section 1362.—Election; Revocation; Termination.—All situations in which the Service has provided an automatic approval procedure or administrative procedure for an S corporation to obtain relief for late S corporation, qualified subchapter S subsidiary, qualified subchapter S trust, or electing small business trust elections. *See* Rev. Proc. 2003-43, 2003-1 C.B. 998; Rev. Proc. 2004-48, 2004-2 C.B. 172; Rev. Proc. 2004-49, 2004-2 C.B. 210; and Rev. Proc. 2007-62, 2007-41 I.R.B. 786. (For instructions on how to seek this relief, see the preceding revenue procedures.)

(45) Section 1362.—Election; Revocation; Termination.—Whether gross receipts from royalties, rents, dividends, interest, and annuities constitute passive investment income for purposes of §1362(d)(3).

(46) Section 1502.—Regulations.—Whether a parent cooperative housing corporation (as defined in §216(b)(1)) will be permitted to file a consolidated income tax return with its transferee subsidiary, if the transferee engages in commercial activity with respect to the real property interest transferred to it by the parent.

(47) Section 2055.—Transfers for Public, Charitable, and Religious Uses.—Whether a transfer to a pooled income fund described in §642(c)(5) qualifies for a charitable deduction under §2055(e)(2)(A).

(48) Section 2055.—Transfers for Public, Charitable, and Religious Uses.—Whether a transfer to a charitable remainder trust described in §664 that provides for annuity or unitrust payments for one or two measuring lives or a term of years qualifies for a charitable deduction under §2055(e)(2)(A).

(49) Section 2503.—Taxable Gifts.—Whether the transfer of property to a trust will be a gift of a present interest in property when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§673 to 677.

(50) Section 2514.—Powers of Appointment.—If the beneficiaries of a trust permit a power of withdrawal to lapse, whether §2514(e) will be applicable to each beneficiary in regard to the power when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§673 to 677.

(51) Section 2522.—Charitable and Similar Gifts.—Whether a transfer to a pooled income fund described in §642(c)(5) qualifies for a charitable deduction under §2522(c)(2)(A).

(52) Section 2522.—Charitable and Similar Gifts.—Whether a transfer to a charitable remainder trust described in §664 that provides for annuity or unitrust payments for one or two measuring lives or a term of years qualifies for a charitable deduction under §2522(c)(2)(A).

(53) Section 2601.—Tax Imposed.—Whether a trust that is exempt from the application of the generation-skipping transfer tax because it was irrevocable on September 25, 1985, will lose its exempt status if the situs of the trust is changed from the United States to a situs outside of the United States.

(54) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether annuity interests are qualified annuity interests under §2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the

trust, or if the value of the remainder interest is less than 10 percent of the initial net fair market value of the property transferred to the trust. For purposes of the 10 percent test, the value of the remainder interest is the present value determined under §7520 of the right to receive the trust corpus at the expiration of the term of the trust. The possibility that the grantor may die prior to the expiration of the specified term is not taken into account, nor is the value of any reversion retained by the grantor or the grantor's estate.

(55) Section 2702—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether a trust with one term holder satisfies the requirements of §2702(a)(3)(A) and §25.2702-5(c) to be a qualified personal residence trust.

(56) Section 3121.—Definitions.—Determinations as to which of two entities, under common law rules applicable in determining the employer-employee relationship, is the employer, when one entity is treating the worker as an employee.

.02 General areas.

(1) Any matter in which the determination requested is primarily one of fact, *e.g.*, market value of property, or whether an interest in a corporation is to be treated as stock or indebtedness. Although it is generally inappropriate for the Service to issue a letter ruling on whether an interest in a corporation is stock or indebtedness, there may be instances in which the Service may issue a letter ruling. For example, the Service may issue a letter ruling with respect to an instrument issued by a domestic corporation if (1) the taxpayer believes that the facts strongly support the classification of the instrument as stock and (2) the taxpayer can demonstrate that there are unique and compelling reasons to justify the issuance of a letter ruling. However, before submitting a letter ruling request, a taxpayer should first contact the office of the Associate Chief Counsel (Corporate) to discuss whether the Service will consider issuing a letter ruling for a particular factual situation (202-622-7700).

(2) Situations where the requested ruling deals with only part of an integrated transaction. Generally, a letter ruling will not be issued on only part of an integrated transaction. If, however, a part of a transaction falls under a no-rule area, a letter ruling on other parts of the transaction may be issued. Before preparing the letter ruling request, a taxpayer should call the Office of the Associate Chief Counsel having jurisdiction for the matters on which the taxpayer is seeking a letter ruling to discuss whether a letter ruling will be issued on part of the transaction. To determine which division has jurisdiction over a particular issue see section 3 of Rev. Proc. 2011-1, this Bulletin. For a list of telephone numbers for the different divisions see section 10.07 of Rev. Proc. 2011-1.

Notwithstanding the previous paragraph, the Office of the Associate Chief Counsel (Corporate) may issue a letter ruling on part of an integrated transaction without ruling on the larger transaction if such transaction occurs in the context of a §355 distribution. *See* section 6.03 of Rev. Proc. 2011-1, this Bulletin.

(3) Situations where two or more items or sub-methods of accounting are interrelated. If two or more items or sub-methods of accounting are interrelated, ordinarily a letter ruling will not be issued on a change in accounting method involving only one of the items or sub-methods.

(4) The tax effect of any transaction to be consummated at some indefinite future time.

(5) Any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of a trade or business.

(6) The tax effect of a transaction if any part of the transaction is involved in litigation among the parties affected by the transaction, except for transactions involving bankruptcy reorganizations.

(7)(a) Situations where the taxpayer or a related party is domiciled or organized in a foreign jurisdiction with which the United States does not have an effective mechanism for obtaining tax information with respect to civil tax examinations and criminal tax investigations, which would preclude the Service from obtaining information located in such jurisdiction that is relevant to the analysis or examination of the tax issues involved in the ruling request.

(b) The provisions of subsection (a) above shall not apply if the taxpayer or affected related party (i) consents to the disclosure of all relevant information requested by the Service in processing the ruling request or in the course of an examination in order to verify the accuracy of the representations made and to otherwise analyze or examine the tax issues involved in the ruling request, and (ii) waives all claims to protection of bank or commercial secrecy laws in the foreign jurisdiction with respect to the information requested by the Service. In the event the taxpayer's or related party's consent to

disclose relevant information or to waive protection of bank or commercial secrecy is determined by the Service to be ineffective or of no force and effect, then the Service may retroactively rescind any ruling rendered in reliance on such consent.

(8) A matter involving the Federal tax consequences of any proposed Federal, State, local, municipal, or foreign legislation. The Service may provide general information in response to an inquiry. However, the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) may issue letter rulings regarding the effect of proposed State, local, or municipal legislation upon an eligible deferred compensation plan under §457(b) provided that the letter ruling request relating to the plan complies with the other requirements of Rev. Proc. 2011-1.

(9) Except as otherwise provided in this revenue procedure (*e.g.*, under section 3.01(38)), where the Service already is ruling on a significant issue in the same transaction), a letter ruling will not ordinarily be issued with respect to an issue that is clearly and adequately addressed by statute, regulations, decisions of a court, revenue rulings, revenue procedures, notices, or other authority published in the Internal Revenue Bulletin. However, the Service may in its discretion determine to issue a ruling on such an issue if the Service otherwise is issuing a ruling on another issue arising in the same transaction.

(10) Whether an amount received (in periodic payments or as a lump sum) in connection with a legal action or a settlement of a legal action is properly allocated (including an allocation of all payments to one category) to recovery of capital, compensatory damages, punitive damages, dividends, interest, back pay, etc., for Federal tax purposes.

SECTION 5. AREAS UNDER STUDY IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED UNTIL THE SERVICE RESOLVES THE ISSUE THROUGH PUBLICATION OF A REVENUE RULING, REVENUE PROCEDURE, REGULATIONS OR OTHERWISE

.01 Section 62(c).—Reimbursement Arrangements.—Whether amounts related to a salary reduction and paid under a purported reimbursement or other expense allowance arrangement will be treated as paid under an "accountable plan" in accordance with §1.62-2(c)(2).

.02 Sections 101 and 7702.—Certain Death Benefits; Life Insurance Contract Defined.—Whether amounts received under an arrangement that is not regulated as an insurance company may be treated as received under a "life insurance contract" within the meaning of §§101(a) and 7702.

.03 Section 148.—Arbitrage.—Permission to use a single yield for two or more issues of qualified mortgage bonds or qualified student loan bonds under §1.148-4(a).

.04 Sections 162 and 1502—Trade or Business Expenses; Consolidated Returns.—Treatment of manufacturer incentive payments under the intercompany transaction regulations of §1.1502-13. *See* T.D. 9261, 2006-1 C.B. 919.

.05 Section 162(m). —Certain Excessive Employee Remuneration.—Whether the deduction limit under §162(m) applies to compensation attributable to services performed for a related partnership.

.06 Sections 302 and 304.—Certain Redemptions.—Treatment of basis in a §§302/304 redemption. *See* Announcement 2006-30, 2006-1 C.B. 879.

07 Sections 351, 358 and 362(a).—Transfers to Corporation Controlled by Transferors; Basis to Distributees; Basis to Corporations.—The issues described as being under study in Rev. Rul. 2006-2, 2006-1 C.B. 261.

.08 Section 451.—General Rule for Taxable Year of Inclusion.—The income tax consequences as a result of being a beneficiary of a trust that an Indian tribe (as defined in 25 U.S.C. §2703(5)) establishes to receive and invest *per capita* payments for its members (regardless of whether they are minors or legal incompetents) under the Indian Gaming Regulatory Act (25 U.S.C. §§2701–2721) if the trust does not meet the requirements of section 5.02 of Rev. Proc. 2003-14, 2003-1 C.B. 319.

.09 Sections 661 and 662.— Deduction for Estates and Trusts Accumulating Income or Distributing Corpus; Inclusion of Amounts in Gross Income of Beneficiaries of Estates and Trusts Accumulating Income or Distributing Corpus.—Whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is a distribution for which a deduction is allowable under §661 or which requires an amount to be included in the gross income of any person under §662.

.10 Sections 671 to 679.—Grantors and Others Treated as Substantial Owners.—Whether an Indian tribe (as defined in 25 U.S.C. §2703(5)) that establishes a trust to receive and invest *per capita* payments for its members (regardless of whether they are minors or legal incompetents) under the Indian Gaming Regulatory Act (25 U.S.C. §§2701–2721) is the grantor and owner of the trust if the trust does not meet the requirements of section 5.02 of Rev. Proc. 2003-14, 2003-1 C.B. 319.

.11 Section 1361.—Definition of a Small Business Corporation.—Whether a State law limited partnership electing under §301.7701-3 to be classified as an association taxable as a corporation has more than one class of stock for purposes of §1361(b)(1)(D). The Service will treat any request for a ruling on whether a State law limited partnership is eligible to elect S corporation status as a request for a ruling on whether the partnership complies with §1361(b)(1)(D).

.12 Section 1502.—See section 5.05, above.

.13 Section 2036.—Transfers with Retained Life Estate.—Whether the corpus of a trust will be included in a grantor's estate when the trustee of the trust is a private trust company owned partially or entirely by members of the grantor's family.

.14 Section 2038.—Revocable Transfers.-Whether the corpus of a trust will be included in a grantor's estate when the trustee of the trust is a private trust company owned partially or entirely by members of the grantor's family.

.15 Section 2041.—Powers of Appointment.—Whether the corpus of a trust will be included in an individual's estate when the trustee of the trust is a private trust company owned partially or entirely by members of the individual's family.

.16 Section 2501.—Imposition of Tax.—Whether the distribution of property by a trustee from an irrevocable trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is a gift under §2501.

.17 Sections 2601 and 2663.—Tax Imposed; Regulations.—Whether the distribution of property by a trustee from an irrevocable generation-skipping transfer tax (GST) exempt trust to another irrevocable trust (sometimes referred to as a "decanting") resulting in a change in beneficial interests is the loss of GST exempt status or constitutes a taxable termination or taxable distribution under §2612.

.18 Section 6050P.—Returns Relating to the Cancellation of Indebtedness by Certain Entities.—Whether amounts reduced pursuant to the terms of a debt instrument are reportable under §6050P and the regulations.

.19 Section 7702.—See section 5.03, above.

SECTION 6. AREAS COVERED BY AUTOMATIC APPROVAL PROCEDURES IN WHICH RULINGS WILL NOT ORDINARILY BE ISSUED

.01 Section 338.—Certain Stock Purchases Treated as Asset Acquisitions.—All requests for an extension of time under §301.9100-3 within which to make an election under §338(g) or (h)(10) where the Service has provided an administrative procedure to seek an extension. See Rev. Proc. 2003-33, 2003-1 C.B. 803 (extension automatically granted to certain persons required to file Form 8023 to make a valid section 338 election that have not filed Form 8023 by its due date).

.02 Section 442.—Change of Annual Accounting Period.—All requests for change in annual accounting period where the Service has provided an automatic change procedure for obtaining a change in annual accounting period. See Rev. Proc. 2002-39, 2002–1 C.B. 1046 (general procedures for prior approval), as clarified and modified by Notice 2002-72, 2002-2 C.B. 843, and modified by Rev. Proc. 2003-34, 2003-1 C.B. 856; Rev. Proc. 2006-45, 2006-2 C.B. 851 (certain corporations), as clarified and modified by Rev. Proc. 2007-64; Rev. Proc. 2006-46, 2006-2 C.B. 859 (partnership, S corporation, personal service corporation, or trust) and Rev. Proc. 2003-62, 2003-2 C.B. 299 (individual seeking a calendar year).

.03 Section 446.—General Rule for Methods of Accounting.—Except as otherwise specifically provided in applicable procedures published in the Internal Revenue Bulletin, all requests for change in method of accounting where the Service has provided an automatic change request procedure for obtaining a change in method of accounting. See the automatic change request procedures listed in section 9.22 of Rev. Proc. 2011-1, this Bulletin.

.04 Section 461.—General Rule for Taxable Year of Deduction.—All requests for making or revoking an

election under §461 where the Service has provided an administrative procedure for making or revoking an election under §461. *See* Rev. Proc. 92-29, 1992-1 C.B. 748 (dealing with the use of an alternative method for including in basis the estimated cost of certain common improvements in a real estate development).

.05 Section 704(c).—Contributed Property.—Requests from Qualified Master Feeder Structures, as described in section 4.02 of Rev. Proc. 2001-36, 2001-1 C.B. 1326, for permission to aggregate built-in gains and losses from contributed qualified financial assets for purposes of making §704(c) and reverse §704(c) allocations.

.06 Section 1362.—Election; Revocation; Termination.—All situations in which an S corporation qualifies for automatic late S corporation relief under Rev. Proc. 97-48, 1997-2 C.B. 521.

.07 Sections 1502, 1504, and 1552.—Regulations; Definitions; Earnings and Profits.—All requests for waivers or consents on consolidated return issues where the Service has provided an administrative procedure for obtaining waivers or consents on consolidated return issues. See Rev. Proc. 2002-32, 2002-1 C.B. 959, as modified by Rev. Proc. 2006-21, 2006-1 C.B. 1050 (certain corporations seeking reconsolidation within the 5-year period specified in §1504(a)(3)(A)); Rev. Proc. 90-39, 1990-2 C.B. 365, as modified by Rev. Proc. 2006-21, and as clarified by Rev. Proc. 90-39A, 1990-2 C.B. 367 (certain affiliated groups of corporations seeking, for earnings and profits determinations, to make an election or a change in their method of allocating the group's consolidated Federal income tax liability); and Rev. Proc. 89-56, 1989-2 C.B. 643, as modified by Rev. Proc. 2006-21 (certain affiliated groups of corporations seeking to file a consolidated return where member(s) of the group use a 52–53 week taxable year).

.08 Section 7701.—Entity Classification Elections.—All requests for an extension of time under §301.9100-3 within which to make an entity classification election under §301.7701-3 where the Service has provided an administrative procedure to seek an extension. See Rev. Proc. 2009-41, 2009-39 I.R.B. 439 (extension automatically granted to certain persons required to file Form 8832 to make a valid entity classification election that have not filed Form 8832 by its due date).

SECTION 7. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 2010-3, 2010-1 C.B. 110, is superseded.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective January 3, 2011.

SECTION 9. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. §3507) under control number 1545-1522.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information in this revenue procedure are in sections 2.03, 3.01(38), 3.01(39), 3.02 (1) and (3), 4.02(2), and 4.02(7)(b).

This information is required to evaluate whether the request for a letter ruling or determination letter is not covered by the provisions of this revenue procedure. The collections of information are required to obtain a letter ruling or determination letter. The likely respondents are businesses or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden of this revenue procedure, and Rev. Proc. 2011-1, is 513,150 hours.

The estimated annual burden per respondent/recordkeeper varies from 1 hour to 200 hours, depending on individual circumstances, with an estimated average burden of 90.1054 hours. The estimated number of respondents and/or record keepers is 5,695.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax

return information are confidential, as required by 26 U.S.C. §6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is Paul Arends of the Office of the Associate Chief Counsel (Corporate). For further information about this revenue procedure, please contact Mr. Arends at (202) 622-7700 (not a toll-free call), or call the division contacts listed in section 10.07 of Rev. Proc. 2011-1, this Bulletin. To determine which division has jurisdiction over a particular issue, see section 3 of Rev. Proc. 2011-1.

ISSN 1947-3923

Copyright © 2011, The Bureau of National Affairs, Inc. | Copyright FAQs | Internet Privacy Policy | BNA Accessibility Statement | License

Reproduction or redistribution, in whole or in part, and in any form, without express written permission, is prohibited except as permitted by the BNA Copyright Policy. http://www.bna.com/corp/index.html#V

Tax and Accounting Center

Source: IRS Documents > PLRs/TAMs and Other Advice > 2007 > PLR 200736002 - Section 2036 - Transfers With Retained Life Estate

PLR 200736002 - Section 2036 - Transfers With Retained Life Estate

Internal Revenue Service
Department of the Treasury Washington, DC 20224

Number: 200736002
Third Party Communication: None Release Date: 9/7/2007
Date of Communication: Not Applicable
Person To Contact: Index Number: 2036.11-00, 2037.00-00, 2038.00-00, 61.00-00, 643.06-00,661.02-01, 662.00-00, 1001.15-01, 1015.03-01, 1223.00-00, 2501.01-00
Refer Reply To: CC:PSI:B04 PLR-104372-07 Telephone Number:
Date: May 22, 2007

In Re:

Legend:

Decedent =
Spouse =
Trust =
Court =
Date 1 =
Date 2 =

Dear [redacted data]:

This is in response to a letter dated January 10, 2007, submitted by your personal representative, and subsequent correspondence, requesting rulings under §§ 61,643, 661,662, 1001, 1015, 1223, 2036, 2037, 2038, 2501, and 2601 of the Internal Revenue Code.

The facts submitted and the representations made are as follows. Decedent died on Date 1, a date prior to September 25, 1985. Pursuant to the terms of his Will, a testamentary trust (Trust) was established for the benefit of his spouse (Spouse) and issue.

Article Seventh of the Will provides that one-half of the residue of Decedent's estate is to be held in trust. Article Seventh, Paragraph A provides that net income is to be distributed to Spouse for her lifetime.

Article Seventh, Paragraph B provides that upon Spouse's death, net income is to be distributed in quarterly installments to Decedent's children in equal shares for their lifetimes. Article Seventh, Paragraph C provides that upon the death of one of Decedent's children leaving lawful issue, the net income payable to the deceased child is to be paid to the child's lawful issue equally, per stirpes, for the remaining trust term.

Article Seventh, Paragraph D provides that if a child dies and is not survived by lawful issue or if the surviving lawful issue of a deceased child dies prior to the termination of Trust, then the net income to which such child or lawful issue of a deceased child would have been entitled shall be paid to Decedent's surviving children and the lawful issue of any deceased children, per stirpes, in equal shares for the remaining trust term. If Decedent is not survived by children or descendants or all of the surviving children and descendants die prior to the termination of Trust then the trust estate is to be paid one-half to Decedent's next of kin, per stirpes, and one-half to Spouse's nieces and nephews and the lawful issue of any of Spouse's deceased nieces and nephews, per stirpes.

Article Seventh, Paragraph F provides that Trust is to terminate 21 years after the death of the last to die of Decedent's children. Upon termination, the trust estate is to be paid free of trust to Decedent's then lawful issue, in equal shares, per stirpes.

Article Eighth provides that Trust shall have three trustees, two individual trustees and one corporate trustee.

On Date 2, Court entered an order contingent upon the Internal Revenue Service issuing favorable rulings with respect to the issues presented in this request. The order stated that Trust would be divided into three trusts, one each for the benefit of Decedent's three children and their respective issue. The order provided that each asset of Trust will be divided pro-rata among the three separate

trusts in accordance with the fractional interest of each trust, except to the extent necessary to avoid fractional shares or unreasonably small interests. The trustees of Trust have represented that the order will be modified to provide that each asset of Trust will be divided pro-rata among the three separate trusts in accordance with the fractional interest of each trust. The terms of each successor trust are substantially the same as the terms of Trust.

Trustees have requested the following rulings:

1. The proposed division of Trust will not result in a loss of exempt status for generation-skipping transfer (GST) tax purposes for Trust or any successor trusts.
in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.
2. The proposed division of Trust will result in the successor trusts being treated as separate trusts under § 643(f).
3. The proposed division of Trust will not result in Trust, the successor trusts, or any beneficiary thereof realizing income, gain or loss under §§ 661 or 662.
4. The proposed division of Trust will not result in Trust, the successor trusts, or any beneficiary thereof realizing gain or loss under §§ 61 and 1001.
5. The adjusted basis of the assets received by the successor trusts from Trust will be the same as the adjusted basis of the assets when held by Trust pursuant to §1015. 6. The holding periods for the assets received by the successor trusts from Trust will be the same as the holding periods for such assets by Trust pursuant to § 1223(2).
7. The proposed division of Trust will not cause any portion of Trust's assets to be includible in the gross estate of the beneficiaries of Trust or the successor trusts pursuant to §§ 2036, 2037, or 2038.
8. The proposed division of Trust will not constitute a transfer by any beneficiary of Trust or the successor trusts that will be subject to tax under § 2501.

Law and Analysis:

Ruling 1:

Ruling request 1 falls within the purview of § 3.01(58) of Revenue Procedure 2007-3, 2007-3 I.R.B.1, which states, in relevant part, that a ruling will not be issued under § 2601 in a factual scenario similar to a factual scenario set forth in one or more of the examples contained in § 26.2601-1(b)(4)(i)(E) of the Generation-Skipping Transfer Tax Regulations. Accordingly, a ruling on this request will not be issued.

Ruling 2:

Section 643(f) provides that two or more trusts shall be treated as one trust if (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of federal income tax.

Upon division of Trust into the successor trusts each of the successor trusts will have different primary beneficiaries. Therefore, based on the facts submitted and the representations made, we conclude that the successor trusts will be treated as separate trusts for federal income tax purposes under § 643(f).

Ruling 3:
Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently, and (2) any other amounts properly paid or credited or required to be distributed for such taxable year, but such deduction shall not exceed the distributable net income (DNI) of the estate or trust.

Section 1.661(a)-2(f) of the Income Tax Regulations provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

Based upon the facts submitted and the representations made, we conclude that because the creation of the successor trusts is a modification of Trust for Federal income tax purposes, the successor trusts are treated as a continuation of Trust. Therefore, the transfer of assets from Trust to the successor trusts will not be treated as a distribution or termination under § 661, and will not result in the realization by Trust, the successor trusts, or by any beneficiary of Trust or the successor trusts of any income, gain, or loss.

Ruling 4:

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

Section 1001(a) provides that the gain from the sale or other disposition of property 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 1.1001-1(a) 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.

A partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests but do not acquire a new or additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), concerns the issue of when a sale or exchange has taken place that results in the realization of gain or loss under § 1001. In Cottage Savings, a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Supreme Court of the United States in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different." 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 Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The 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. Cottage Savings, 499 U.S. at 566.

Based upon the facts submitted and the representations made and provided Court revises the order to provide for the pro-rata division and distribution of each and every Trust asset to the successor trusts, we conclude that it is consistent with the Supreme Court's opinion in Cottage Savings to find that when Trust is divided into three successor trusts and the assets distributed into the successor trusts on a pro-rata basis, the division does not result in the realization or recognition of gain or loss. Moreover, even though the modified order will change the terms governing who will serve as trustees, the legal entitlements and interests of the beneficiaries of each of the separate successor trusts will not differ materially in kind or extent from their interests in Trust. Accordingly, no gain or loss is recognized on the partition of Trust for purposes of § 61(a)(3) or § 1001(a) by Trust, by any of the three successor trusts, or by any beneficiary of those trusts. See Rev. Rul. 56-437.

Rulings 5:

Section 1015 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 1.1015-2(a)(1) provides that, in the case of property acquired after December 31, 1920, by transfer in trust (other than by 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 in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer is made.

In this case, based upon the facts submitted and the representations made and provided the Court order is modified to provide that all of Trust's assets are divided pro-rata among the successor trusts, we conclude that because neither § 61 nor § 1001 applies to the proposed transaction, the basis of the assets for each of the successor trusts will be the same as Trust's basis in the assets at the time of the transfer.

Ruling 6:

Under §§ 1223(2) and 1.1223-1(b), in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person, if under chapter 1 of subtitle A such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have

in the hands of such other person.

Therefore, because under § 1015 the basis of the assets received by the successor trusts is the same as the basis of those assets in the hands of Trust at the time of the transfer, we conclude, based upon the facts submitted and the representations made and provided the Court order is modified to provide that all of Trust's assets are divided pro-rata among the successor trusts, that, pursuant to § 1223(2), the holding periods of the assets held by the successor trusts will include the holding periods of the assets when the assets were held by Trust.

Ruling 7:

Section 2031(a) provides that the value of the gross estate of the decedent shall be determined by including the value at the time of death of all property, real or personal, tangible or intangible, wherever situated.

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

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death- (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, if - (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period on the date of the decedent's death.

In this case, Trust was irrevocable on the date it was created. Decedent did not retain a reversionary interest in Trust and did not retain any power to change the disposition of the trust estate. Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed division of Trust will not cause any portion of Trust's assets to be includible in the gross estate of the beneficiaries of Trust or the successor trusts pursuant to §§ 2036, 2037, or 2038, except to the extent of property that is distributed to a beneficiary and remains in the beneficiary's estate at the date of death.

Ruling 8:

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 division as it was prior to the division. Accordingly, based on the facts submitted and the representations made and provided the Court order is modified to provide that all of Trust's assets are divided pro-rata among the successor trusts, we conclude that the proposed division and pro-rata distribution of Trust into three successor trusts will not constitute a transfer of property by the beneficiaries of Trust or any successor trust subjecting them to the gift tax under § 2501.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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,
Melissa C. Liquerman

Melissa C. Liquerman
Senior Technician Reviewer
(Passthroughs & Special Industries)

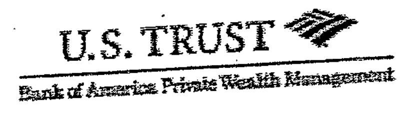
Enclosures: Copy for § 6110 purposes

cc:

Contact us at http://www.bna.com/contact/index.html or call 1-800-372-1033

ISSN 1947-3923

Copyright © 2010, The Bureau of National Affairs, Inc. Reproduction or redistribution, in whole or in part, and in any form, without express written permission, is prohibited except as permitted by the BNA Copyright Policy. http://www.bna.com/corp/index.html#V



State Decanting Statutes

State	New York	Alaska	Delaware	Tennessee
Statute	NY EPTL §10-6.6(b)	AK Stat. §13.36.157	12 Del. C. §3528	Tenn. Code Ann. §35-15-816(b)(27)
Effective date	July 24, 1992	Sept. 15, 1998	June 30, 2003	July 1, 2004
Absolute discretion required?	Yes	No; but new trust must have same discretionary distribution standard (if any)	No	No
May reduce fixed income interest?	No	No	No specific restriction provided in statute	No
Must be a current beneficiary entitled or eligible to receive income in order to decant to new trust?	No	Yes	No	No
Beneficiaries' interests must be identical in both trusts?	Probably No; statute merely provides the power must be exercised "in favor of the proper objects of" its exercise; but see next row; perhaps changes to interests within a class okay	Probably No; statute merely provides the power must be exercised "in favor of the beneficiaries of the invaded [old] trust;" see NY at left. Unclear under statute what meaning is to be given to provision stating that new trust may provide that upon the occurrence of a time or event, the "nature and extent of the interests of the beneficiaries" of new trust can be "substantially identical" to those of old trust	Probably No; statute merely provides the power must be exercised "in favor of a second trust having only beneficiaries who are the proper objects of its exercise;" see NY at left. Unclear under statute what meaning is to be given to provision stating that the new trust may provide that upon the occurrence of "a time or event specified" in new trust, the "nature and extent of each such beneficiary's interest" of new trust can be "substantially identical" to those of old trust	Probably No; statute merely provides the power must be exercised "in favor of the proper objects of" its exercise; see NY at left
Identical beneficiaries in both trusts required?	Probably No; statute merely provides the power must be exercised "in favor of the proper objects of" its exercise; probably can exclude beneficiaries of original trust, but cannot add new beneficiaries. However, query whether the new trust can change the nature of the interest of old trust's beneficiaries (e.g., move up presumptive remainderman to eligible beneficiary of discretionary principal distributions.) Would doing this be "in favor of the proper objects of the exercise of the power" or would it violate that principle since the remainderman was not part of the class to whom discretionary principal distributions from the old trust could be made?	Probably No; statute merely provides the power must be exercised "in favor of the beneficiaries of the invaded [old] trust;"See NY at left	Probably No; statute merely refers to the second trust's having "only beneficiaries who are the proper objects" of the power's exercise; See NY at left	Probably No; statute merely provides the power must be exercised "in favor of the proper objects of" its exercise; See NY at left
Applies to inter vivos and testamentary trusts?	Yes	Yes	Yes	Yes
Can be a new trust created under a new instrument or a trust under the old instrument?	Yes	No; statute refers solely to "an instrument other than that under which the power to invade was created"	Yes	Yes
Notice to or consent of beneficiaries required?	Yes; trustee must serve written exercise of power on all interested parties, though no consent required	No	No	No
Consent of court required?	No, but may seek court approval	No	No	No
Increase trustee commissions?	Only if directed by court	No reference	No reference	No reference
Filings required	Trustee's written exercise must be filed with court having jurisdiction	None	Trustee's written exercise must be filed with trust records	Trustee's written exercise must be filed with trust records
Same trustee required?	No	No	No	No
Rule against perpetuities savings provision?	Yes	Yes	Yes	Yes
Marital deduction savings provision?	No	No	Yes	No
Unique statutory attributes			Power cannot be exercised over the portion of a trust that is currently withdrawable by a beneficiary (e.g., Crummey or "5 and 5" power) who is the trust's sole beneficiary	

The information contained herein is current as of the date noted and is solely for information purposes. It has been obtained from sources believed to be reliable, but we cannot guarantee its accuracy or completeness.
U.S. Trust, Bank of America Private Wealth Management operates through Bank of America, N.A. and other subsidiaries of Bank of America, N.A., Member FDIC.
© 2009 Bank of America Corporation. | ARXXXXX | PRES-06-09-0149 | 8/2009

State Decanting Statutes (continued)

State	Florida	South Dakota	New Hampshire
Statute	Fla. Stat. §736.04117	S.D. Laws §§55-2-15-55-2-21	N.H. Rev. Stat. §564-B:4-418
Effective date	July 1, 2007	March 5, 2007	September 8, 2008
Absolute discretion required?	Yes	No	No
May reduce fixed income interest?	No	May not reduce a fixed income interest of trust for which a federal marital deduction has been taken	No
Must be a current beneficiary entitled or eligible to receive income in order to decant to new trust?	No	No	No. However statute provides limitations on exercise of power if trustee is also a beneficiary of first trust
Beneficiaries' interests must be identical in both trusts?	Probably No; statute merely provides the power must be exercised "for the current benefit of one or more of such persons [persons to whom the trustee of the old trust could make principal distributions]"	No; statute merely provides that the second trust has as beneficiaries ... (1) those beneficiaries of the first trust to or for whom a discretionary distribution may be made from the first trust and who are the proper objects of the exercise of the power, or (2) those other beneficiaries of the first trust to or for whom a distribution of income or principal may have been made in the future from the first trust at a time or upon the happening of an event specified in the first trust. Presumably the second criteria may permit a remainderman to move up to a current beneficiary. See NY column	Probably No; statute merely provides the power must be exercised "in favor of another trust for the benefit of one or more of those beneficiaries [of the first trust]"
Identical beneficiaries in both trusts required?	Probably No; statute specifies that the new trust "may include only beneficiaries of the first trust" but does not provide whether beneficiaries can be excluded; statute also uses the phrase "in favor of a trustee of another trust . . . for the current benefit of one or more of such persons"	No, statute provides that "second trust has as beneficiaries only one or more of those beneficiaries of the first trust"	Probably No; statute merely provides the power must be exercised "in favor of another trust for the benefit of one or more of those beneficiaries [of the first trust]"
Applies to inter vivos and testamentary trusts?	Yes, although statute speaks to "trust instrument," such term is defined by FL Trust Code §736.0103(2) to be "an instrument executed by a settlor" and "settlor" is defined to include a testator (§736.0103(16))	Yes	Yes
Can be a new trust created under a new instrument or a trust under the old instrument?	Yes	Yes	Yes
Notice to or consent of beneficiaries required?	Yes, trustee must notify all qualified beneficiaries of the first trust in writing at least 60 days prior to the effective date of the exercise; a copy of written exercise will satisfy the requirement. Notice period and requirement can be waived by all qualified beneficiaries	No	Yes, but only to charitable organizations who have the rights of a qualified beneficiary of the first trust
Consent of court required?	No	No	No
Increase trustee commissions?	No reference	No reference	No reference
Filings required	Trustee's written exercise must be filed with trust records	Trustee's written exercise must be filed with trust records	No
Same trustee required?	No	No	No
Rule against perpetuities savings provision?	Yes	Yes	No
Marital deduction savings provision?	Yes	No	Yes
Unique statutory attributes	(1) Includes charitable deduction savings provision; (2) Specifically states that the statute does not create or imply a duty to exercise the power; (3) Specifically provides that the exercise of the power is not prohibited by a spendthrift clause or by a provision in the instrument which prohibits amendment or revocation	(1) Power cannot be exercised if the trustee of the first trust is also a beneficiary of such trust, except if trust is for HEMS; (2) Cannot extend IRC Sec. 2503(c) vesting period	(1) Power cannot be exercised over the portion of a trust that is currently withdrawable by a beneficiary (e.g., Crummey or "5 and 5" power); (2) Includes charitable deduction and gift tax exclusion savings provision; (3) Specifically states that the statute does not create or imply a duty to exercise the power; (4) Specifically provides that the exercise of the power is not prohibited by a spendthrift clause or by a provision in the instrument which prohibits amendment or revocation

State Decanting Statutes (continued)

State	North Carolina	Arizona
Statute	N.C.S.G.A 36C-8-816.1	A.R.S. 14-10819
Effective date	Oct 1, 2009	September 30, 2009
Absolute discretion required?	No	No
May reduce fixed income interest?	No	No
Must be a current beneficiary entitled or eligible to receive income in order to decant to new trust?	No - Opposite: trustee who is a beneficiary cannot exercise power. Remaining co-trustees can exercise or in absence, court can appoint special fiduciary to exercise the power	No
Beneficiaries' interests must be identical in both trusts?	Probably No. However note following: (i) a future beneficial interest, vested or contingent, in the original trust [cannot be] accelerated to a present interest in the second trust; (ii) if power to distribute in original trust subject to ascertainable standard, then power to distribute in the second trust must be subject to same ascertainable standard and must be exercisable in favor of same current beneficiaries as in original trust; and (iii) if beneficiary of original trust has power of withdrawal then either terms of second trust must provide a power of withdrawal identical to power in original trust or sufficient trust property must remain in original trust to satisfy outstanding power of withdrawal	Probably No; statute merely provides that second trust "is in favor of the beneficiaries of the trust." However, where trustee is a beneficiary any ascertainable standard in the second trust must be the "same or more restrictive than the standard in original trust."
Identical beneficiaries in both trusts required?	No. Beneficiaries of the second trust "are one or more of the current beneficiaries of the original trust." Also "the beneficiaries of the second trust may include only beneficiaries of the original trust"	No; statute merely provides that second trust "is in favor of the beneficiaries of the trust."
Applies to inter vivos and testamentary trusts?	Inter-vivos only	Yes
Can be a new trust created under a new instrument or a trust under the old instrument?	Yes	Must be new instrument
Notice to or consent of beneficiaries required?	Yes, trustee must notify all qualified beneficiaries of the first trust in writing at least 60 days prior to the effective date of the exercise; a copy of written exercise will satisfy the requirement. Notice period and requirement can be waived by all qualified beneficiaries. Consent not required	No reference
Consent of court required?	No	No, but may seek court approval
Increase trustee commissions?	No reference	No reference
Filings required	Trustee's written exercise must be filed with trust records	No reference
Same trustee required?	No	No
Rule against perpetuities savings provision?	Yes	Yes
Marital deduction savings provision?	Yes	Yes, statute states that the second trust must not adversely affect the tax treatment of the trust, the trustee, the settlor or the beneficiaries
Unique statutory attributes	(1) Includes charitable deduction and gift tax exclusion savings provision; (2) Specifically states that the statute does not create or imply a duty to exercise the power; (3) Specifically provides that the exercise of the power is not prohibited by a spendthrift clause or by a provision in the instrument which prohibits amendment or revocation	

TAX EFFECTS OF DECANTING—OBTAINING AND PRESERVING THE BENEFITS

BY DIANA S.C. ZEYDEL AND JONATHAN G. BLATTMACHR

The problem that may arise with irrevocable trusts is, of course, that they are irrevocable and might no longer fit the circumstances of the family. One solution, available by statute in ten states, is to pour the corpus into a new trust that will do a better job. Careful consideration of the tax consequences—income, gift, estate, and generation-skipping transfer tax—is essential.

A well-constructed estate plan typically includes the use of at least some irrevocable trusts. These trusts can offer asset management during minority or incapacity, and also can permit the donor to control the enjoyment of the property placed in trust. In many circumstances, an irrevocable trust is necessary to accomplish the desired estate planning objective.

For example, suppose a parent wishes to give a particular asset to a child, but the child is unable or unwilling to pay the income taxes associated with owning the asset. An irrevocable grantor trust, within the meaning of Sections 671-679, will permit the parent to transfer the property to the child while continuing to pay all the income taxes personally.[1] A parent could not pay income taxes on an asset owned by the child outright without making further gifts. Or a donor may wish to maximize the use of the donor's generation-skipping transfer (GST) tax exemption, under Section 2631. An outright transfer will permit only the specific donee to enjoy the property without potentially incurring additional transfer tax. But a transfer to an irrevocable trust to which GST exemption is allocated will permit multiple generations to benefit from the property without future wealth transfer tax cost.

The advent of the current version of the GST tax under Chapter 13 of the Code is likely partially responsible for the increased popularity of long-duration irrevocable trusts.[2] Many states have modified their statutes to accommodate this trend either by eliminating the rule against perpetuities, or by substantially increasing the period during which property may be held in trust.[3] An increased desire to achieve asset protection through the use of trusts also may be responsible for the increased use of long-duration irrevocable trusts.

Nevertheless, the drafting of a long-term irrevocable trust is a challenging undertaking for the drafter. The circumstances of the beneficiary or the law may change during the continuation of the trust in a way that was not foreseen or at least considered when the drafting occurred, and might render the trust's terms essentially adverse, inefficient, or not as beneficial for the beneficiaries as other terms would be. The drafting committee of the provision that extended Florida's rule against perpetuities to 360 years addressed the problem by requiring a trust that takes advantage of the longer term to permit judicial modification of the trust in the interest of the beneficiaries.[4]

Most states permit judicial modification of a trust, at least in certain circumstances. Yet a judicial modification of an irrevocable trust may not be entirely satisfactory as the authority may be constrained by the requirement to respect, at least to some degree, the set-

DIANA S.C. ZEYDEL is a shareholder in the Miami office of the law firm of Greenberg Traurig, P.A. JONATHAN G. BLATTMACHR is a member of the New York, California, and Alaska Bars. Both have previously written for THE JOURNAL.

Copyright © 2009, Diana S.C. Zeydel and Jonathan G. Blattmachr.

tlor's intent.[5] In addition, a judicial modification that requires beneficiary approval may have adverse tax consequences.

DECANTING

If instead of a judicial modification, what if the trustee could pay all or part of the corpus over to a different trust? Such a pour-over may remove the adversity, inefficiency, or lack of benefit with the least number of negative consequences, including adverse tax consequences or opposition by one or more of the beneficiaries.

Despite the increased popularity of long-term irrevocable trusts, their drafting remains a challenging undertaking.

In some instances, the drafter will expressly authorize the trustee or another to make such a payment to "decant" the trust. But many trust instruments do not expressly contain that authority, although one may contend that a power to "apply" for the benefit of a beneficiary includes a power to pay trust assets over to another trust for the beneficiary or beneficiaries. In any event, a growing number of states do by statute expressly authorize a trustee, at least in certain circumstances, to pay the corpus (and, in some cases, the income) of one trust over to another.

New York was the first state to enact decanting legislation.[6] Although amended since its original enactment in 1992, it essentially allows a trustee who has authority to invade the trust corpus for a beneficiary to pay the corpus over to another trust for the beneficiary. Despite the fact that New York enacted a statute, the legislative history provides that it is consistent with and declaratory of what likely is existing common law.[7] Indeed, the only case that seems directly on point under common law, *Phipps v. Palm Beach Tr. Co.*, 142 Fla. 782, 196 So. 299 (1940), held that a trustee could invade trust property by paying it over to another trust for the beneficiary.[8]

Invasion Power as Power of Appointment

It seems that a power held by a trustee to invade the corpus of a trust is a power of appointment for property law purposes.[9] Indeed, as a general rule, the holder of a power of appointment may appoint the property in further trust, which is what the trustee with a decanting power may do.[10] That further suggests, if a decanting power is a power of appointment, that a trustee who may invade the corpus of a trust, unless the instrument provides otherwise, may pay it to a different trust for the benefit of the beneficiary or beneficiaries for whom it may be invaded.[11]

Case law supports that conclusion. For example, as mentioned above, in what is perhaps the only case dealing expressly with the issue, the Florida Supreme Court held in *Phipps* that the trustee could invade the trust by paying the corpus to a new trust.

Nevertheless, there was no developed law about decanting in New York or in most other states when New York adopted its statute, which was the first decanting statute to be enacted in the U.S. And even though the Florida Supreme Court had ruled that a trustee could transfer the property from the original trust to another pursuant to an absolute power of invasion, Florida nevertheless determined to adopt a decanting statute to clarify many aspects of decanting authority and its exercise. Hence, it may be preferable for the legislature of a state to adopt a decanting statute

NOTES

1 See Rev. Rul. 2004-64, 2004-2 CB 7, confirming that the payment of income tax by the grantor of a grantor trust does not constitute a taxable gift by the grantor or by any beneficiary.

2 See Sitkoff and Schanzenbach, "Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds," 43rd Ann. Heckerling Inst. on Est. Plan. (2009), Ch. 12.

3 *Id.*, page 12-10.

4 See Fla. Stat. section 736.04115(3), which provides that its provisions permitting judicial modification of a trust in the best interests of the beneficiaries will not apply to a trust created after 2000 only if all beneficial interests in the trust must vest or terminate within the period prescribed by the rule against perpetuities in section 689.225(2), notwithstanding section 689.225(2)(f) (that is, the common law rule), and the trust prohibits judicial modification.

5 See, e.g., Fla. Stat. section 736.4115(2)(a) (the court shall exercise discretion in a manner that conforms to the extent possible with the intent of the settlor, taking into account the current circumstances and best interests of the beneficiaries).

6 See N.Y.E.P.T.L. section 10-6.6. See also Halperin and O'Donnell, "Modifying Irrevocable Trusts: State Law and Tax Considerations in Trust Decanting," 42nd Ann. Heckerling Inst. on Est. Plan. (2008), Ch. 13.

7 Memorandum in Support of Legislation, Governor's Bill Jacket, 1992 Chapter 591, page 4.

8 See also Wiedenmayer v. Johnson, 106 N.J. Super. 161, 254 A.2d 534 (App. Div., 1968). Wiedenmayer concerned an indirect decanting, however, in that the trustees exercised their power of invasion in favor of the beneficiary contingent on the beneficiary's agreeing to transfer the property in further trust. The court concluded the transfer was in the beneficiary's best interests, describing "best interests" as follows: "The expression is not limited to a finding that distribution must be to the son's best 'pecuniary' interests. His best interests might be served without regard to his personal financial gain. They may be served by the peace of mind, already much disturbed by matrimonial problems, divorce and the consequences thereof, which the new trust, rather than the old contingencies provided for in his father's trust indenture, will engender. Of what avail is it to rest one's 'best interests' on a purely financial basis, and without regard to the effect upon a man's mind, heart and soul, if the end result would produce a wealthier man, but a sufferer from mental anguish?"

9 If the trustee can invade for his or her own benefit, then the power of invasion may constitute a general (estate taxable) power of appointment under Sections 2514(c) and 2041(b). The power to invade for one's own benefit (that is, to withdraw property from the trust) may cause the powerholder to be the owner of the trust for purposes of Section 671 so that the income, deductions, and credits against tax of the trust are attributed to the powerholder. See Section 678(a). If the power is held in a fiduciary capacity, however, Section 678 may not apply. See Blattmachr, Gans, and Lo, "A Beneficiary as Trust Owner: Decoding Section 678," to be published in the Fall 2009 issue of the ACTEC Journal.

10 See, generally, *Scott on Trusts* (Aspen, 5th ed., 2008), § 3.1.2 at pages 144-45 (the trend is to construe the language conferring a power of appointment with increasing liberality, and to hold that the donee of the power has broad discretion as to the manner in which the power may be exercised).

11 See, e.g., Restatement (Third) of Property: Wills & Other Transfers (Tentative Draft No. 5), § 19.14 (except to the extent the donor has manifested a contrary intention, the donee of a nongeneral power is authorized to make an appointment, including one in trust and one that creates a power of appointment in another, that solely benefits permissible appointees of the power).

rather than rely on general principles of property law. In any event, legislation somewhat similar to that in New York now has been enacted in Alaska, Arizona, Delaware, Florida, Nevada, New Hampshire, North Carolina, South Dakota, and Tennessee,[12] which appears to reflect an acknowledgment of such a statute's utility. Also, with heightened appreciation for the authority to distribute to new trusts, many practitioners now include decanting provisions in their trust forms.

The New York, Delaware, Alaska, Florida, South Dakota, North Carolina, Arizona, and Nevada statutes all expressly state that the power to invade in further trust is a special power of appointment. Delaware, South Dakota, Florida, North Carolina, and Nevada also expressly state that the power is not exercisable in favor of the trustee, the trustee's estate, the trustee's creditors, or the creditors of the trustee's estate. The restriction is intended to avoid having the power to decant treated as a general power of appointment under Section 2041.

In *Phipps*, the Florida court cited the Restatement of Trusts, section 17, for the proposition that if a trustee has a special power of appointment, that is, a power to appoint among the members of a specified class, then whether the trustee can effectively appoint a trustee for members of the class depends on the terms of the power vested in him. Accordingly, the court concluded as follows: "The general rule gleaned from the foregoing and other cases of similar import is that the power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent."

Decanting legislation has now been enacted in ten states, which appears to reflect an acknowledgment of such a statute's utility.

Because the power to decant is deemed held by the trustee, it is by definition a fiduciary power. The *Comments* to Restatement (Third) of Trusts, section 75, draw a distinction between powers held in a fiduciary capacity, and those that are held for the powerholder's own benefit. The discussion echoes the Reporter's Notes on section 64, which also draws a distinction between a personal power that may be exercised for the personal benefit of the donee of the power and a fiduciary power that must be exercised for the purpose for which the settlor created it. The Reporter's Notes on section 64 indicate that if the powerholder's power is personal, then the trustee's only duty is to ascertain whether the attempted exercise is or is not within the terms of the trust.

The Restatement (Second) of Property, Donative Transfers, section 11.1 (1986) took the position that a power of appointment could be held in a fiduciary capacity and that a power of appointment may be exercised in further trust (see section 19.3). Nevertheless, the foregoing distinction between personal and fiduciary powers may explain why the tentative draft of the Restatement (Third) of Property, Wills and Donative Transfers, section 17.1 (Tentative Draft No. 5, 2006) defines a power of appointment as a power that enables the donee of the power, acting in a nonfiduciary capacity, to designate recipients of beneficial ownership interests in the appointive property.[13]

The donee of a power of appointment would seem to have no affirmative duty to act in good faith, and could exercise a power of appointment to exclude a person from beneficial enjoyment for personal reasons.[14] A fiduciary, on the other hand, would be precluded by fiduciary duties from acting in a similar manner. Instead, a fiduciary would seem always to be held to a minimum standard of good faith, with an obligation to act consistently with the terms of the trust and the interests of the beneficiaries.[15]

All of this simply means that "power of appointment" may be the wrong term to use when referring to a trustee's power to distribute in further trust because the term connotes a lack of fiduciary duties surrounding its exercise. It would not seem, however, to imply a change in the law concerning whether a trustee has such authority.

The Goals of Decanting a Trust

Although the New York decanting statute was enacted principally to confirm the authority of a New York trustee to exercise an invasion power in further trust for GST tax purposes,[16] New York courts subsequently approved decanting for numerous other reasons. The goals or purposes of using decanting include:

NOTES

12 Alaska Stat. section 13.36.157; Ariz. Rev. Stat. section 14-10819; Del. Code Ann. tit. 12, section 3528; Fla. Stat. section 736.04117; Nev. Rev. Stat. section 163.37; N.H. Rev. Stat. section 564-B:4-418; N.C. Gen. Stat. section 36C-8-816.1; S.D. Laws sections 55-2-15 to 55-2-21; Tenn. Code Ann. section 35-15-816.

13 Comment g, *Fiduciary distributive powers*, states: "As used in this Restatement and in the Restatement Third of Trusts, a fiduciary distributive power is not a power of appointment. See *Restatement Third, Trusts § 50*, Comment a. Fiduciary distributive powers include a trustee's power to distribute principal to or for the benefit of an income beneficiary, or for some other person or to pay income or principal to a designated beneficiary, or to distribute income or principal among a defined group of beneficiaries. Unlike the exercise of a power of appointment, a fiduciary distributive power does not lapse upon the death of the fiduciary but survives in a successor fiduciary. Nevertheless, a fiduciary distributive power, like a power of appointment, cannot be validly exercised in favor of or for the benefit of someone who is not a permissible appointee and may be subject to a common-law or statutory rule relating to perpetuities under the same rules applicable to a nongeneral power of appointment."

14 See Restatement (Third) of Trusts, section 50 (2003), Comment a ("A trustee's discretionary power with respect to trust benefits is to be distinguished from a power of appointment. The latter is not subject to fiduciary obligations and may be exercised arbitrarily within the scope of the power").

15 See section 105 of the Uniform Trust Code, adopted in 2003 by the National Conference of Commissioners on Uniform State Laws, which prohibits a trust instrument from exonerating a trustee's duty to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.

16 See *Turano Supplementary Practice Commentary, McKinney's Cons. Laws of N.Y.*, Book 17B, N.Y.E.P.T.L. section 10-6.6 (1992), page 24.

1. Addressing changed circumstances, such as changes in applicable fiduciary or tax law or changes in family circumstances or dynamics.

2. Protecting the tax treatment of a trust.[17]

3. Modifying administrative provisions, such as restrictions on investment powers or to create a directed trust.

4. Granting a beneficiary a power of appointment, presently exercisable or otherwise.[18]

5. Reducing administrative costs.[19]

6. Altering trusteeship provisions such as the identity or manner of appointing fiduciaries.[20]

7. Extending the termination date of a trust.[21]

8. Converting a nongrantor trust to a grantor trust or the reverse.[22]

9. Changing a trust's governing law.[23]

10. Dividing trust property to create separate trusts.

11. Reducing potential liability.[24]

12. Converting a trust into a supplemental needs trust to permit a beneficiary to qualify for certain governmental benefits.[25]

13. Making trust interests spendthrift or the reverse.[26]

14. Correcting a drafting error without the necessity of going to court.

Nevertheless, in *Estate of Mayer*, 176 Misc.2d 562, 672 N.Y.S.2d 998 (Surr. Ct., N.Y. County, 1998), relief was denied in the case of a testamentary sprinkling trust that authorized the independent trustee to distribute principal "in [his] sole and absolute discretion, [as he] may deem necessary for the *health, support, maintenance and education of any person or persons who may at such time be a person or persons eligible to receive income from the trust....*" (Emphasis by the Surrogate's Court.) The court concluded that "absolute" discretion connotes a standard that is unconstrained except by the implicit requirements of reasonableness and good faith. The court held that the proposed invasion was in essence a request to invade for estate planning purposes (the petitioners alleged that it would permit the reduction of taxes) and outside the parameters established by the testator, "even when reviewed with the greatest possible leniency."

TAX ISSUES OF DECANTING

There is, nearly always, the possibility of tax consequences from the transfer of property. There may be:

- Income tax where, among other situations, the property is being sold or exchanged for another asset.
- Gift tax where the property is transferred (or deemed transferred) during lifetime for less than full and adequate consideration in money or money's worth.
- Estate tax where such a transfer is made (or deemed made) at death.
- GST tax where the property is being transferred to a "skip person."
- Other taxes, such as state or local transfer taxes, and property taxes affected by changes in the value of the property transferred.

There is little developed law about the tax consequences of decanting. Hence, it may be appropriate, in attempting to discern what the tax effects of decanting are, to analogize it to some other transfer where there is more developed law.

The act of decanting may be most closely analogized, as indicated above, to the exercise of a special power of appointment over trust property or to the discretionary dis-

NOTES

17 Matter of Ould, N.Y.L.J., 11/28/01, page 21, col. 5 (Surr. Ct., N.Y. County), in which the trustees were permitted to appoint the trust estate consisting of a second-to-die insurance policy to a new trust, thereby eliminating the Crummey power of withdrawal of one of the insureds.

18 See Phipps v. Palm Beach Trust Co., 142 Fla. 782, 196 So. 299 (1940). Granting a beneficiary a power of appointment will allow the beneficiary to not only change the remainder or other successor beneficiaries but also expose property to estate rather than GST tax, such as where the beneficiary is given a general power of appointment or a special power that can be used to trigger the "Delaware tax trap" under Section 2041(a)(3). See Blattmachr and Pennell, "Using 'Delaware Tax Trap' to Avoid Generation-Skipping Taxes," 68 JTAX 242 (April 1988), updated and reprinted in 24 Real Prop. Prob. & Tr. J. 75 (Spring 1989).

19 Matter of Vetlesen, N.Y.L.J., 6/29/99, page 27, col. 3 (Surr. Ct., N.Y. County), in which a sole trustee appointed principal of an inter vivos trust to himself and another as trustees of a testamentary trust and the trustees agreed to share one commission.

20 Matter of Klingenstein, N.Y.L.J., 4/20/00, page 33, col. 6 (Surr. Ct. Westchester County), in which limitations on number of individual trustees, powers to remove and replace trustees, requirement for a corporate trustee, designation of successor trustees, and ability of corporate trustee to appoint a successor were changed.

21 In re Alfred Hazan, N.Y.L.J., 4/11/00 (Surr. Ct., Nassau County), in which a trustee was permitted to extend a trust for a beneficiary's lifetime. See also Matter of Dornbush (Riese), 164 Misc.2d 1028, 627 N.Y.S.2d 232 (Surr. Ct., N.Y. County, 1995), in which the corpus of an irrevocable trust subject to New York law, which was to end at the first to die of the grantor and the beneficiary, was paid to a new Florida trust for the beneficiary's lifetime in order to protect the trust assets from the beneficiary's potential creditors.

22 Converting a trust into a grantor trust allows the trust to grow on an income-tax-free basis, a great benefit for the trust and its beneficiaries. Nevertheless, the grantor's income tax will increase and those statutes that prohibit any adverse tax effect may block a trustee from converting a trust into a grantor trust or the reverse. See CCA 200923024, holding that the mere conversion of a nongrantor trust to a grantor trust is not a transfer for income tax purposes requiring the recognition of gain. (See also Letter Rulings: "Trust Conversion Was Not a Recognition Event Despite Apparent Abuse," 111 JTAX 116 (August 2009).) Grantor trust status also would permit the trust and the grantor to buy and exchange assets between themselves without gain; see Rev. Rul. 85-13, 1985-1 CB 142. It also may expose the trust to or eliminate the application of state and local income taxation.

23 Matter of Dornbush (Riese), *supra* note 21, in which the trustees of two irrevocable trusts subject to New York law were allowed to pay over assets to substantially identical Florida trusts in order to protect the trusts' assets from New York real property transfer gains taxes.

24 Matter of Kaskel, 163 Misc.2d 203, 620 N.Y.S.2d 217 (Surr. Ct., N.Y. County, 1994), in which the trustees of several family trusts, which included spendthrift provisions, were allowed to terminate the existing trusts and pay over assets to new trusts without spendthrift provisions so that the beneficiaries could assign their interests in distressed real estate properties from the trusts to corporations, followed by an invasion of the principal of the trusts in favor of the corporations.

25 Estate of Grosjean,, N.Y.L.J., 12/10/97, page 35, col. 6 (Surr. Ct., Nassau County). See also In re Estate of Alfred Hazan, *supra* note 21; Estate of Barkman, N.Y.L.J., 5/20/03, page 23, col. 3 (Surr. Ct., Nassau County), in which remarkably the court permitted the conversion even though the beneficiary had a fixed income interest.

26 Matter of Rockefeller, N.Y.L.J., 8/24/99, page 28, col. 2 (Surr. Ct., Nassau County), in which a committee of individuals with discretionary distribution authority over a trust was permitted to pay trust assets to a new trust to protect the trust principal by providing a spendthrift restraint.

tribution of property from a trust by the trustee to a beneficiary—indeed, each of the statutes essentially is premised on the idea that decanting is part of the act of making a discretionary distribution from the trust for (rather than to) one or more of the trust beneficiaries.

Indeed, as a general matter, the Code does not distinguish for gift or estate tax purposes between a power held in a fiduciary capacity and one held in a nonfiduciary capacity. For example, a power to withdraw property from a trust for one's own benefit is a general (gift and estate taxable) power of appointment whether the power is held in a fiduciary or nonfiduciary capacity.[27] Similarly, a power to distribute trust property only to persons, other than the powerholder, his or her estate, creditors, or creditors of his or her estate, is a special (nongeneral) power of appointment under Section 2514. But a power held in a fiduciary capacity to withdraw income or principal from a trust for the powerholder may not cause the income, deductions, and credits of the trust to be attributed to the powerholder, under Section 678, as it would if held in a nonfiduciary capacity.[28]

A more explicit treatment for tax purposes "comparing" a nonfiduciary power of appointment and a power to decant occurs under the final GST tax "grandfathering" Regulations. Under Reg. 26.2601-1(a), an irrevocable trust (and distributions from it) created before 9/26/85 is exempt (or "grandfathered") from GST tax, as a general rule. In addition, the trust remains grandfathered even if a beneficiary holds and exercises a special power of appointment as long as the vesting of ownership of the trust property occurs by the end of the historic rule against perpetuities (that is, lives in being plus 21 years) or 90 years from the inception of the trust under which the special power was granted.[29]

There does not appear, at least under the common law, to be any restriction on the class of measuring lives that may be selected for purposes of the rule against perpetuities, so long as the members of the class are ascertainable.[30] An otherwise grandfathered trust also remains exempt from the tax if the trustee has the power to pay the trust property over to another trust or to keep it in the same trust as long as the vesting occurs within the time period specified in the Regulations (that is, 90 years or lives in being plus 21 years) and the trustee's power to pay the corpus over to another trust or to keep it in trust was granted to the trustee under the original trust instrument or by state law in effect as of the time the trust was created.[31]

It seems that the treatment under the GST tax Regulations with respect to powers of appointment and powers to decant should be similar.

Although decanting is not explicitly treated as a power of appointment, it seems that the treatment under the GST tax Regulations with respect to powers of appointment and powers to decant should be similar. In fact, it seems that the trustee's power to decant, the exercise of which (subject to the vesting time discussed above) will not cause grandfathering to be lost, must have been contained in or be authorized by a state law applicable to the original trust. It seems that granting a beneficiary a power of appointment by any means after 9/25/85 with respect to a grandfathered trust where that authority to grant the power was not contained in or authorized to be conferred by a state law applicable to the original trust, may cause grandfathering to be lost if the power could be exercised to postpone the vesting of ownership of the trust property beyond the time otherwise provided in the original trust.[32] Hence, it seems that the final GST tax Regulations treat a special power of appointment and a decanting power in a similar manner.[33]

The alternative analogy to how distributions from a trust are made by a trustee also may be appropriate to consider. In some situations, discretionary distributions made by a trustee will be taxed in the same

NOTES

27 See, e.g., O'Malley, 383 U.S. 627, 17 AFTR2d 1393 (1966); Estate of Lanigan, 45 TC 247 (1965).

28 See the discussion in Blattmachr, Gans, and Lo, *supra* note 9.

29 Reg. 26.2601-1(b)(1)(v)(B)(*2*) (referring to "any life in being at the date of creation of the trust").

30 At common law, there was no restriction on the class of persons that could be used as measuring lives for purposes of complying with the rule against perpetuities so long as the lives used in the instrument of transfer were identifiable so that proof of the deaths of the individuals taken as measuring lives could be obtained. See Thellusson v. Woodford, 11 Ves. Jr. 112, 32 Eng. Rep. 1030 (Ch., 1805); *Gray on Perpetuities* (Fourth Ed., 1942), § 217; Restatement (Second) of Property, Donative Transfers, § 1.3 (1983), Reporter's Note 3. English law permitted a class consisting of all the lineal descendants of Her Late Majesty Queen Victoria, which at the time was thought to include approximately 120 known descendants; see In re Villar, 1 Ch. 243 (1929). In Ltr. Rul. 200928013, however, the holder or a power of appointment quoted the language of the Regulation in prohibiting any trust funded by exercise of a special power of appointment from postponing or suspending vesting for a period, measured from date of creation of original trust, extending beyond "any life in being at the date of creation plus 21 years," and the IRS ruled that grandfathering was preserved, which is remarkable since the language would seem to encompass a class consisting of everyone in the world living on the date of creation of the trust.

31 Reg. 26.2601-1(b)(4)(i)(A).

32 See Reg. 26.2601-1(a)(4)(i)(D) (a modification of the governing instrument of an exempt trust (including a trustee distribution) will not cause an exempt trust to be subject to the GST tax provisions if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in Section 2651) than the person or persons who held the beneficial interests in the trust 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).

33 The qualified severance Regulations under Reg. 26.2642-6(h) would appear to permit trusts created as a result of a decanting that does not take the form of a qualified severance to be respected as separate trusts on a prospective basis if state law would treat the new trusts as separate. See generally Harrington, Kwon, McCaffrey, Plaine, and Schneider, "Breaking Up Is No Longer Hard to Do: Final GST Tax Qualified Severance Regulations," 107 JTAX 273 (November 2007), and "Breaking Up May Get Even Easier to Do—Proposed GST Tax Severance Regulations," 107 JTAX 331 (December 2007).

manner as a distribution by a trustee mandated by the exercise of a power of appointment held by a beneficiary. Both transfers, as a general rule, will be deemed to consist of the trust's distributable net income (DNI) defined in Section 643(a).[34] In other circumstances, however, they will not be the same.

For example, if a trustee chooses to distribute $100 worth of property to a beneficiary, that distribution, even if made with non-cash assets, will not ordinarily cause the trust to recognize gain or loss. On the other hand, if a person other than the trustee exercises a power of appointment mandating that the trustee distribute $100 worth of assets to a beneficiary, the distribution would cause the trust to realize gain or loss if a non-cash asset were distributed in satisfaction of the right to the $100.[35]

Because, in general, a distribution by reason of decanting is discretionary, it likely would not be treated as one requiring the distribution of a fixed dollar amount, such as in the case of a pecuniary distribution mandated by the exercise of a power of appointment held by someone other than the trustee. Accordingly, the income tax treatment should be similar to that applicable to the exercise of a trustee's discretionary distribution authority.

Income Tax

As mentioned above, as a general rule any distribution from a trust is deemed to consist of the trust's DNI to the extent of the lesser of the amount distributed or the amount of DNI, which is the trust's taxable income for the year of distribution as specially computed under Section 643(a).[36] Not all trust distributions are deemed to consist of DNI (or at least not all of the DNI). Exceptions exist for distributions described in Section 663(a)(1) in satisfaction of certain bequests of specific sums and specific property, and to the extent the DNI is allocated pursuant to Section 663(c) to another separate share or other shares of the estate or trust.

One private ruling, Ltr. Rul. 200736002, may be read as suggesting that if the entire trust property is "decanted" into another trust (the "new trust"), then the new trust is the same trust for income tax purposes as the one from which the payment was made (the "old trust"). As a general matter, whether the new trust is considered the same as the old one when the entire trust corpus is decanted would seem academic: even if the new trust is a different trust from the old one, all of the old trust's DNI (which would include, under Reg. 1.643(a)-3(e), Example 7, capital gain because it would be the year of termination of the old trust) would be shifted to the new trust.

As a general matter, whether the new trust is considered the same as the old one when the entire trust corpus is decanted would seem academic.

The trust's identity might make a difference where the undistributed taxable income of the old trust will be subject to a state or local income tax but the new trust is not.[37] The distribution from the old trust to the new trust would eliminate the state or local income tax as there would be no undistributed income left in the old trust. The opposite result could be effected as well—that is, the old trust may not have been subject to state or local income tax but the new one is, in which event the decanting may cause such state or local income taxation that otherwise could have been avoided.

The argument that there is no change in the trust by decanting is perhaps stronger where the trustees of the old trust create (or declare) the new trust rather than paying it to another trust someone else created. If the assets of the old trust are paid to a trust created by someone other than the trustees, it may seem that the new trust is not the same as the old one. And it should be kept in mind that the new trust, if created by someone other than the grantor or the trustees acting as such of the old trust, presumably will hold some property received from the new grantor—as a general matter, a trust is created only if it has a *res* (that is, holds property contributed by someone).[38] In other words, the new trust likely would hold some asset contributed by the grantor of the new trust.[39]

This analysis should perhaps be informed by whether or not state law treats a power to decant as a special power of appointment. A special power of appointment is typically viewed as nothing more than an extension of the intent of the original settlor to dispose of his or her property in trust. Thus, it is generally construed as an authority that must operate within the confines of the original settlor's intent, which intent includes the incorporation of applicable common law or statutory law at the time the original trust was created.

Case law will sometimes describe a trust created by the exercise of a power of appointment as being "read back into" the original trust.[40] This generally means that the new trust must be created within the scope of the authority conferred on the powerholder by the original trust. In addition, the rule against perpetuities begins to run from the date the original trust became irrevocable. But where the power of appointment is

NOTES

34 See Sections 651, 652, 661, and 662.

35 See Reg. 1.661(a)-2.

36 See Sections 652 and 662.

37 See, e.g., N.Y. Tax Law section 605, which exempts from New York income tax the income of a trust created by a New Yorker if, among other conditions, the trust has no trustee who is a New Yorker.

38 Restatement (Third) of Trusts, section 2. But see N.Y.E.P.T.L. section 3-3.7 (no *res* required in some situations).

39 Nevertheless, for purposes of determining who is the grantor of a trust for tax purposes, the grantor who contributed property to the old trust will remain the grantor of the new trust as to the property derived from the old trust as a result of the decanting. See Reg. 1.671-1(e)(5) (if a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust).

40 See, e.g., Northern Trust Company v. Porter, 368 Ill. 256, 13 N.E.2d 487 (1938) (the rule against perpetuities begins to run from the date of the original trust).

exercised to create different disposition, as opposed to different governance (such as changing the identity or authority of the trustees), it would seem that the new trust follows the terms set forth in the instrument of the powerholder, even if that instrument incorporates by reference terms of the original trust, and is indeed a new trust. In that case, the tax analysis should follow from the property law treatment. Therefore, perhaps the tax treatment should be identical to the treatment if a nonfiduciary were granted a lifetime power of appointment over the trust.

A distribution by the trustee, pursuant to a decanting statute, of less than the entire corpus of the trust seems, as indicated above, to be the equivalent of a discretionary distribution by the trustee to a beneficiary. Presumably, it will be deemed to consist of DNI although special rules may limit the amount of DNI that is shifted from the trust to the beneficiary.[41]

In any event, when property is paid to a new trust, such new trust presumably has to obtain a tax identification number unless it is a grantor trust under Subpart E of Part 1 of Subchapter J, in which case it may choose to use the grantor's TIN.[42]

Negative basis assets. Where the property paid by the trustee pursuant to a decanting has a liability against it that exceeds the property's income tax basis (i.e., a "negative basis" asset), whether gain will be recognized under *Crane*, 331 U.S. 1, 35 AFTR 776 (1947), is uncertain. Under the *Crane* doctrine, the amount realized, which will be used to determine tax profit or loss, includes indebtedness discharged, including nonrecourse indebtedness. There is no developed law as to whether or when an estate or trust realizes gain by distributing a negative basis asset to a beneficiary.

Some have contended that Section 643(e), which provides in general for the fiduciary's basis in distributed property to carry over to the beneficiary, may override the *Crane* doctrine. This argument may not be persuasive, however, as the section by its own terms provides that the basis of the property distributed by the fiduciary to the beneficiary is "adjusted for ... any gain ... recognized to the ... trust by the distribution."[43]

Because it is possible that gain would be recognized by the trust on the distribution (by decanting or otherwise) by the trustee, such a distribution should be made only after careful consideration. The trustee might ask for a private ruling from the Service clarifying the issue (perhaps seeking to have the IRS rule that no gain will be recognized if the entire trust is decanted because the new trust is the same trust as the old one). Alternatively, the trustee could leave the negative basis asset in the old trust.

Nevertheless, the law seems well developed that the conversion of a grantor trust under Subpart E of Part 1 of Subchapter J, during the grantor's lifetime, to a nongrantor trust is a gain recognition event to the extent liabilities with respect to an asset owned by the trust exceed its basis.[44] Whether the same result would occur by reason of decanting is uncertain.

Beneficiary gain. Another question is whether the beneficiary realizes any gain by reason of decanting. Normally, under Section 662(a) a beneficiary may experience income by reason of a trust distribution only to the extent of the trust's DNI. It is possible, however, that the IRS might contend that a "change" in the quality of the beneficiary's interest in the trust could cause the beneficiary to experience income.

In *Cottage Savings Assn.*, 499 U.S. 554, 61 AFTR2d 91-808 (1991), the Supreme Court held that a company realized a loss when it exchanged certain mortgage note interests for other such notes that were "materially different." The Service has indicated that it may view a beneficiary as experiencing gain under *Cottage Savings* where, for example, the beneficiary's income interest is "converted" into a unitrust interest unless the conversion is pursuant to a state statute (or opinion of the highest court of the state).[45] Also, Reg. 1.643(b)-1 provides in part that a switch from an income interest to a unitrust interest if "not specifically authorized by state statute, but valid under state law (including a switch via judicial decision or a binding non-judicial settlement) may constitute a recognition event to the trust or its beneficiaries for purposes of section 1001...."

Nevertheless, it seems that if the trustee were expressly authorized in the governing instrument to change the beneficiary's interest from an income interest to a unitrust interest there should be no gain recognition by the beneficiary because the beneficiary's interest in the trust was always subject to that potential conversion. In Ltr. Rul. 200810019, the IRS approved without any adverse income, gift, or GST tax consequences the conversion under state law of an income interest to a unitrust interest.

NOTES

41 See, e.g., Reg. 1.643(a)-3(e), Examples 8 and 9, but note that these two example arise under the Regulation defining DNI and not under the provision dealing with separate shares.

42 See Blattmachr and Crawford, "Grantor Trusts and Income Tax Reporting Requirements: A Primer," 13 Prob. Prac. Rptr. 1 (May 2001).

43 Section 643(e)(1). *Cf.* Reg. 1.661(a)-2(f).

44 See Madorin, 84 TC 667 (1985) (the court assumed that the power to add to the class of beneficiaries under Section 674 conferred grantor trust status, and thus relinquishment of the power eliminated grantor trust status, triggering income tax realization). See, generally, Blattmachr, Gans, and Jacobson, "Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death," 97 JTAX 149 (September 2002).

45 See Ltr. Rul. 200013015, in which the IRS held that the partition of the trust and changes in administrative provisions pursuant to N.Y. E.P.T.L. section 10-6.6 would not cause the beneficiaries, whose interests remained the same in the "new" trusts as in the old, to realize gain under Cottage Savings Assn., 499 U.S. 554, 61 AFTR2d 91-808 (1991). But see Ltr. Rul. 200736002, in which the Service indicated that a beneficiary might realize gain if the beneficiary's interest in a successor trust, pursuant to a pro rata division of a trust, was "materially" different than in the original trust, and Ltr. Rul. 200231011, in which the IRS held, under Cottage Savings, that a court-approved settlement under which an annuitant received a unitrust interest instead of the annuity stream constituted an income-taxable exchange.

It does not appear, for this purpose, that state law permitting a unitrust conversion must have been in effect from the inception of the trust.

If the assets of the old trust are paid to a trust created by someone other than the trustees, it may seem that the new trust is not the same as the old one.

A partial answer also may be found in Reg. 1.1001-1(h), which deals with the severance of a trust (including without limitation a severance that meets the requirements of Reg. 26.2642-6 (the qualified severance Regulation) or of Reg. 26.2654-1(b) (retroactive severances at death)). It provides that a severance is not an exchange of property for other property differing materially either in kind or extent if an applicable state statute or the governing instrument authorizes or directs the trustee to sever the trust and any non-pro-rata funding, whether mandatory or in the discretion of the trustee, is authorized by an applicable state statute or the governing instrument.

"Severance" is not defined by the Code. It would seem, however, that the term implies an action by the trustee, without judicial intervention or beneficiary consent, that is authorized by the governing instrument or applicable state law. Accordingly, if a complete decanting to one trust may be treated as a continuation of the original trust, perhaps a decanting to create more than one trust might be treated as a severance likewise having no gain realization consequences. Certainly, the qualified severance Regulations treat certain divisions of a trust that produce new trusts with different beneficiaries as a severance.[46] And Reg. 1.1001-1(h) does not appear to require a "qualified severance." Instead, the result seems to turn on the ability of the trustee to take the action under the terms of the governing instrument or under state law.

Thus, it seems that the exercise by a trustee of a decanting power, whether conferred under the instrument itself or pursuant to state law, should not result in any beneficiary recognizing any gain or loss. It seems critical to this conclusion that beneficiary consent, and possibly court approval—which indirectly may require that the beneficiary consent or at least acquiesce—not be required for the trustee to distribute to the new trust. This may raise a concern about what could be perceived as "stealth" modifications of trusts by ill-motivated trustees. Such concerns caused the Florida drafting committee to include a notice—but not consent—requirement in the Florida statute, and an express statement that beneficiaries retain all rights under the law, which would include a right to complain if the exercise of the decanting power is an abuse of discretion or otherwise a breach of trust, which presumably would occur only if exercised beyond its scope.

Collateral consequences. There can be "collateral" consequences of decanting as well. For example, the old trust might not be a grantor trust but the new one is, or vice versa.[47] In that regard, it may be appropriate to note, as mentioned above, that gain may be recognized with respect to a negative basis asset by reason of the conversion of a grantor trust to one that is not such a trust. Nevertheless, the "mere" conversion of a nongrantor trust to a grantor trust would not appear to have tax consequences.[48]

Similarly, the conversion of a U.S. (domestic) trust to a foreign trust may result in gain recognition under Section 684, although if the grantor is living, it is likely that the exception under Section 684(b) would apply. It seems likely that the result would be the same if the assets of a U.S. trust were paid (by decanting or otherwise) to a foreign trust.

Another possible concern under the grantor trust rules arises under Section 674. Some of the decanting statutes do not appear to prohibit advancing a remainder beneficiary into the class of current beneficiaries. The power to add to the class of beneficiaries is an exception to the exceptions under Section 674. Thus, if the decanting power permits beneficiaries to be added, perhaps it causes grantor trust status for every trust that includes the power. This exception is articulated five times in Section 674, including in Section 674(c) relating to the use of independent trustees to avoid grantor trust status.

Accordingly, in a trust that is intended to be a nongrantor trust, one may wish, in an abundance of caution, to preclude the use of a decanting power in a manner that would permit the trustees to add to the class of beneficiaries within the meaning of Section 674. It would seem that some statutes avoid this issue, such as New York's, which permits decanting only in favor of "proper objects" of the exercise of the power to invade principal. And it seems that the other statutes should be construed to contain a similar prohibition, or else they would be inconsistent with the concept that one is invading in further trust for the benefit of the beneficiaries in respect of whom the power to invade exists.

Yet another question that arises is whether giving a beneficiary a lifetime power of appointment constitutes a power to add to the class of beneficiaries, implicating Section 674 discussed above. Under Florida law, generally, neither a permissible appointee under a power of appointment nor the takers in default are necessary parties in a proceeding concerning the administration of a trust and can be virtually represented by the powerholder.[49] Accordingly, the permissible appointee may be more properly regarded as a person

NOTES

46 See, e.g., Reg. 26.2642-6(j), Example 2 (the trustee of a discretionary trust for T's children, A and B, and their descendants, divides the trust pursuant to state law into two trusts, one for A and A's descendants and one for B and B's descendants; the "severance" constitutes a "qualified severance").

47 See Sections 671-679.

48 See CCA 200923034; Rev. Rul. 2004-64, *supra* note 1.

49 Fla. Stat. section 736.0302.

with a mere expectancy and not a "beneficiary" of the trust for any property law purpose that would implicate Section 674.

There is no developed law as to whether or when an estate or trust realizes gain by distributing a negative basis asset to a beneficiary.

Powers of appointment generally are regarded as personal powers that may be exercised without holding the powerholder to any fiduciary standard.[50] This also might support the conclusion that the permissible appointees under a lifetime power of appointment are not "beneficiaries" of the trust, and therefore also not beneficiaries for any tax purpose. In that case, permissible appointees under a power of appointment could not be regarded as persons that may be "added to the class of beneficiaries."

Gift Tax

At least two potential gift tax issues arise in the context of decanting:

- Does a beneficiary who acquiesces to a decanting and thereby dilutes or forfeits a beneficial interest in the trust make a taxable gift?
- Does the power to decant itself, if held by a beneficiary acting as trustee, have gift tax consequences?

Gift by beneficiary. A person makes a gift for federal tax purposes to the extent she transfers property worth more than what she receives, in money or money's worth, in exchange.[51] Take a beneficiary who neither created the trust nor holds a fixed interest in it (such as a right to income) or a general power of appointment described in Section 2514(b). Although it seems apparent that such a beneficiary should not be treated as making a gift if the trust invades by placing the property in further trust pursuant to a decanting statute, the IRS might possibly argue otherwise.

Indeed, in Reg. 1.643(b)-1, cited above, it is provided, in part, that a switch from an income interest to a unitrust interest if "not specifically authorized by state statute, but valid under state law (including a switch via judicial decision or a binding non-judicial settlement) may ... result in taxable gifts from the trust's grantor and beneficiaries, based on the relevant facts and circumstances." That contention seems inconsistent with the apparently well-established law that a person may make a taxable gift only by making a voluntary transfer.[52]

Nevertheless, the statement seems consistent with the GST Regulations cited above where implied consent or acquiescence to changes effected by judicial proceedings or nonjudicial settlement can have tax consequences different from the exercise of fiduciary powers, at least where the fiduciaries are not independent. Hence, it appears that only if the beneficiary were the trustee (or, perhaps, one of the trustees) who decanted and in the process "gave up" property interests could the beneficiary be charged with making a gift by the act of decanting.[53] If, however, decanting is akin to a power of appointment, a beneficiary-trustee may have tax consequences even if the beneficiary's interests in the trust are discretionary.[54]

The statutes that require the trustee to have absolute discretion to invade principal, New York's and Florida's, do not appear to create additional tax difficulties for the beneficiary acting as a trustee over and above those already present as a result of the absolute distribution authority. A trustee who is a beneficiary of the trust would be treated as holding a general power of appointment within the meaning of Sections 2514 and 2041 if the trustee had absolute discretion to distribute principal to herself.

In addition, a trustee who is also a beneficiary and who is not permitted to make distributions to herself, but is permitted to make distributions to other beneficiaries, might be treated as making a taxable gift on the exercise of such authority.[55] Accordingly, a trustee who is also a beneficiary typically would be afforded tax protection either by a restriction in the governing instrument, or by means of a state statute,[56] which would restrict distributions by a beneficiary who is also a trustee to an ascertainable standard of health, education, maintenance, and support within the meaning of Section 2041(b)(2). In either case, the trustee/beneficiary would not, as a result of the application of the standard, be deemed to have the authority to decant under the New York or Florida statutes.

To attempt to ensure that any gift a beneficiary of a decanted trust may be charged with making would not be complete, it may be appropriate to grant the beneficiary a special power of appointment.[57]

Estate Tax

If the decanting resulted in a beneficiary's making a gift for federal gift tax purposes, it may well be that her gross estate would have to include the trust property so decanted if the beneficiary's transfer fell under any of Sections 2035, 2036, 2037, 2038, 2039, or 2042. If the beneficiary otherwise would be treated as making a gift for federal gift tax purposes by

NOTES

50 See Restatement (Third) of Trusts, section 75.

51 Section 2512.

52 Harris, 340 U.S. 106, 39 AFTR 102 (1950); Estate of DiMarco, 87 TC 653 (1986), *acq. in result*.

53 See generally Gans, Blattmachr, and Heilborn, "Gifts By Fiduciaries by Tax Options and Elections," 18 Probate & Property No. 6 (Nov./Dec. 2004), republished in Digest of Tax Articles (March 2005).

54 See Ltr. Rul. 200243026 (exercise of a lifetime special power by the spouse who was also a discretionary beneficiary was a taxable gift and direct skip); see also Rev. Rul. 75-550, 1975-2 CB 357 (cited in Ltr. Rul. 200243026 for the possible method of computing the taxable gift; Rev. Rul. 75-550 concluded that the value of the spouse's income interest in a trust for purposes of Section 2013 was computed "by taking into account the estimated amount of all *possible* invasions from the corpus on a year-to-year basis" (emphasis in original)).

55 Ltr. Rul. 9811044; *cf.* Rev. Rul. 67-370, 1967-1 CB 324.

56 See, e.g., N.Y.E.P.T.L. section 10-10.1.

57 *Cf.* Reg. 25.2511-2(c) (second sentence).

the decanting and was given a special power of appointment to prevent any such gift from being complete, it seems likely that the decanted property would be included in her gross estate under Sections 2036(a)(2) and/or 2038.

Under Rev. Rul. 95-58, 1995-2 CB 191, powers described in Section 2036 or 2038 held by a trustee are attributed to the trust's settlor (causing estate tax inclusion in her estate) if the settlor may remove the trustee and name another as trustee, unless the settlor may not appoint herself or anyone who is related or subordinate to the settlor within the meaning of Section 672(c). This attribution of the trustee's powers has been extended, unofficially, by the IRS to beneficiaries acting as trustees, potentially causing them to be deemed to hold a general power of appointment.[58]

The exercise by a trustee of a decanting power, whether under the instrument itself or pursuant to state law, should not result in any beneficiary realizing any gain or loss.

If a beneficiary acting as a co-trustee can, with the consent of a non-adverse trustee, participate in a decanting, does that raise tax concerns for the beneficiary? It should not be the case that the powers of a co-trustee are attributed to the beneficiary merely because decanting is one of those powers. If the co-trustee is required to acquit his fiduciary duties appropriately, and is not, via a removal and replacement power, deemed to be a puppet of the beneficiary, then the beneficiary's ability to participate in the decision to decant should not, by itself, raise tax concerns unless the power to decant confers authority on the beneficiary/trustee that would enable the latter to participate in making distributions not limited by an ascertainable standard within the meaning of Section 2041.

Many states have enacted legislation that would prohibit this result as a general matter.[59] It would also seem that the statement in the decanting statutes that the power to decant is to be construed as a nongeneral power of appointment would be enough to prohibit a beneficiary/trustee from participating in a decanting that would confer on the beneficiary/trustee an interest in the trust that could be tantamount to a general power of appointment. Moreover, the Service's view that a removal and replacement power vitiates the fiduciary duties of a trustee is wrong-minded in any event because it ignores the fiduciary duties of a trustee who, even if related and subordinate, will be liable to the beneficiaries for failure to fulfill the duty of impartiality by preferring the interests of a beneficiary/trustee.

Certain of the statutes contain an exception to the prohibition on a beneficiary/trustee's participation in the power to decant if distributions are limited by an ascertainable standard. The exception appears intended to reflect the fact that if a beneficiary/trustee's authority with respect to distributions or a power of appointment is limited by an ascertainable standard, then under Section 2041 the power would not be construed as a general power of appointment. The Delaware statute states that if the trust contains a standard, the exercise of the power to decant must be in furtherance of the standard. Other statutes simply permit a beneficiary/trustee to participate in the decanting only if distributions are limited to a standard. The question is whether it should be inferred that the standard also must be contained in the trust to which property is decanted. The answer would seem to be "yes."

Admittedly, the result may be different in the case of a self-settled trust. Normally, the self-settled trust is a candidate for estate tax inclusion, and gift incompleteness, where it can be reached by the creditors of the settlor. But in those states that have enacted specific legislation barring creditor access where the settlor is a beneficiary but not a trustee, the gift and estate tax concerns seem to have been minimized.[60] Thus, it would seem that decanting of a self-settled trust by the trustee would not raise additional estate tax concerns unless the decanting moves the trust to a jurisdiction without self-settled trust legislation.

Practice Notes

In the absence of Regulations, it would seem difficult for the IRS to argue that exemption from taxation is lost for a trust that is exempt from tax by reason of an allocation of GST exemption when the trustee exercises a decanting power even if the term of the trust is extended or beneficial interests are shifted—if the authority to decant existed, either in the governing instrument or under state law, at least where statutory decanting was in effect when the trust became irrevocable.

GST Tax

As mentioned above, the final GST tax Regulations provide that grandfathering from the tax may be forfeited if the trustee decants other than by a state law in effect when the trust became irrevocable or a power contained in the governing instrument. Nevertheless, it may be that, if under the law at the time the trust was created, the trust could have been "moved" to Florida, where under *Phipps* a trustee may invade in further trust, then, in essence, the decanting power did exist at the time the trust was created.

More important, perhaps, is that the powers of a trustee (of which decanting would appear to be one) are determined by the law of the jurisdic-

NOTES

[58] See, e.g., Ltr. Rul. 200551020.

[59] See, e.g., Fla. Stat. section 736.0814(2).

[60] See, e.g., Estate of German, 7 Cls.Ct. 641, 55 AFTR2d 85-1577 (1985).

tion where the trust is located.[61] For example, if a pre-9/26/85 trust, the validity, construction, and effect of which, by its terms, was governed by the law of New York, began to be administered in Florida (perhaps, by an appointment of a majority of trustees resident in that state), the trustees would have the decanting power provided under *Phipps*. Hence, the safest option, if the trustee wishes to decant and postpone vesting of interests in the grandfathered trust, may be to move the administration, if not also the governing law.

But it seems that such a step should be undertaken only if the effect of losing grandfathering would not be adverse. For example, assume a trust created in 1980 provided for the trust to end when the beneficiary reaches age 50 and for the entire trust to be paid to the beneficiary at that time or, if the beneficiary died before age 50, to be paid on the beneficiary's death to her then living descendants. If the beneficiary then dies before age 50, the wealth taxation of the property will bypass the beneficiary's generation but, if grandfathering were lost, might be imposed if the beneficiary died before age 50 and the trust property were distributed to her descendants.

It is even possible that the IRS would contend that the loss of grandfathering meant that a GST tax was due if the beneficiary survived to age 50 and received the property at that time, assuming the grantor of the trust were the beneficiary's grandparent or someone assigned to that or an older generation. Assuming the trustee had a power to invade corpus, and if the administration of the trust were moved to Florida, the trustee could invade the corpus just before the beneficiary turned 50, relying on *Phipps*. If that causes grandfathering to be lost, it seems there should be no immediate adverse effect—at least if the beneficiary receives a special testamentary power of appointment to avoid a completed gift by the beneficiary.

As to a grandfathered trust, at least, even if vesting may be postponed, for example by the exercise of a beneficiary's special power of appointment, it seems that the duration of the trust may not be extended beyond the GST rule against perpetuities. If the trust is not a grandfathered one, but rather a trust that is exempt by reason of an allocation of GST exemption, the Service appears to agree that a change to a trust that would not affect the GST-exempt status of a grandfathered trust should likewise not affect the GST-exempt status of a trust exempt by reason of an allocation of GST exemption.[62]

The Regulations deal with discretionary powers, which decanting should be, differently from a modification. Reg. 26.2601-1(b)(4)(i)(A) states that a distribution of trust principal from an exempt trust to a new trust will not cause loss of exempt status if the terms of the governing instrument or applicable state law at the time the trust became irrevocable authorizes the distribution to the new trust without the consent or approval of any beneficiary or court and the terms of the governing instrument of the new trust will not extend the time for vesting beyond any life in being at the date the original trust became irrevocable plus a period of 21 years.

If the vesting of interests is not postponed, then other changes that do not shift beneficial interests to lower generations will not cause loss of exempt status, even if done pursuant to a statute enacted after the trust became irrevocable.[63]

Further grandfathering thoughts. The exercise by the trustee of a state-conferred decanting power that extends the term of the trust created before the effective date of the GST tax could cause grandfathering of the trust from the tax to be lost.[64] The Regulations indicate that the distribution of trust principal in a grandfathered trust to a "new" or "continuing" trust will not cause the property to lose its exemption from taxation if either (1) the terms of the exempt trust instrument authorize such distribution or (2) state law, in effect when the trust became irrevocable, authorized the distribution without the consent of a court or any beneficiary.

None of the decanting statutes were in effect when the GST tax took effect. Thus, the requirement that state law authorized the distribution when the trust became effective would not be met based on such state statutes for trusts that are exempt by reason of the grandfathering rule.[65]

There seem to be at least three issues with respect to the question of whether the trustee may exercise the power to invade in trust without negative GST effects. The first issue is whether the applicable state's common law permitted decanting. As discussed above, under Florida law, it seems a decanting power was present, and it is at least arguable that it existed under the common law of all states.

Second, the IRS has not construed the Regulation strictly. For example, it has allowed trustees under N.Y.E.P.T.L. section 10-6.6 to exercise the power of a grandfathered trust to make the trust a spendthrift one and to change the situs of the trust.[66] It may well be that, as long as the trustee does not extend the term of the trust or shift beneficial interests to a lower generation, grandfathering is not lost. This may mean that the trustee could grant a beneficiary a special power of appoint-

NOTES

61 *Scott on Trusts*, *supra* note 10, § 615.

62 See, e.g., Ltr. Rul. 200919009.

63 See Ltr. Rul. 9737024 (no loss of grandfathering where no change in quality, value, or timing of any beneficiary's interest or power pursuant to decanting under N.Y.E.P.T.L. section 10-6.6); Ltr. Rul. 9804046 (no loss of grandfathering where spendthrift provision changed by decanting under N.Y.E.P.T.L. section 10-6.6); Ltr. Rul. 200227020 (no loss of grandfathering where situs of trust changed from New York pursuant to decanting under N.Y.E.P.T.L. section 10-6.6 where the trust would end at the same time); Ltr. Rul. 9438023 (same).

64 Reg. 26.2601-1(b)(4)(A). But see Ltr. Rul. 200520023 (inclusion of a spendthrift clause in the appointed trust would not affect GST-exempt status).

65 Certain trusts created after the initial effective date of the GST tax are exempted (e.g., where the settlor was incompetent); see Reg. 26.2601-1(b)(3). It may be that one of the state decanting statutes might have been enacted for such special-date grandfathered trusts by the time such a trust became irrevocable.

66 See, e.g., Ltr. Ruls. 199942013 and 200227020.

ment which, perhaps, could be exercised without loss of grandfathering.

Third, it seems that the trustee could exercise the power for the shorter of (1) a standard lives in being when the original trust became irrevocable plus 21 year term and (2) the maximum period so that the trust would not lose grandfathering protection.[67] The challenge in this approach is that the trustee will not know when the trust in fact terminates, and thus when payments of GST tax are due.

Non-grandfathered but GST exempt in whole or part. A generation-skipping trust may be exempt, in whole or in part, from GST tax not just by reason of grandfathering but also by reason of allocation of GST exemption to transfers to the trust.[68] Although, as previously mentioned, the IRS in private rulings has applied certain of the grandfathering rules to trusts that are exempt by reason of allocations of GST exemption,[69] it is uncertain whether the exercise of a state decanting power would cause such exemption from taxation to be lost.[70]

Most "new" trusts likely were irrevocable when the applicable decanting statute (at least in New York, Alaska, Tennessee, and Delaware) was enacted. Therefore, applying the literal grandfathering requirements to a GST exemption allocated trust would not cause exemption from taxation to be lost.

Also, the policy considerations with respect to trusts that are exempt from tax by reason of allocation of GST exemption seem quite different from those with respect to trusts exempt from tax by reason of their effective date. In the absence of Regulations, it would seem difficult for the IRS to argue that exemption from taxation is lost for a trust that is exempt from tax by reason of an allocation of GST exemption when the trustee exercises a decanting power even if the term of the trust is extended or beneficial interests are shifted—if the authority to decant existed, either in the governing instrument or under state law, at least where statutory decanting was in effect when the trust became irrevocable.

The effects of decanting on a trust that is not grandfathered from GST tax but is not subject in its entirety to the tax by reason of allocation of GST exemption is not covered by the Regulations or other authority. Many of the rulings addressing trusts exempt by reason of an allocation of GST exemption include the following language: "No guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a change that would not affect the GST status of a trust that was irrevocable on September 25, 1985, should similarly not affect the exempt status of such a trust."

Indeed, because a trust exempt, in whole or in part, by reason of allocation of GST exemption could have postponed vesting for whatever period was permitted under applicable law, it seems decanting to attain that result should not result in the loss of that exemption. Moreover, at least in some states (e.g., New York), the decanting statutes have been in place for a sufficiently long enough period that the decanting law may well have been in effect when the trust was created, suggesting that using it should not result in loss of exemption effected through the allocation of GST exemption.

It also is possible that the decanting of a trust pursuant to applicable state law might be construed as a severance that does not meet the requirements of a qualified severance.[71] In that event, even though the severance is not qualified, after the date of severance the trusts will be treated as separate trusts for purposes of GST tax, provided the trusts resulting from such severance are recognized as separate trusts under state law.

Assuming the trusts are treated as separate trusts, GST tax exemption may be effectively allocated to only one or more of the trusts without being treated as having been allocated ratably to all the trusts. This would permit, for example, a trust to be divided in order to permit a late allocation of GST exemption to only part of the trust estate, with the result that one or more trusts will have an inclusion ratio of zero and one or more trusts will have an inclusion ratio of one.

In addition, if the severance results in a taxable termination as to a portion of the trust, for example because one of the trusts is a skip person, the taxable termination will be deemed to occur only with regard to that particular resulting trust, with no GST tax impact on any other trust resulting from the severance. Each trust resulting from such a severance (prior to the allocation of any additional GST exemption) will have the same inclusion ratio as the original trust. It would seem that changes to the governance of the trust permitted under state law or by judicial reformation should all be respected, particularly if these occur prior to the time GST exemption is allocated to the trust.

CONCLUSION

Decanting may seem like a strange provision, more powerful than effective drafting, faster than a court proceeding, and able to leap over improvident trust provisions in a single bound, and which, disguised as a benign statute, fights for better trust administration and tax effects under American law. ■

NOTES

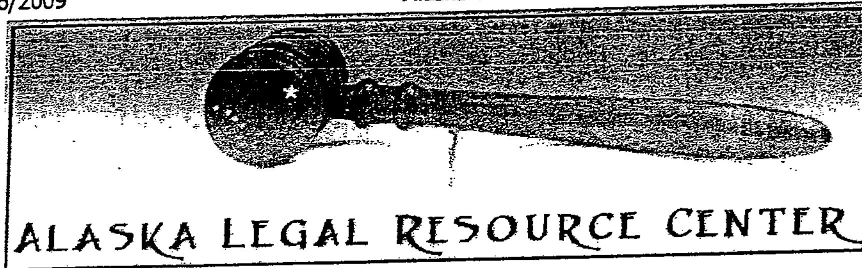
67 In Ltr. Rul. 200227020, the IRS ruled that grandfathering would not be lost in decanting a trust and explicitly noted that the new trust "will provide that, notwithstanding any other provision, no exercise of a power of appointment granted in the trust shall result in a termination date for a trust or a share thereunder or created pursuant to a power of appointment granted thereunder which is later than the date twenty-one years after the death of the survivor of all of Sister's descendants living at Decedent's death."

68 Section 2631(a).

69 See, e.g., Ltr. Rul. 200551020.

70 See Ltr. Rul. 9849005 (holding that GST exemption allocation to a trust that made it exempt from the tax would continue if the trust were to use N.Y.E.P.T.L. section 10-6.6 to pay the corpus over to a trust with "identical" terms).

71 See Reg. 26.2642-6(h).



Advertising with us can place you in front of thousands of visitors a day. Learn more!

Ask a AZ Lawyer Online
14 Lawyers Are Online. Ask a Question, Get an Answer ASAP.
JustAnswer.com/Law/AZ

Alaska Statutes.

Title 13. Decedents' Estates, Guardianships, Transfers, and Trusts.

Chapter 36. Trust Administration

Section 157. Trustee's Special Power to Appoint to Other Trust.

previous: Section 155. Permitted Sales Between Trusts Held By Same Corporate Trustee.
next: Section 160. Corporate Trustee Buying Its Own Stock.

AS 13.36.157. Trustee's Special Power to Appoint to Other Trust.

(a) Subject to (d) of this section, unless the terms of the instrument expressly provide otherwise, a trustee who has authority under the terms of an instrument or irrevocable inter vivos agreement to invade the principal of a trust for the benefit of a beneficiary who is eligible or entitled to the income of the trust may exercise without prior court approval the trustee's authority by appointing, whether or not there is a current need to invade the principal under any standard stated in the governing instrument, part or all of the principal of the trust in favor of a trustee of another trust under an instrument other than that under which the power to invade was created if the exercise of this authority

(1) does not reduce any fixed income interest of a beneficiary of the invaded trust;

(2) is in favor of the beneficiaries of the invaded trust;

(3) does not violate the limitations on validity under AS 34.27.051 or 34.27.100; and

(4) results, in the appointed trust, in the standard for invading principal that is the same as the standard for invading principal in the invaded trust.

(b) This section applies to a trust governed by the laws of this state, including a trust whose governing jurisdiction is transferred to this state.

(c) The exercise of the power to invade the principal of a trust under (a) of this section is considered to be the exercise of a special power of appointment.

(d) The governing instrument of an appointed trust may provide that, after a time or an event specified in the governing instrument, the trust assets of the appointed trust remaining after the time or event shall be held for the benefit of the beneficiaries of the invaded trust on terms and conditions regarding the nature and extent of the interests of the beneficiaries of the invaded trust that are substantially identical to the terms and conditions governing the interests of the beneficiaries in the invaded trust.

(e) In this section,

(1) "appointed trust" means the trust to which principal is appointed under (a) of this section;

(2) "invaded trust" means the trust whose principal is invaded under (a) of this section.

All content © 2008 by Touch N' Go/Bright Solutions, Inc.

Note to HTML Version:

This version of the Alaska Statutes is current through December, 2007. The Alaska Statutes were automatically converted to HTML from a plain text format. Every effort has been made to ensure their accuracy, but this can not be guaranteed. *If it is critical that the precise terms of the Alaska Statutes be known, it is recommended that more formal sources be consulted.* For statutes adopted after the effective date of these statutes, see, Alaska State Legislature If any errors are found, please e-mail Touch N' Go systems at E-mail. We hope you find this information useful.

This page has been updated: Tue, 06 Jan 2009 00:55:08 GMT

Sec. 13.36.043. Change of situs to Alaska.

(a) The situs of a foreign trust is moved to this state when the trust satisfies AS 13.36.035 (c) and a qualified person serving as trustee registers the trust under AS 13.36.010 .

(b) If the situs of a foreign trust is moved to this state as provided in this section, a provision in the trust that restricts the transfer of trust assets in a manner similar to AS 34.40.110 , that allows the trust to be perpetual, or that is not expressly prohibited by the law of this state is effective and enforceable under the laws of this state.

(c) A foreign trust that moves its situs to this state is valid whether or not the trust complied with the laws of this state at the time of its creation or after its creation.

(d) In this section, "foreign trust" means a trust that is created in another state or country and that is valid in that state or country.

Sec. 13.36.045. Trust proceedings; matters relating to foreign trusts.

(a) The court will not, over the objection of a party, entertain proceedings under AS 13.36.035 involving a trust registered or having its principal place of administration in another state, unless

(1) all appropriate parties could not be bound by litigation in the courts of the state where the trust is registered or has its principal place of administration;

(2) the interests of justice otherwise would seriously be impaired; or

(3) the trust satisfies AS 13.36.035 (c).

(b) The court may condition a stay or dismissal of a proceeding under this section on any party's consent to jurisdiction of the state in which the trust is registered or has its principal place of business, or the court may grant a continuance or enter any other appropriate order.

Sec. 13.36.035. Court jurisdiction; choice of law.

(a) The court has exclusive jurisdiction of proceedings initiated by interested parties concerning the internal affairs of trusts, including trusts covered by (c) of this section. Except as provided in (c) and (d) of this section, proceedings that may be maintained under this section are those concerning the administration and distribution of trusts, the declaration of rights, and the determination of other matters involving trustees and beneficiaries of trusts. These include proceedings to

(1) appoint or remove a trustee;

(2) review trustees' fees and to review and settle interim or final accounts;

(3) ascertain beneficiaries, determine any question arising in the administration or distribution of any trust including questions of construction of trust instruments, instruct trustees, and determine the existence or nonexistence of any immunity, power, privilege, duty, or right; and

(4) release registration of a trust.

(b) Neither registration of a trust nor a proceeding under this section results in continuing supervisory proceedings. The management and distribution of a trust estate, submission of accounts and reports to beneficiaries, payment of trustee's fees and other obligations of a trust, acceptance and change of trusteeship, and other aspects of the administration of a trust shall proceed expeditiously consistently with the terms of the trust, free of judicial intervention and without order, approval or other action of any court, subject to the jurisdiction of the court as invoked by interested parties or as otherwise exercised as provided by law.

(c) A provision that the laws of this state govern the validity, construction, and administration of the trust and that the trust is subject to the jurisdiction of this state is valid, effective, and conclusive for the trust if

(1) some or all of the trust assets are deposited in this state and are being administered by a qualified person; in this paragraph, "deposited in this state" includes being held in a checking account, time deposit, certificate of deposit, brokerage account, trust company fiduciary account, or other similar account or deposit that is located in this state;

(2) a trustee is a qualified person who is designated as a trustee under the governing instrument or by a court having jurisdiction over the trust;

(3) the powers of the trustee identified under (2) of this subsection include or are limited to

(A) maintaining records for the trust on an exclusive basis or a nonexclusive basis; and

(B) preparing or arranging for the preparation of, on an exclusive basis or a nonexclusive basis, an income tax return that must be filed by the trust; and

(4) part or all of the administration occurs in this state, including physically maintaining trust records in this state.

(d) The validity, construction, and administration of a trust with a state jurisdiction provision are determined by the laws of this state, including the

(1) capacity of the settlor;

(2) powers, obligations, liabilities, and rights of the trustees and the appointment and removal of the trustees; and

(3) existence and extent of powers, conferred or retained, including a trustee's discretionary powers, the powers retained by a beneficiary of the trust, and the validity of the exercise of a power.

(e) *[Repealed, Sec. 22 ch 105 SLA 1998].*

14-10107. Governing law

A. The meaning and effect of the terms of a trust are determined by the law of the jurisdiction designated in the terms of the trust instrument.

B. In the absence of a controlling designation in the terms of the trust, the laws of the jurisdiction where the trust was executed determine the validity of the trust, and the laws of descent and the law of the principal place of administration determine the administration of the trust.

14-10108. Principal place of administration

A. Without precluding other means for establishing a sufficient connection with the designated jurisdiction, terms of a trust designating the principal place of administration are valid and controlling if either:

1. A trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction.
2. All or part of the administration occurs in the designated jurisdiction.

B. A trustee is under a continuing duty to administer the trust at a place appropriate to its purposes, its administration and the interests of the beneficiaries.

C. Without precluding the right of the court to order, approve or disapprove a transfer, the trustee, in furtherance of the duty prescribed by subsection B of this section, may transfer the trust's principal place of administration to another state or to a jurisdiction outside of the United States and, subject to the requirements of section 14-10818, may change the applicable law governing the trust.

D. The trustee shall notify the qualified beneficiaries of a proposed transfer of a trust's principal place of administration at least sixty days before initiating the transfer. Unless a corporate trustee indicates an intent to change the principal place of business in a notice to qualified beneficiaries, a transfer by the corporate trustee of some of the functions of a trust to another state or states is not a transfer of the trust's principal place of business if the corporate trustee maintains an office in this state. The notice of proposed transfer must include:

1. The name of the jurisdiction to which the principal place of administration is to be transferred.
2. The address and telephone number of the new location at which the trustee can be contacted.
3. An explanation of the reasons for the proposed transfer.
4. The date on which the proposed transfer is anticipated to occur.
5. The date, at least sixty days after the giving of the notice, by which the qualified beneficiary must notify the trustee of an objection to the proposed transfer.

E. The authority of a trustee under this section to transfer a trust's principal place of administration terminates if a qualified beneficiary notifies the trustee in writing of a reasonably founded objection to the proposed transfer on or before the date specified in the notice.

F. In connection with a transfer of the trust's principal place of administration, the trustee may transfer some or all of the trust property to a successor trustee designated in the terms of the trust or appointed pursuant to section 14-10704.

14-10819. Trustee's special power to appoint to other trust

A. Unless the terms of the instrument expressly provide otherwise, a trustee who has the discretion under the terms of a testamentary instrument or irrevocable inter vivos agreement to make distributions, regardless of whether a standard is provided in the instrument or agreement, for the benefit of a beneficiary of the trust may exercise without prior court approval the trustee's discretion by appointing part or all of the estate trust in favor of a trustee of a trust under an instrument other than that under which the power to make distributions was created if the exercise of this discretion:

1. Does not reduce any fixed nondiscretionary income payment to a beneficiary.
2. Does not alter any nondiscretionary annuity or unitrust payment to a beneficiary.
3. Is in favor of the beneficiaries of the trust.
4. Results in any ascertainable standard applicable for distributions from the trust being the same or more restrictive standard applicable for distributions from the recipient trust when the trustee exercising the power described in this subsection is a possible beneficiary under the standard.
5. Does not adversely affect the tax treatment of the trust, the trustee, the settlor or the beneficiaries.
6. Does not violate the limitations on validity under sections 14-2901 and 14-2905.

B. This section applies to a trust governed by the laws of this state, including a trust whose governing jurisdiction is transferred to this state.

C. The exercise of the power to invade the principal of a trust under subsection A of this section is considered to be the exercise of a special power of appointment.

D. The trustee, in the trustee's sole discretion, prior to or after the exercise of the trustee's discretion under this section, may request the court to approve the exercise.

"Decanting"
Statute under AZ Trust Code