

Internal Revenue Service

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Date:

April 23, 2004

Trust =
1

Trust =
2

A =

B =

C =

D =

Dear :

This letter responds to a letter dated September 16, 2003, and subsequent correspondence submitted on behalf of Trust 1 and Trust 2 (the Trusts) by their authorized representative, requesting rulings under § 671 of the Internal Revenue Code.

The information submitted states that A created and funded Trust 1, naming B, A's father, as initial trustee. The terms of Trust 1 provide that Trust 1 is irrevocable. During A's life, the trustee of Trust 1 shall pay or apply for the benefit of A's children and their issue so much of the income or principal of Trust 1 as the trustee, in the trustee's sole and absolute discretion, shall deem advisable. No part of the principal or of the undistributed income of Trust 1 shall be paid to discharge any legal obligation of A or of the trustee. Upon A's death, the trust estate shall be divided into the number of equal shares that will provide one share each for each of A's children who is surviving at the

time of division and one share for the issue, collectively, of each of A's children who died before the time of division but who has issue then surviving. If a beneficiary has attained the age of thirty at the time of division, that beneficiary's share shall be distributed outright; if not, it shall continue to be held as a separate trust. Trust 1 further provides that any one or more of B, or A's brothers, C and D, may, at any time or from time to time, without approval or consent of any person acting in a fiduciary or non-fiduciary capacity, acquire any property held in Trust 1 at such time by substituting property of equivalent value. B, C, and D may at any time, in their sole discretion, irrevocably release such power of substitution.

A subsequently created Trust 2, an irrevocable trust with an unrelated initial trustee. The terms of Trust 2 provide that, during A's life, the trustee may pay so much of the net income or principal in such proportions and amounts as the trustee shall determine to any one or more of A's living issue. No payment shall be made which would relieve A or A's spouse of any legal obligation. Upon A's death, the trust estate shall be divided into such number of separate equal parts as shall provide one part for each child of A who survives A and one part for each child of A who predeceases A leaving issue who survive A. Each part shall be held as a separate trust. Trust 2 includes additional provisions for the disposition of the trust estate if A is not survived by any child or the issue of any child. A shall have the power, solely in a nonfiduciary capacity and without the approval of any person in a fiduciary capacity, to reacquire the trust principal by substituting other property of equivalent value. A may waive this power at any time. The power shall not be exercisable to the extent that its exercise would reasonably be expected to result in the inclusion of any portion of the trust in A's gross estate.

Trust 1 proposes to transfer all of its assets to Trust 2, in exchange for a promissory note issued by Trust 2 payable to Trust 1. It is represented that the note will be for a term of years at the appropriate long term applicable federal rate for the month in which the note is issued. The face value of the note will equal the value of the assets held by Trust 1, as valued by a qualified appraiser.

Section 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Sections 673 through 678 specify the circumstances under which the grantor or a person other than the grantor is treated as the owner of a portion of a trust.

Section 675(4)(C) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power of administration is exercisable in a

nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. The term “power of administration” includes a power to reacquire the trust corpus by substituting other property of an equivalent value.

Section 1.675-1(a) of the Income Tax Regulations provides, in general, that the grantor is treated as the owner of any portion of a trust if under the terms of the trust instrument or circumstances attendant on its operation administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust.

Section 1.675-1(b)(4)(iii) provides that the circumstances which may cause administrative controls to be considered exercisable primarily for the benefit of the grantor include the existence of certain powers of administration exercisable in a nonfiduciary capacity by any nonadverse party without the approval or consent of any person in a fiduciary capacity. The term “powers of administration” includes a power to reacquire the trust corpus by substituting other property of an equivalent value. If a power is not exercisable by a person as trustee, the determination of whether the power is exercisable in a fiduciary or a nonfiduciary capacity depends on all the terms of the trust and the circumstances surrounding its creation and administration.

Rev. Rul. 85-13, 1985-1 C.B. 184, holds that if a grantor is treated as the owner of any portion of an entire trust, the grantor is the owner of the trust’s assets for federal income tax purposes.

Based solely on the facts and representations submitted, we conclude:

1. The circumstances surrounding the administration of Trust 1 and Trust 2 will determine whether the power of administration is exercisable in a fiduciary or nonfiduciary capacity. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the Internal Revenue Service office where the returns are filed. Therefore, we cannot determine at this time whether A will be treated as the owner of Trust 1 and Trust 2, or any portion thereof, under § 675(4)(C). Provided that the circumstances indicate that the power of administration is exercisable in a nonfiduciary capacity, A will be treated as the owner of Trust 1 and Trust 2 under §§ 671 and 675.

2. If A is treated as the owner of all of Trust 1 and Trust 2, then the proposed transfer of the assets of Trust 1 to Trust 2 in exchange for a promissory note of equal value will be disregarded for federal income tax purposes, and neither A nor Trust 1 will be subject to federal income tax on such transfer.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the transactions described above under any other provision of the Code, specifically including the gift tax provisions of § 2501 and the generation-skipping transfer tax provisions of § 2601. Additionally, when either Trust 1

or Trust 2 ceases to be treated as a trust owned by A under § 671 by reason of A's death or the waiver or release of any power under § 675, no opinion is expressed or implied concerning whether the termination of such grantor trust treatment results in a sale or disposition of any property within the meaning of § 1001(a), a change in the basis of any property under § 1012 or § 1014, or any deductible administration expense under § 2053.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Trust 1's authorized representative.

Sincerely,

J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2

Copy of this letter

Copy for § 6110 purposes