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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B9-PLR-126012-00
Date:
November 15, 2001

LEGEND:

Decedent =

Trust =

Trustee =

X =

A =

B =

B1 =

B2 =

C =

CC =

C1 =

C2 =

D =

E =

F	=	
Contingent Remaindermen	=	

Contingent
Remaindermen
(continued)

Contingent Remaindermen (continued)

Modification Agreement

Date 1 =

Date 2 =

Date 3 =

Date 4	=	
a	=	
b	=	
c	=	
d	=	
e	=	
f	=	
State	=	
State Supreme Court	=	
Court	=	
Special Master	=	
State Statute 1	=	
State Statute 2	=	

Dear Sir or Madam:

This is in response to your authorized representative's letter, dated November 10, 2000, and subsequent submissions, requesting rulings on the income tax, gift tax, and generation-skipping transfer tax ("GSTT") consequences of the modification of a trust. The facts as represented are as follows:

Decedent died on Date 1. Pursuant to Item 11 of Decedent's will, the residue of Decedent's estate was transferred to Trust. Low-yield, closely-held stock in Decedent's company, X, constitutes approximately e percent of the assets of Trust. The remaining Trust assets include cash and marketable securities. Item 14(a) of Decedent's will directs the trustee to retain all investment properties "so long as in [its] discretion it is advisable so to do regardless of whether or not such investments or property fall within the classes of investments in which fiduciaries are or may be authorized by a statute or case, or rule of Court to invest Trust Funds." Item 14(a) further directs that the stock of X should, if possible, be held as part of Trust corpus until Trust's termination.

Item 11(b) of Decedent's will directs that the net income of Trust is to be paid to six income beneficiaries. Upon the death of any income beneficiary and the death of E, one of the income beneficiaries, such beneficiary's share of net income is to be accumulated and added to Trust corpus. Four of the income beneficiaries predeceased Decedent and E died within one year of Decedent's death. A, the only surviving income beneficiary, is entitled under Item 11(b) to receive a percent of Trust annual net income. Trust was irrevocable on September 25, 1985, and no additions (actual or constructive) have been made to Trust since September 25, 1985.

Item 12 of Decedent's will provides that Trust will cease and determine upon the death of all of the income beneficiaries. Pursuant to Item 13 of the will, Trust corpus is to be divided and distributed at termination as follows: (1) one-fourth (1/4) to B if living; if B is not living, then B's share is to be divided equally among B's children, B1 and B2, or their heirs; (2) one-fourth (1/4) to C if C is living, married to and living with CC; if C is not living or if living and not married to CC, or if CC predeceases C, then C's share is to be divided equally among their children, C1and C2, or their heirs; (3) one-fourth (1/4) to D or D's heirs; and (4) one-fourth (1/4) to F or F's heirs.

In a case addressing Trust, State Supreme Court held that Trust could not terminate until the death of A, the last surviving income beneficiary, and that the beneficiaries listed in Item 13 of Decedent's will possess contingent remainder interests in Trust ("Contingent Remaindermen") that will not vest until Trust terminates.

On Date 2, A and several of the Contingent Remaindermen instituted a lawsuit (the "Litigation") in Court requesting modification of Trust under State law. Under State Statute 1, a court may modify a trust in any manner for good cause shown if the court finds that the modification will neither materially impair the accomplishment of the trust purposes nor adversely affect the interests of any beneficiary, or if made, materially benefit the trust or any beneficiary. The parties sought commutation of the life income interest of A and reformation of Trust to include as beneficiaries individuals in family lines that were expressly excluded in Decedent's will as remaindermen. A subsequent Cross Bill for relief sought authorization for modest interim distributions of income to certain adults who were either named remaindermen or heirs presumptive of named remaindermen, and to remote infant claimants and those who may become remote infant claimants. The Cross Bill abandoned the request for reformation relief that would have included the additional family lines among named remaindermen.

During the course of the Litigation, State enacted State Statute 2 authorizing a trustee to make adjustments between principal and income in a trust under a prudent investor standard. Following the enactment of State Statute 2, A alleged that the Trustee failed to invest Trust assets in a manner consistent with his interest as a life tenant and to apportion Trust receipts and expenses between income and principal in the manner required by law, all greatly to his detriment. The Contingent Remaindermen became concerned that A would continually demand that Trustee transfer some of the principal of Trust to income pursuant to State Statute 2 and/ or influence Trustee by such demands to invest Trust assets in a way that might harm their long-term interests. On Date 3, the parties filed an Amended Complaint requesting modification of Trust pursuant to State Statute 1 or pursuant to the equitable approximation doctrine (allowing a court to alter the terms of a testamentary trust to ensure that the intent of the testator is not frustrated). The Amended Complaint alleged that the terms of Trust, when examined in context (including Decedent's family situation and the value of Trust assets), clearly express a general or broad intent to substantially and generously benefit Decedent's cousins who are named or alternate remaindermen after adequate provision for designated income beneficiaries. The Amended Complaint further alleged that disagreements had arisen between A and Trustee regarding investment policies and practices and allocations between income and principal. These differences were, in part, due to the fact that the Contingent Remaindermen were interested in corpus growth and reduced income taxation and A was interested in maximizing income. The parties alleged that these disagreements threatened the orderly administration of the Trust. The parties requested that Court: (i) allow A to commute his interest in Trust for a fair price, taking into account the interests of the parties; (ii) approve and order implementation of the Modification Agreement; (iii) find that the interests of the infants and unborn parties are properly represented; (iv) find that the Modification Agreement is in the interests of all infants and unborn parties; (v) find that good cause has been shown to modify Trust in accordance with the Modification Agreement; (vi) find that a modification to Trust in accordance with the Modification Agreement will neither materially impair the accomplishment of Trust purposes nor adversely affect the interest of any beneficiary; (vii) order all infant and unborn parties to be bound by the terms of the Modification Agreement; and (viii) order that Trust be modified in accordance with the Modification Agreement.

The Modification Agreement states that the agreement is the culmination of arm's length negotiations between the parties for the settlement of a bona fide controversy relating to the administration and construction of Trust. The parties were all represented by counsel and consulted experts in the field of medicine, actuarial statistics, finance and law in order to perfect a settlement that is within the range of reasonable outcomes under Decedent's will and State law. The Modification Agreement states further that those persons who would receive corpus in the event of the death of A at this time are among Decedent's nearest living relatives and are persons whom he must be deemed to have wished to benefit from the extraordinary wealth now contained in Trust. The agreement provides:

(1) A's income interest will be commuted for a one-time payment from Trust of $b;

(2) Trust then will be partitioned into Trusts A and B;

(3) Trust B will be funded with $c in cash and securities from Trust. No stock in X will be transferred to Trust B. Net income will be paid quarterly to those persons to whom it is believed that the corpus of Trust would be paid if A were to have died immediately prior to each quarterly distribution under Item 13 of Decedent's will and State law of descent and distribution. The quarterly distributions of net income shall cease upon A's death;

(4) To protect the interest of infant parties and unknown parties, and in the event the establishment of and the income distributions from Trust B diminish the amounts an infant remainderman would otherwise receive upon A's death, a Makeup Amount shall

be paid to such infant remaindermen from the corpus of Trust B without regard to the percentage distributions mandated by Items 12 and 13 of Decedent's will. The parties agree to make a similar restoration from the corpus of Trust B to unknown parties who become vested remaindermen upon the death of A. The Makeup Amount shall be determined at A's death pursuant to a calculation described in the Modification Agreement;

(5) Trust A will be funded with the remaining assets of Trust, governed by the same terms as Trust, and administered in the same manner as Trust. Trust A income will be accumulated and added to corpus; and

(6) The trustees of Trusts A and B shall be the same as the Trustee of Trust.

The Court appointed Special Master to receive evidence and consult the parties' experts, and to recommend to the Court whether the proposed modifications would materially impair the accomplishment of Trust purposes or would adversely affect the interests of any beneficiary. Special Master reviewed the fairness of the proposed commutation of A's interest and the probability of infant and unborn potential remaindermen coming to possess vested interests in Trust. Experts had concluded that the proposed $b commutation settlement amount to be paid to A is within the range that can be considered financially fair. These opinions were based on factors including State Statute 2, the nature of Trust assets, Trust's historical earnings, values generally earned by trusts, the expected future growth of the value of Trust and of A's income from Trust, and A's life expectancy. Another expert determined that the expected share of infant or unborn remaindermen will be approximately 2.5 percent and that the probability that the Makeup Amount will be inadequate approaches zero.

Special Master found:

> The finding that modification of the Trust to establish Trust B will not materially impair accomplishment of Trust purposes is based on an understanding of Trust purposes as inferred from the provisions in the testator's will and from an analysis of the effect of proposed Trust B on distributees and potential remaindermen, all in the context of assumptions, in the absence of evidence to the contrary, that the testator possessed reasonable intellect and customary values. From an analysis of the provisions in the will considered in the context of circumstances at the time of execution and time of death one can infer that the testator, in establishing [Trust], had a primary purpose of providing defined life income interests to six relatives who were closest in relationship or affection and a secondary purpose of providing deferred or remainder interests to other close relatives living at the death of the last surviving income beneficiary, all with respect to enjoyment of a comparatively modest initial trust estate of [d].
>
> Although the will provides for an accumulation of income with respect to

> expired income interests, it would appear unlikely that the testator anticipated that five of the six life income beneficiaries would be dead within a year of his death, and that [f percent] of the income from the trust would be accumulated for more than 41 years, or perhaps longer, without direct present benefit to the relatives who are the closest natural objects of his bounty. In context, the provision for accumulation appears more a mechanism for defining administratively the extent of respective income and corpus interests than an expression of a material purpose that remaindermen for whose benefit income is accumulated for distribution be refused opportunities for earlier enjoyment.

Following his review, Special Master reported that all the necessary parties were before the Court and the interests of the infant, unborn and unknown parties were properly represented; that all the adult parties and Trustee had executed the Modification Agreement; that the Modification Agreement was within the prayer for relief; that the commutation amount to be paid to A was a fair equivalent of his interest in Trust, was fair to the beneficiaries of Trust, and was prudent from the standpoint of the remaindermen in Trust; that good cause had been shown to modify Trust to commute the lifetime interest in A; that commutation of A's interest would neither materially impair accomplishment of Trust purposes nor adversely affect the interests of any beneficiary; that good cause had been shown to establish Trust B as set forth in the Modification Agreement; that establishment of Trust B would neither materially impair the accomplishment of Trust purposes nor adversely affect the interest of any beneficiary; and that the compromise and settlement set forth in the Modification Agreement was in the interests of all infant and unborn parties.

On Date 4, the Court entered an interlocutory order adopting Special Master's findings, approving the Modification Agreement and the settlement of the matters in controversy in the Litigation, and modifying Trust in accordance with the Modification Agreement subject to any conditions precedent, including obtaining this private letter ruling.

It is represented that Trust B will be created as a result of the settlement agreement reached by the parties to the Litigation and that there is no tax purpose for the existence of Trust B as a separate trust.

The following rulings are requested:

1. None of the transactions contemplated by the Modification Agreement will result in a taxable gift by any party to the Litigation for purposes of chapter 12 of the Internal Revenue Code.

2. The partition of $c of cash and marketable securities from Trust into Trust B pursuant to the Modification Agreement will not effect the exempt status of the partitioned trusts for generation-skipping transfer tax purposes under chapter 13.

3. The commutation of A's income interest in Trust will not result in Trust, Trust A or Trust B or any distribution therefrom becoming subject to the generation-skipping transfer tax under chapter 13.

4. Distributions of income from Trust B contemplated by the Modification Agreement will not result in Trust, Trust A or Trust B or any distribution therefrom becoming subject to the generation-skipping transfer tax under chapter 13.

5. Trust A and Trust B will be treated as separate trusts for federal income tax purposes.

6. No gain shall be recognized to any party to the Modification Agreement or to Trust, Trust A or Trust B on the partition of assets.

7. No party to the Modification Agreement will be taxable as the grantor or owner of Trust A or Trust B for purposes of sections 671 through 678.

8. Commutation of the life estate of A will result in long-term capital gain to A to the extent that the $b exceeds his basis, if any.

LAW AND ANALYSIS

Ruling Request #1

Section 2501 provides that a tax, computed as provided in section 2502, is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides, in pertinent part, that, subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply 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.

Whether a transfer pursuant to a compromise settling a dispute between members of a family results in a taxable gift depends on whether the compromise is based on valid claims and on whether the result is economically fair. Thus, state law must be examined to ascertain the relative value of each party's claim. If it is determined that each party has a valid claim, it must next be determined that the distribution under the settlement reflects the result that would apply under state law. See Commissioner v. Bosch, 387 U.S. 456 (1967); cf., Ahmanson Foundation v. United States, 674 F.2d 761 (9th Cir. 1981). If there is a difference, it is necessary to consider whether the difference may be justified because of the uncertainty of the result if the question were litigated.

There is no decision by State Supreme Court addressing a dispute involving State Statute 2 that results in a settlement under which a trust is modified. Accordingly, we must apply what we find to be State law after giving "proper regard" to the Court's determination and to relevant rulings of other courts of State. See Bosch, supra. We have examined the Modification Agreement in this context. The Modification Agreement provides a result that is within the range of reasonable settlements considering the fairness opinions of the experts, the findings of the Special Master, and the findings of State Court in its interlocutory order. In applying these standards, we have determined that the terms of the Modification Agreement fairly reflect the relative merits of the contentions of the respective parties to the dispute. Accordingly, we conclude that none of the transactions contemplated by the Modification Agreement will result in a taxable gift by any party to Litigation under chapter 12.

Ruling Requests #2, #3, and #4

Section 2601 imposes a tax on every generation-skipping transfer.

Pursuant to section 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax generally is applicable to generation-skipping transfers made after October 22, 1986. Pursuant to section 1433(b)(2)(A) of the Tax Reform Act and section 26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

Section 26.2601-1(b)(1)(ii) provides that, unless otherwise provided in either paragraph (b)(1)(ii)(B) or (C) of this section (pertaining to trusts includible in the gross estate of the settlor under section 2038 or 2042, if the settlor had died on September 25, 1985), any trust (as defined in section 2652(b)) in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(4)(i) provides rules for determining whether a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy section 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer.

Section 2611 defines the term "generation-skipping transfer" to mean a taxable distribution, a taxable termination, or a direct skip.

Section 2651 provides, generally, that the generation to which any person (other than the transferor) belongs shall be determined in accordance with the rules in this section.

The generation-skipping transfer tax would not generally apply to Trust or distributions from Trust because Trust was irrevocable on September 25, 1985, and no additions (actual or constructive) have been made to Trust since that date. The proposed modifications under the Modification Agreement will not shift a beneficial interest in Trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the proposed modifications do not extend the time for vesting of any beneficial interest in Trust beyond the period originally provided for in Trust. Accordingly, based upon the facts submitted and the representations made, and pursuant to section 26.2601-1(b)(4)(i)(D), we conclude that the partition of $c in cash and marketable securities from Trust into Trust B pursuant to the Modification Agreement will not affect the exempt status of the partitioned trusts for generation-skipping transfer tax purposes. Similarly, the commutation of A’s income interest in Trust will not result in Trust, Trust A or Trust B or any distribution therefrom becoming subject to the generation-skipping transfer tax. Finally, distributions of income from Trust B contemplated by the Modification Agreement will not result in Trust, Trust A or Trust B or any distribution therefrom becoming subject to the generation-skipping transfer tax.

Ruling Request #5

Section 643(f) provides that, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 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.

A primary purpose of establishing Trust A and Trust B is the need to eliminate the dispute that has arisen among the beneficiaries concerning investment strategies. It is represented that avoidance of income tax is not a primary purpose of Trust A and Trust B within the meaning of section 643(f)(2). Determining whether avoidance of income tax is a primary purpose of Trust A and Trust B is a question of fact, the determination of which must be deferred until the federal income returns of the parties involved have been examined by the office having examination jurisdiction over the income tax returns.

Therefore, provided that Trust A and Trust B are separately managed and administered and it is determined that tax avoidance is not a primary purpose of Trust A and Trust B, each will be treated as a separate trust for federal income tax purposes.

Ruling Request #6

Section 61 provides that income includes gains derived from dealings in property.

Section 1001 provides that the gain from the sale or other disposition of property will be the excess of the amount realized therefrom over the adjusted basis as provided in section 1011 for determining gain.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise stated in subtitle A, the gain of loss realized from the exchange of property for other property differing materially either in kind or extent, is treated as income or as loss sustained.

Cottage Savings Ass'n. v. Commissioner, 499 U.S. 554 (1991), concerns when a sale or exchange has taken place that results in a realization of gain or loss under section 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 in Cottage Savings, 499 U.S. at 560-61, concluded that section 1.1001-1 reasonably interprets section 1001(a) and stated that the exchange of property is a realization event under section 1001(a) if the properties exchanged are materially different.

In defining what constitutes a material difference for purposes of section 1001(a) the Court stated that properties are "different" in the sense that is "material" to the Code so long as they embody legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65.

In Helvering v. Flaccus Oak Leather, 313 U.S. 247 (1941), the Supreme Court held that where a taxpayer received insurance proceeds as compensation for the loss of a building, there was no sale or exchange. The court reasoned that neither of these terms was appropriate to characterize the demolition and subsequent compensation by the insurance company. Plainly the pair of events was not a sale. Nor could they be regarded as an exchange since exchange implies a reciprocal transfer of capital assets, not a single transfer to compensate for the demolition of the taxpayer's asset.

Thus, in order for a transaction to result in a section 1001 taxable event, the transaction must be (1) a sale, exchange or other disposition, and (2) if an exchange, the exchange must result in the receipt of property that is "materially different" from the property that was given up. In this case, as to the Contingent Remaindermen, the first element will not be present, because the beneficiaries do not acquire their interests in Trust A or Trust B as the result of an exchange of their interests in Trust. Trust A is a continuation of Trust without the distribution of income to A. There is no exchange of trust interests by the beneficiaries since the Trust A interests are the same interests they had in Trust. As to their receipt of Trust B interests, there is no exchange because there is no reciprocal transfer of property. The beneficiaries do not give up interests in Trust to get their interests in Trust B. Without the reciprocal transfer of capital assets, there can be no realization event. Here, there is a single transfer of Trust B interests as part of the Modification Agreement.

The Modification Agreement itself, is the result of a proceeding under State Statue 1 seeking modification of Trust. It construes whether the income accumulation provision of Trust precludes early enjoyment by the Contingent Remaindermen. Special Master found:

> The finding that modification of the Trust to establish Trust B will not materially impair accomplishment of Trust purposes is based on an understanding of Trust purposes as inferred from the provisions in the testator's will and from an analysis of the effect of proposed Trust B on distributees and potential remaindermen, all in the context of assumptions, in the absence of evidence to the contrary, that the testator possessed reasonable intellect and customary values. From an analysis of the provisions in the will considered in the context of circumstances at the time of execution and time of death one can infer that the testator, in establishing [Trust], had a primary purpose of providing defined life income interests to six relatives who were closest in relationship or affection and a secondary purpose of providing deferred or remainder interests to other close relatives living at the death of the last surviving income beneficiary, all with respect to enjoyment of a comparatively modest initial trust estate of [d].
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> Although the will provides for an accumulation of income with respect to expired income interests, it would appear unlikely that the testator anticipated that five of the six life income beneficiaries would be dead within a year of his death, and that [f percent] of the income from the trust would be accumulated for more that 41 years, or perhaps longer, without direct present benefit to the relatives who are the closest natural objects of his bounty. In context, the provision for accumulation appears more a mechanism for defining administratively the extent of respective income and corpus interests than an expression of a material purpose that remaindermen for whose benefit income is accumulated distribution be refused opportunities for earlier enjoyment.

The creation of Trust B should not be viewed as deviating from the intent of Decedent, rather it should be seen as carrying out his intent by means of the Modification Agreement. As such, it is a clarification of the original intent and not an exchange of interests by the beneficiaries. Therefore it is consistent with section 1001 to conclude that the modifications will not constitute a sale or disposition under section 1001 with respect to Trust, Trust A, Trust B, or the parties to the Modification Agreement. Neither Trust, Trust A, Trust B nor the parties to the Modification Agreement will realize gain or loss under sections 61 and 1001 as a result of the modifications.

Ruling Request #7

Sections 671 through 678 provide rules for determining when the grantor or another person is treated as the owner of any portion of all of a trust.

Section 1.671-2(e)(1) of the Income Tax Regulations provides that a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer (within the meaning of section 1.671-2(e)(2)) of property to a trust.

Section 1.671-2(e)(2)(i) provides that a gratuitous transfer is any transfer other than a transfer for fair market value. A transfer of property to a trust may be considered a gratuitous transfer without regard to whether the transfer is treated as a gift for gift tax purposes. Section 1.671-2(e)(2)(ii) provides that for purposes of paragraph (e), a transfer is for fair market value only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust.

Section 1.671-2(e)(5) provides that, 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.

Section 678(a) provides that a person other than the grantor is treated as the owner of any portion of a trust with respect to which (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in such person, or (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

Decedent was the grantor of Trust and the beneficiaries of Trust had no powers with respect to the income or corpus of Trust. As directed by a court order, Trustee will transfer all of Trust's assets to Trust A and Trust B after payment of A's commutation amount. The transfer is a gratuitous transfer within the meaning of section 1.671-2(e)(2). The Contingent Remaindermen had no right to, possession of, or dominion over Trust assets and did not transfer assets to Trusts A and B, and the beneficiaries of Trust A and Trust B have no powers with respect to the income or corpus of Trusts A and B.

Accordingly, the beneficiaries of Trust, Trust A and Trust B will not be treated as owners of Trust A and Trust B for purposes of sections 671 through 678.

Ruling Request #8

Section 1234A provides that gain or loss attributable to the cancellation, lapse, expiration or other termination of a right or obligation with respect to property which is a capital asset in the hands of the taxpayer will be treated as gain or loss from the sale of a capital asset.

Section 1222 provides that the term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 1 year.

Rev. Rul. 72-243, 1972-1 C.B. 233, holds that a life tenant’s sale of her entire life interest in a testamentary trust is the sale of a capital asset. The revenue ruling states that the Internal Revenue Service will follow the case of McAllister v. Commissioner, 157 F.2d 235 (2d. Cir. 1946), cert. denied, 330 U.S. 826 (1946), which held that the proceeds received by the life tenant of a testamentary trust in consideration of her transfer of her entire interest in the trust to the remainderman are to be treated as an amount realized from the sale or exchange of a capital asset under section 1222. The revenue ruling further states that the life tenant's basis attributable to her life interest at the time of the sale is considered to be zero. See Treas. Reg. § 1.1001-1(f)(1).

If A’s surrender of his life estate is characterized as a sale, it results in capital gain or loss under Rev. Rul. 72-243 and the rationale of McAllister. If it is treated as an extinguishment or “other termination” it results in capital gain or loss under Rev. Rul. 72- 243, McAllister, and section 1234A.

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(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any Federal tax return to which it is relevant.

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

Enclosure
copy for section 6110 purposes