



TAX SECTION

2012-2013 Executive Committee

ANDREW W. NEEDHAM

Chair
Cravath, Swaine & Moore LLP
825 Eighth Avenue
New York, NY 10019
212/474-1440

DIANA L. WOLLMAN

First Vice-Chair
212/558-4055

DAVID H. SCHNABEL

Second Vice-Chair
212/909-6336

DAVID R. SICULAR

Secretary
212/373-3082

COMMITTEE CHAIRS:

Bankruptcy and Operating Losses

Stuart J. Goldring
Deborah L. Paul

Compliance, Practice & Procedure

Elliot Pisem
Bryan C. Skarlatos

Consolidated Returns

Lawrence M. Garrett
Edward E. Gonzalez

Corporations

Karen Gilbreath Sowell
Linda Z. Swartz

Cross-Border Capital Markets

S. Douglas Borisky
Andrew Walker

Employee Benefits

Eric Hillers
Andrew L. Oringer

Estates and Trusts

Alan S. Halperin
Laura M. Twomey

Financial Instruments

Michael S. Farber
William L. McRae

"Inbound" U.S. Activities of Foreign

Taxpayers

Peter J. Connors
Yaron Z. Reich

Individuals

Robert E. Brown
Sherry S. Kraus

Investment Funds

Marcy G. Geller
Joel Scharfstein

New York City Taxes

Maria T. Jones
Irwin M. Slomka

New York State Taxes

Paul R. Comeau
Arthur R. Rosen

"Outbound" Foreign Activities of

U.S. Taxpayers

Andrew H. Braiterman
David R. Hardy

Partnerships

David W. Mayo
Eric Sloan

Pass-Through Entities

James R. Brown
John T. Lutz

Real Property

Robert Cassanos
Lisa A. Levy

Reorganizations

Peter F. G. Schuur
Gordon Warnke

Securitizations and Structured

Finance

Jiyeon Lee-Lim
W. Kirk Wallace

Tax Exempt Entities

Elizabeth T. Kessenides
Richard R. Upton

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE

Lee E. Allison Stephen B. Land Amanda H. Nussbaum Philip Wagman
Janet A. Andolina Matthew Lay David M. Schizer
Steven A. Dean Robert J. Levinsohn Stephen E. Shay
Kathleen L. Ferrell Vadim Mahmoudov Ansgar A. Simon
Joshua M. Holmes Gary B. Mandel Andrew P. Solomon
Charles I. Kingson Charles M. Morgan Eric Solomon

April 26, 2012

The Honorable Emily S. McMahon
Acting Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Notice 2011-101 and Trust Decanting

Dear Ms. McMahon, Mr. Wilkins, and Mr. Shulman:

In response to the request in Notice 2011-101 (the "Notice"), we write to provide comments regarding the income, gift, estate and generation-skipping transfer ("GST") tax consequences of a transfer by a trustee of all or a portion of the principal of an irrevocable trust (a "Distributing Trust") to another irrevocable trust (a "Receiving Trust"), commonly referred to as "decanting".

As requested in the Notice, the attached report addresses the various tax consequences when a decanting results in a change in the beneficial interests in the Distributing Trust. Where relevant, we further address tax consequences of decanting in other contexts. In examining the tax consequences, we consider the specific facts and circumstances identified in the Notice to the extent relevant to the tax analysis.

Our report begins with an overview of decanting and the circumstances under which decanting may be used to further the grantor's objectives, safeguard the interests of the beneficiaries and/or preserve the

FORMER CHAIRS OF SECTION:

John E. Morrissey, Jr. Richard J. Hiegel John A. Cory Robert H. Scarborough David S. Miller
Peter L. Faber Dale S. Collinson Peter C. Canellos Robert A. Jacobs Erika W. Nijenhuis
Hon. Renato Beghe Richard G. Cohen Michael L. Schler Samuel J. Dimon Peter H. Blessing
Alfred D. Youngwood Donald Schapiro Carolyn Joy Lee Andrew N. Berg Jodi J. Schwartz
Gordon D. Henderson Herbert L. Camp Richard L. Reinhold Lewis R. Steinberg
David Sachs William L. Burke Richard O. Loengard David P. Hariton
J. Roger Mentz Arthur A. Feder Steven C. Todrys Kimberly S. Blanchard
Willard B. Taylor James M. Peaslee Harold R. Handler Patrick C. Gallagher

Ms. McMahon
Mr. Wilkins
Mr. Shulman
April 26, 2012
Page 2

trust assets. In addition, because many trustees rely on state law for decanting authority, we have summarized the pertinent provisions of the existing state statutes.

In summary, we recommend that Treasury and the Internal Revenue Service issue the following guidance:

- For income tax purposes:
 - that the general rules of Subchapter J apply to a decanting unless the Receiving Trust is deemed a continuation of the Distributing Trust;
 - that when the Distributing and Receiving Trusts have substantially similar terms and the Receiving Trust receives all of the Distributing Trust assets, the Receiving Trust be considered a continuation of the Distributing Trust, such that all of the tax attributes of the Distributing Trust carry over to the Receiving Trust;
 - that no beneficiary recognizes gain upon a decanting unless the decanting requires such beneficiary's consent *and* the terms of the Distributing and Receiving Trusts are materially different;
 - that the Distributing Trust does not recognize gain or loss upon a distribution to a Receiving Trust; and
 - that decanting does not affect the charitable deduction otherwise available to a Distributing Trust, unless the decanting, under state law (statutory and common law) or the trust instrument, may defeat the charitable interests that otherwise gave rise to the charitable deduction.
- For gift tax purposes:
 - that if the trustee of the Distributing Trust has no beneficial interest (or a beneficial interest limited to an ascertainable standard), a trust decanting does not give rise to a taxable gift, even when the decanting results in a change in beneficial interest;
 - unless the beneficiary participates (as trustee) or such beneficiary's consent is required for a decanting and such action reduces his or her beneficial interest, that the beneficiary will not be deemed to have made a taxable gift;
 - that no taxable gift occurs upon a decanting from a Distributing Trust that is a non-grantor trust for income tax purposes to a Receiving Trust that is a grantor trust;
 - that the provisions of Section 2514(d) do not apply to the exercise of a trustee's decanting power so long as the trustee has no beneficial interest in the Distributing Trust; and

- that decanting will not affect the annual exclusion or charitable or marital deduction otherwise available to a Distributing Trust, unless the decanting, under state law (statutory and common law) or the trust instrument, may defeat the interests that otherwise give rise to the exclusion or deduction.
- For estate tax purposes:
 - that a trust decanting does not cause estate tax inclusion with respect to the grantor unless the grantor has retained the power to participate in the exercise of the decanting power;
 - that the provisions of Section 2041(a)(3) do not apply to the trustee's exercise of a decanting power; and
 - that decanting does not affect the charitable or marital deduction otherwise available to a decedent's estate for an interest in a Distributing Trust, unless the decanting, under state law (statutory and common law) or the trust instrument, may defeat the interests that otherwise give rise to the estate tax deduction.
- For GST tax purposes:
 - in the case of a decanting of the entire trust, that the tax attributes of the Receiving Trust flow from the Distributing Trust, including the identity of the transferor;
 - where less than the entire Distributing Trust is decanted, that no GST tax should apply with respect to any property remaining in the Distributing Trust;
 - that decanting a Grandfathered Trust (as defined in the report) that is a complex trust for income tax purposes to a grantor trust does not affect GST exempt status;
 - that the safe harbor rules under Treasury Regulations §§ 26.2601-1(b)(4)(i)(A) and (D) (which apply to Grandfathered Trusts) also apply, with certain modifications, to a trust that is exempt from GST tax as a result of an allocation of GST exemption;
 - that assets decanted from a Distributing Trust created by a non-US person, which was not subject to US estate or gift tax, will not be subject to GST tax even if the perpetuities period is extended or the decanting results in other changes in beneficial interests;
 - with respect to exempt trusts that lose exempt status as a result of a decanting, that such trusts should have an inclusion ratio of one and that such GST tax consequences be applied only on a prospective basis; for purposes of ascertaining whether future GST events occur, the rules under Chapter 13 should be applied to the trust from inception; and
 - that decanting does not affect the favorable zero inclusion ratio treatment of a trust that otherwise qualifies under Section 2642(c), unless the decanting, under

Ms. McMahon
Mr. Wilkins
Mr. Shulman
April 26, 2012
Page 4

state law (statutory and common law) or the trust instrument, may defeat the interests that otherwise qualify the trust under such Section.

We also provide a number of other comments and technical recommendations.

As described more fully in the report, many of these recommendations have certain elements in common. For income and gift tax purposes, we generally recommend that the decanting power be treated as a form of distribution. For income, gift and GST tax purposes, we recommend that the tax attributes of the Receiving Trust, including the identity of the transferor, be measured by reference to the Distributing Trust and that certain tax attributes of the Distributing Trust continue with the Receiving Trust (except in limited circumstances). We further recommend that any exclusions, deductions and other favorable tax treatment should not be affected by a decanting power unless the decanting power may be exercised in a fashion that may defeat the rights which give rise the exclusion, deduction or other favorable tax treatment.

We appreciate your consideration of our recommendations.

Respectfully submitted,



Andrew W. Needham
Chair

Enclosure

cc: Erik Corwin
Deputy Chief Counsel (Technical)
Internal Revenue Service

James F. Hogan
Associate Chief Counsel (Passthroughs and Special Industries)
Internal Revenue Service

Lisa Zarlenga
Acting Tax Legislative Counsel (Regulatory Affairs)
Department of the Treasury