Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-105823-00
Date:
February 5, 2001

Re:

Legend
Decedent =
Child A =
Child B =
Child C =
Trust A =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Date 1 =
Date 2 =
Date 3 =

Dear :

This is in response to your letter dated March 8, 2000, submitted by your authorized representatives, requesting income tax and generation-skipping transfer tax rulings concerning the partition of Trust A.

Decedent died on Date 1, survived by three children, Child A, Child B, and Child C. Under Decedent's Will, executed on Date 2, Decedent bequeathed the balance of his residuary estate to three testamentary trusts, with each separate trust for the primary benefit of one child. This ruling concerns Trust A, created for the benefit of Child A.

Under the terms of Trust A, the net income is to be paid to Child A for life and, upon Child A's death, net income is to be paid to Child A's issue, per stirpes. Trust A will terminate twenty-one years after the death of the survivor of Child A, Child B, and Child C, or twenty-one years after the death of the last grandchild of Decedent living at the date of his death. Upon termination, the assets of Trust A will be distributed outright to the income beneficiaries, according to their respective rights in such income. If Child A is not survived by issue, the assets of Trust A are to be distributed equally to the trusts for Child B and Child C. The terms of Trust A also authorize the trustee to divide one trust estate into several sub-trust estates.

Child A died on Date 3, survived by four children, Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4.

The trustee proposes to petition the appropriate state court to divide Trust A into four separate and equal successor trusts, with one successor trust for each of Child A's children and their issue. The trustee purposes that no new trust instrument will be created; rather, the terms of the Will shall govern the trusts with respect to income and principal distribution, termination, distribution of assets, and the other terms and conditions. For purposes of partitioning Trust A, the assets of Trust A will be divided on a fractional basis, and the successor trusts will not terminate until the expiration of the applicable perpetuities periods.

The trustee has represented that there have been no additions to Trust A, constructive or otherwise, after September 25, 1985.

The trustee has requested the following rulings:

1. The resulting successor trusts are not subject to the generation-skipping transfer tax imposed under § 2601 of the Internal Revenue Code.

2. The proposed reformation will not constitute an addition to Trust A or a change in the substance of Trust A that will cause it to lose its exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986.

3. After the division of Trust A into four separate equal trusts, the resulting successor trusts will not lose their exempt status and shall continue to be exempt from the generation-skipping transfer tax imposed under § 2601 provided there are no additions to the trusts after September 25, 1985.

4. Neither the partition of Trust A nor the distributions of the assets to the newly created successor trusts on a fractional share basis will require the recognition of gain or loss for federal income tax purposes.

LAW AND ANALYSIS ISSUES 1-3

Section 2601 imposes a tax on every generation-skipping transfer (GST) made after October 26, 1986.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust (as defined in § 2652(b)) in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the 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 will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer.

In this case, Trust A was irrevocable on September 25, 1985, and no additions have been made to the Trust after that date. The trustee proposes to divide Trust A into four separate and equal successor trusts, with one trust for each of Child A's children and their respective issue. The trustee also proposes that no new trust instrument will be created. Instead, the terms of Trust A, as provided for in Decedent's Will, shall govern each of the successor trusts. Furthermore, the assets of Trust A will be divided on a fractional basis, and the successor trusts will not terminate until the expiration of the applicable perpetuities periods. The proposed partition of Trust A will not result in a shift of any beneficial interest in the trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the renunciation and release. In addition, the proposed partition of Trust A will not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Based on the information submitted and representations made, we conclude that the partition, as proposed, will not subject Trust A, or any successor trust created under the partition, to the generation-skipping transfer tax. Further, the proposed reformation will not constitute an addition to Trust A or a change in the substance of Trust A that will cause it to lose its exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986. Finally, after the division of Trust A into four separate equal trusts, the resulting successor trusts will not lose their exempt status and shall continue to be exempt from the generation-skipping transfer tax imposed under § 2601 provided there are no additions to the trusts after September 25, 1985.

LAW AND ANALYSIS ISSUES 4

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 § 1001 for determining loss over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations provides that except as otherwise provided in subtitle A of the Code, 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 extent, is treated as income or loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, held that the severance of a joint tenancy in stock under a partition action provided for by state law to compel the issuance of separate stock certificates is not a sale or exchange. Likewise, the conversion of a joint tenancy in stock into a tenancy in common is a nontaxable transaction. Under applicable state law, the right of the owner of the property to pursue such a result is an inherent ownership right each had in the property involved.

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 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 group of residential mortgage loans. The two groups of mortgage loans were considered "substantially identical" by the agency that regulated the financial institution.

In Cottage Saving, at 499 U.S. at 560-561, the Supreme Court 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 Supreme Court stated that properties are "different" in a 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 564-565. The Supreme Court held that mortgage loans made to different obligors and secured by different homes embodied distinct legal entitlements, and that the taxpayer realized losses when it exchanged the loans. Cottage Savings, 499 U.S. at 566.

Thus, in order for a transaction to result in a § 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" (as defined in Cottage Savings) from the property that was given up. In this case, the first element will not be present because the beneficiaries of Trust A do not acquire their interest in the successor trusts as a result of an exchange of their interests in

Trust A, but rather by reason of the authority granted the Trustee of the trust by Decedent at the time Trust A was first created. There is no exchange of property here, instead the Trustee is merely exercising a right to divide Trust A and create the successor trusts. In this, the transaction is similar to Rev. Rul. 56-437 in which the joint owners of property exercised a right inherent in their ownership rights of the property to partition the property. If the Trustee of Trust A had not had the right to partition the trust, the beneficiaries would have had to exchange their interests in the old trust for interests in the new trust, thereby fulfilling the exchange requirement for a § 1001 transaction.

Further, Trust A establishes that each of the successor trust's trustee's will be required to continue to exercise the same standard of fiduciary responsibility as the Trustee previously exercised with respect to Trust A. Therefore, Trust A and the four successor trusts, and the beneficiaries of any of these trusts will not realize gain or loss under § 1001.

Except as specifically ruled above, we express no opinion about the federal tax consequences of the transaction described above under any other provisions of the Code.

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

Sincerely yours,
Associate Chief Counsel
(Passthroughs and Special Industries)
By: James Hogan
Assistant to the Branch Chief

Enclosure
Copy for 6110 purposes