Internal Revenue Service

Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-113408-01

Number: **200213011**
Release Date: 3/29/2002
Index Nos.: 0061.00-00; 1001.00-00; 2501.00-00; 2511.00-00; 2601-00.00

Date: December 11, 2001

Legend:

Decedent =
Wife =
Son =
Daughter =
Grandson =
Granddaughter =
Trust =

Bank =
A =
Date 1 =
Date 2 =
Court =

State =

Dear :

This responds to a letter dated February 28, 2001, and subsequent correspondence, from your authorized representative requesting rulings regarding the income, gift and generation-skipping transfer (GST) tax consequences of the proposed division of Trust.

FACTS

The facts submitted and representations made are as follows. Decedent died on Date 1, prior to September 25, 1985. Trust is a testamentary trust created under the last will and testament of Decedent. Bank and A are the co-trustees of Trust, Trustees. The terms of Decedent's will provide that the income of Trust is to be paid equally among Decedent's Wife and Decedent's children, Son and Daughter, or per stirpes, to the issue of any deceased child of Decedent.

Trust is to continue until the expiration of twenty years after the death of the last survivor of Wife and Decedent's issue living at the time of Decedent's death. At that time, Trust is to terminate and the principal is to be distributed, per stirpes, among the Decedent's then living issue. Wife and Daughter are deceased. Grandson and Granddaughter are Daughter's children. At present, Son receives one-half of the Trust income and the remaining one-half of the income is paid equally to Grandson and Granddaughter.

As permitted under the laws of State, the Trustees and the beneficiaries propose to divide Trust into three parts. One part, which would be equal in value to one-half of the assets of Trust, would be held for Son and his issue. A second part, which would be equal in value to one-quarter of the assets of Trust, would be held for Grandson and his issue. The third part, which would be equal in value to one-quarter of the assets of Trust, would be held for Granddaughter and her issue. The Trustees intend to allocate the assets of the Trust among the divided trusts on a pro rata basis. These assets consist of marketable securities and cash. Each of the trusts, as so divided, will otherwise be held on the same terms and conditions as provided in Decedent's will. Therefore, the terms of the divided trusts with respect to the distribution of income and principal during the lifetime of the beneficiaries as well as upon the termination of Trust will be identical to the current terms of the Will.

The parties petitioned the Court with jurisdiction over Trust and on Date 2, obtained an order from the Court approving the proposed division. You represent that no additions, actual or constructive, have been made to Trust since September 25, 1985.

We have been asked to rule that:

1. Division of Trust into separate trusts in accordance with the terms of the Court's order will not affect the grandfathered status of Trust for generation-skipping transfer tax purposes.

2. Neither Trust nor any beneficiary thereof will recognize gain or loss as a result of compliance with the terms of the Court's order.

3. No taxable gift will be made by any party as a result of the implementation of the Court's order and such party's compliance therewith.

LAW AND ANALYSIS

Generation-Skipping Transfer Tax Ruling Request No. 1

Section 2601 imposes a tax on every generation-skipping transfer (within the meaning of Subchapter B).

Under § 1433(a) of the Tax Reform Act of 1986, GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) 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. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under §§ 2038 or 2042, if the settlor had died on September 25, 1985.

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 GST 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 the present case, Trust was irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, have been made to the trust after that date. Under Court's order, Trust will be divided into three separate trusts and each separate trust will be subject to the original terms of Trust as set forth in Decedent's Will.

Section 26.2601-1(b)(4)(i) discusses certain actions taken with respect to a trust which will not cause a trust to lose its exempt status. Under § 26.2601-1(b)(4)(i)(D), a modification will not cause an exempt trust to lose its exempt status, if the modification does not shift a beneficial interest in the trust to any beneficiary in a generation lower than the persons who held the beneficial interests 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 that does not cause an increase in the amount of a GST transfer or the creation of a new GST transfer will not cause the trust to lose its exempt status. See, § 26.2601-1(b)(4)(i)(E), Example 5.

In this case, the proposed division of Trust will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the proposed division. Further, the proposed division will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in Decedent's will. Further, the proposed division of Trust will not constitute an "addition" to Trust within the meaning of § 1433(b)(2)(A) of the Tax Reform Act of 1986. Accordingly, based on the facts submitted and the

representations made, the proposed division of Trust into three separate trusts will not subject the three separate trusts to GST tax by reason of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(4)(i)(D). Therefore, after the division, the resulting successor trusts will continue to be exempt from the GST tax imposed under § 2601 provided there are no additions to the trusts after September 25, 1985.

Income Tax Ruling Request No. 2

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 will be the excess of the amount realized from the sale over the adjusted basis provided in § 1011 for determining gain, and the loss will be the excess of the adjusted basis provided in such section 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 in extent, is treated as income or as loss sustained.

A pro rata 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 thereof. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries and was subject to the provisions of § 1001.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that the assets of Trust will be allocated among the three accounts on a pro rata basis, and each account will receive an equal share of each asset in Trust. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of Trust.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). There is a material difference when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565.

We conclude that, after the division of Trust into three separate trusts, the beneficiaries will not have different rights to or interests in the trust income or principal than they presently have. The same substantive provisions of Decedent's will will continue to control the interests of the beneficiaries after the division. Therefore, under Cottage Savings Association v. Commissioner, the properties exchanged are not materially different, and there is no realization of gain or loss.

Gift Tax Ruling Request No. 3

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, we conclude that the proposed division will not cause any beneficiary to be considered as having made a taxable gift under § 2501.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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

Pursuant to a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,
By: Lorraine E. Gardner
Assistant to the Branch Chief
Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes