Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200306010**
Release Date: 02/07/2003
Index Number: 61.00-00, 1001.00-00,1015.00-00, 1223.00-00, 2501.01-00, 2601.04-03

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:9-PLR-118078-02
Date:
October 30, 2002

In Re:

Legend

Settlor 1	=
Settlor 2	=
A	=
B	=
C	=
D	=
E	=
F	=
G	=
H	=
Trust 1	=
Trust 2	=
Trust 1(a)	=
Trust 2(a)	=
Date 1	=
Trustee	=
State	=

Dear Trustee:

This is in response to your letter of March 12, 2002, and subsequent correspondence, in which you requested rulings with respect to the federal income, gift, and generation-skipping transfer (GST) tax consequences of a proposed division of two trusts.

On Date 1, Settlor 1 and Settlor 2, who were sisters, created identical irrevocable inter vivos trusts (Trusts). Settlor 1 created Trust 1, and Settlor 2 created Trust 2, and each trust provides that, during the life of the settlor, Trustee is to pay the net income to a charitable trust. Each trust further provides that, after the death of the settlor, Trustee is to pay the net income from the trust to eight named beneficiaries, A, B, C, D, E, F, G, and H, in equal shares. If any named beneficiary dies leaving lawful issue, the issue are to take, per stirpes, the net income that the deceased beneficiary would have been entitled to receive if living. In the event that any beneficiary dies without lawful issue, Trustee will pay that share of net income to the surviving named beneficiaries and the lawful surviving issue, if any, of any named deceased beneficiary, the issue to take, per stirpes.

Trusts 1 and 2 will terminate twenty years after the death of the last survivor of the named beneficiaries. All assets of each Trust's estate will be distributed outright to the persons entitled to the income at the time the Trusts terminate, in the same proportions that the persons are entitled to the income immediately prior to termination. If there are no surviving issue of the named beneficiaries, the property from each trust is to be distributed to each settlor's heirs at law under the laws of descent of State.

Of the eight named beneficiaries, only A is currently living. A has two descendants. Of the seven deceased beneficiaries, B died without surviving descendants. The six other deceased beneficiaries, C, D, E, F, G, and H, have died and are survived by descendants.

C's descendants intend to file two petitions (one for Trust 1 and one for Trust 2) in State court requesting that each of the trusts be partitioned into two trusts. Trust 1 will be partitioned into Trust 1 and Trust 1(a). Trust 1(a) will receive one-seventh of the assets of Trusts 1 and will be administered for the benefit of C's descendants. The remaining six-sevenths of Trust 1 assets will be retained by Trust 1 and administered for the benefit of the descendants of A, D, E, F, G, and H. Trust 2 will also be partitioned into Trust 2 and Trust 2(a). Trust 2(a) will receive one-seventh of the assets of Trusts 2 and will be administered for the benefit of C's descendants. The remaining six-sevenths of Trust 2 assets will be retained by Trust 2 and administered for the benefit of the descendants of A, D, E, F, G, and H. Trustee will remain the trustee of the four trusts. In the event Trustee ceases to be the trustee of the four trusts, the adult beneficiaries of each trust may select a trustee.

The terms of Trusts 1(a) and 2(a) will be the same as the terms of Trusts 1 and 2, except that, the income beneficiaries of Trusts 1(a) and 2(a) will be limited to C's descendants. In keeping therewith, the income beneficiaries of Trusts 1 and 2 will be limited to the descendants of A, D, E, F, G, and H. In the event that all of the beneficiaries of a family trust die with no surviving descendants, then their share of the trust estate will be divided and distributed to the beneficiaries of the remaining trusts.

The four trusts will terminate twenty years after the death of A. At that time, the corpus of Trusts 1, 1(a), 2, and 2(a), will be distributed to the surviving descendants in proportion to the net income they are receiving from the trusts immediately prior to termination. In the event that no descendants of A, and D through H survive when the trusts terminate the corpus from all four trusts will be distributed to the each settlor's heirs at law under the laws of descent of State.

It is represented that Trusts 1 and 2 were created and irrevocable before September 25, 1985 and that no additions, actual or constructive, have been made to the Trusts since September 25, 1985.

The following rulings have been requested:

1. The proposed partition of Trust 1 into Trust 1 and Trust 1(a), and the proposed partition of Trust 2 into Trust 2 and Trust 2(a) will not constitute an addition to any of the trusts, will not cause any of the trusts to lose their exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986, and will not subject distributions from any of the trusts to the generation-skipping transfer tax under chapter 13 of the Code, so long as there are no additions to these trusts.
2. The proposed pro rata in kind distribution of the assets of Trusts 1 and 2 among the trusts will not cause any beneficiary, Trusts 1 and 2, nor the trusts to recognize any gain or loss from a sale or other disposition of the property under § 61 or § 1001.
3. The proposed partition and pro rata in kind distribution will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries.
4. The basis of each trust in each asset received from Trusts 1 and 2 will be the same as Trusts 1 and 2's basis in that asset pursuant to § 1015.
5. The holding period of each trust for each asset received from Trusts 1 and 2 will include the Trusts 1 and 2's holding period for that asset according to § 1223(2).

LAW and ANALYSIS:

ISSUE 1:

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

Section 2611(a) provides that, for purposes of the GST tax, the term "generation skipping-transfer" means: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides in part that the GST tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985.

The rule of the preceding sentence does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions 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)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 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 § 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.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of § 26.2601-1(b)(4)(i)(D)(2), 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. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from the GST tax is divided into two trusts. Under the facts presented, the division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division, and the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Accordingly, the two partitioned trusts will not be subject to the provisions of chapter 13.

In this case, Trust 1 and Trust 2 are considered irrevocable because neither § 2038 or § 2042 apply. Also, it has been represented that no actual or constructive additions have been made to the Trusts since September 25, 1985. Consequently, Trusts 1 and Trust 2 are currently exempt from GST tax.

The proposed partitions are not modifications that shift a beneficial interest in Trust 1 or Trust 2 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, nor extend the time for vesting of any beneficial interest in the four trusts beyond the period provided for in Trust 1 and Trust 2. Accordingly, based on the information submitted and representations made, we conclude that the proposed partition of Trust 1 into Trust 1 and Trust 1(a), and the proposed partition of Trust 2 into Trust 2 and Trust 2(a) will not constitute an addition to any of the trusts, will not cause any of the trusts to lose their exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986, and will not subject distributions from any of the trusts to the generation-skipping transfer tax under chapter 13 of the Code so long as there are no additions to these trusts.

ISSUE 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 disposition of property is the excess of the amount realized therefrom over the adjusted basis provided in § 1001 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations generally provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property or other property differing materially either in kind or in extent, is treated as income or loss sustained.

For purposes of § 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional property interest. Such an exchange of property is a disposition under § 1001(a). See § 1.1001-1.

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

In the present case, based upon the information submitted and the representations made herein the assets of Trusts 1 and 2 will be divided pro rata in kind among the four trusts, entitling each beneficiary to the same interest in Trusts 1 and 2 that they held prior to the partition. The beneficiaries will hold the same legal entitlements and succession of interests before and after the pro rata division. Thus, there will be no material difference in the kind or extent of the legal entitlements held by any of the trust beneficiaries. Accordingly, there will be no gain or loss realized by any beneficiary or trust under §§ 61 or 1001 as a result of the partition.

ISSUE 3:

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

In this case, after the partition of Trusts 1 into Trust 1 and Trust 1(a) and the partition of Trust 2 into Trust 2 and Trust 2(a), each beneficiary of a partitioned trust will have the same beneficial interest as he or she had under Trusts 1 and 2. Because the beneficial interests of the beneficiaries are substantially the same, both before and after the proposed transaction, no transfer of property will be deemed to occur as a result of the division. Accordingly, we conclude that the proposed partition of Trusts 1 and 2 and the proposed pro rata distribution of the assets of Trust 1 and Trust 2 will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries.

ISSUES 4 and 5:

Section 1015(b) provides that if property is acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by gift, bequest, or devise), the basis is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer is made.

Section 1.1015-2(a)(1) of the Income Tax Regulations provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by transfer in trust by gift, bequest, or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Section 1223(2) provides that, in determining the period for which that taxpayer has held property however acquired, there is included the period for which the property was held by any other person, if under chapter 1 of the Code, the property has, for the purposes of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of the other person.

Because the partition of Trusts 1 and 2, creating Trusts 1(a) and 2(a) will not constitute a sale or other disposition for purposes of § 1001, pursuant to § 1.1001-1, no gain or loss will result. Accordingly, we conclude that the bases of the assets in Trusts 1(a) and 2(a) will be same as the bases of those assets in Trusts 1 and 2 before the partition. In addition, we conclude that the holding period of each partitioned trust for each asset received from its corresponding original trust, as a result of the proposed partition of the original trusts, will include such original trust's holding period for that asset.

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) 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 your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James F. Hogan

James F. Hogan
Senior Technician Reviewer, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)