Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

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Legend

Trust 1 =

Date 1 =

Grantor =

Spouse =

State =

Date 2 =

Child 1 =

Child 2 =

Child 3 =

Child 4 =

Trust A =

Trust B =

Trust C =

Trust D =

Date 3 =

Court 1 =

Date 4 =

Date 5 =

Court 2 =

Dear Sir or Madam:

This letter responds to your letter, dated November 1, 2000, and subsequent correspondence, submitted on behalf of Trust 1, requesting rulings under §§ 61, 643(f), 661, 1001, 1015, 1223 and 2601 of the Internal Revenue Code.

Trust 1 was created on Date 1, by Grantor for the benefit of Spouse and the issue of Grantor and Spouse.

Article Two(a) of the Trust 1 agreement provides the trustees may, in their discretion, accumulate the income of Trust 1 and add it to principal or, at any time or from time to time, distribute any part or all of the income and principal of Trust 1 to or among Grantor's lineal descendants and their spouses, and Spouse.

Article Two(b) provides that the distributions authorized under Article Two(a) may be outright or in further trust for any one or more of the classes among which the trustees may distribute. However, any distribution to a new trust shall be made so that no part of the income or principal of such new trust will at any time be distributed to any person to whom a distribution could not have been made under the Trust 1.

Article Two(c) provides that if not otherwise terminated sooner, Trust 1 shall terminate twenty years and eleven months after the death of the last survivor of Spouse and all Grantor's lineal descendants living at the time of creation of Trust 1. Upon such termination, the trustees shall distribute all property remaining in Trust 1, including all principal and undistributed income, per stirpes, to Grantor's lineal descendants to whom the trustees were authorized to make distributions from such trust immediately before such termination.

Article Two(d) provides that if not otherwise terminated sooner, Trust 1 shall terminate upon the death of the last survivor of Spouse and Grantor's lineal descendants, whenever born. Upon such termination, the trustees may distribute the remaining Trust 1 property to any one or more of any surviving spouse of Grantor's lineal descendants. The trustees shall also distribute the rest of the property, if any, to and among the persons who would have been entitled to Grantor's personal property, and in such proportions as they would have been entitled to, if Grantor died intestate, domiciled in State, immediately following the death of the last survivor of Spouse and Grantor's lineal descendants. No distribution under this paragraph may be made after the time for termination of Trust 1 under Article Two(c).

Article Four(a) provides, in relevant part, that the trustees have the power and discretion to act as they deem proper in any recapitalization, merger, reorganization, consolidation, partition or other transaction affecting any of the property held by them.

Spouse died on Date 2. Grantor and Spouse had four children: Child 1, Child 2, Child 3, and Child 4. Currently, Child 1 has four children, Child 2 has three children and two grandchildren, Child 3 has two children, and Child 4 has two children.

The current beneficiaries of Trust 1 have differing personal and financial situations. As a result, the beneficiaries have differing financial needs concerning distributions of principal and income. In order to better serve the beneficiaries, the trustees propose to divide Trust 1 into four trusts: Trust A, Trust B, Trust C and Trust D (collectively referred to as the "resulting trusts"). The division will be a pro rata division of the assets of Trust 1. Each of the resulting trusts will be for the benefit of one of Grantor's children, that child's issue, that child's spouse, and the spouse of any of the child's issue (collectively referred to as the child's "family line"). The division will allow the trustees to structure the resulting trust investments in a way that will produce income or increase principal as required by each beneficiary's personal situation.

On Date 3, Court 1 issued an opinion stating, among other things, that the trustees' decision to divide the Trust 1 assets into four equal shares was a proper exercise of their discretionary powers. Court 1 approved the division of Trust 1 into Trust A, Trust B, Trust C and Trust D pending a favorable ruling from the Internal Revenue Service. On Date 4, Court 1 issued an order implementing the Date 3 opinion. On Date 5, Court 1's decision regarding the division of Trust 1 was affirmed by Court 2.

The dispositive terms of each resulting trust will be identical to the dispositive terms of Trust 1, except that the discretionary distributees of income and principal of each resulting trust will be limited to child's family line for whom the resulting trust is named. On the death of the last survivor of the family line for whom the resulting trust is named, the resulting trust shall terminate (if not already terminated sooner) and be divided equally among the then remaining resulting trusts in existence, if any. The resulting trusts must terminate no later than twenty years and eleven months after the death of the last survivor of Spouse and all of Grantor's lineal descendants living on Date 1, in accordance with Article Two(c) of Trust 1.

The trustees have requested rulings that the proposed division of Trust 1 and the proposed pro rata allocation of each existing asset among the resulting trusts: (1) will not cause Trust 1 or the resulting trusts to lose the status as grandfathered trusts exempt from the generation-skipping transfer ("GST") tax and will not cause a distribution from, or termination of any interests in, Trust 1 or any of the resulting trusts to be subject to the GST tax; (2) will result in resulting trusts that will be treated as separate taxpayers under § 643(f); (3) will not result in the realization by Trust 1, the resulting trusts, or a beneficiary of Trust 1 or the resulting trusts of any income, gain or loss under § 661; (4) will not result in the realization of any income, gain, or loss under § 61 or § 1001 by Trust 1, the resulting trusts, or a beneficiary of Trust 1 or the resulting trusts; (5) will result in resulting trusts with assets that have the same basis as they had at the time of the allocation under § 1015, and holding periods for all the assets allocated to each resulting trust that include Trust 1's holding period under § 1223; (6) will not cause any portion of the assets of Trust 1 or any of the resulting trusts to be includible in the gross estate of any beneficiary of Trust 1 or the resulting trusts under §§ 2036 through 2038; and (7) will not constitute a transfer by any beneficiary of Trust 1 or the resulting trusts that will be subject to the gift tax under § 2501.

Ruling 1

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

Section 2611(a) defines the term "generation-skipping transfer" to include a taxable distribution, taxable termination, and a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer 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, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

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 in existence on September 25, 1985, is considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, Trust 1 is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(4) 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 under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

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) of this section) 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 in the original trust. Furthermore, 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 a shift in a beneficial interest in a trust.

In this case, Trust 1 is a generation-skipping trust because it provides for distributions to more than one generation of beneficiaries below the grantor's generation. Date 1 is prior to September 25, 1985, and Trust 1 was irrevocable on September 25, 1985. Trust 1, therefore, is exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i).

The proposed division of Trust 1 will result in four trusts, one for each of Grantor's children's family line (the child, the child's spouse, child's issue and the spouses of child's issue). Because the terms of the resulting trusts will be the same as the terms of Trust 1, the proposed division of Trust 1 and pro rata allocation of assets among the resulting trusts does not shift a beneficial interest 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. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Based on the facts submitted and representations made, we conclude that the proposed division of Trust 1 into the four resulting trusts will not affect Trust 1's status as exempt from the generation-skipping transfer tax. As a result, neither the division of Trust 1 nor the proposed pro rata allocation of the assets will cause a distribution from, or termination of any interest in, Trust 1 or any of the resulting trusts to be subject to the GST tax.

<u>Ruling 2</u>

Section 643(f) provides that under regulations prescribed by the Secretary, two or more trusts shall be treated as one 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 the tax imposed by Chapter 1 of the Code.

Based on the facts submitted and representations made, we conclude that while the resulting trusts have the same grantor, they have different beneficiaries and will be managed and administered separately. Therefore, we conclude that the resulting trusts will be treated as separate trusts for federal income tax purposes.

Ruling 3

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year.

Section 1.661(a)-2(f)(1) of the Income Tax Regulations provides that if property is paid, credited, or required to be distributed in kind, no gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of the distribution, unless the distribution is in satisfaction of a right to receive a distribution in a specific dollar amount or in specific property other than that distributed.

Section 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

Based on the facts submitted and representations made, the division of Trust 1 into Trust A, Trust B, Trust C, and Trust D is not a distribution under § 661 or § 1.661(a)-2(f)(1) and will not result in the realization by Trust 1, the resulting trusts, or any beneficiary of Trust 1 or the resulting trusts of any income, gain, or loss on the division.

Ruling 4

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 shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1.1001-1(a) provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized 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 holds that the transaction is equivalent to a pro rata distribution followed by an exchange between the beneficiaries and is subject to the provisions of § 1001.

In Cottage Savings Ass'n v. Commissioner, 499 U.S.554 (1991), the Supreme Court addressed the issue of when an exchange of property gives rise to a realization event under § 1001. Under the facts of that case, 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 institutions. 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." 499 U.S. at 560-61.

In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. 499 U.S. 564-65. The Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged the loans. 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," within the meaning of Cottage Savings, from the property transferred.

The present case is distinguishable from Rev. Rul. 69-486 because the assets of Trust 1 will be allocated among the four separate resulting trusts on a pro rata basis, and each resulting trust will receive an equal share of each asset in Trust 1. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of the Trust 1.

Furthermore, Trust 1 authorizes the trustees to act as they deem proper in any recapitalization, merger, reorganization, consolidation, partition or other transaction affecting any property held by them and make any distributions in further trust. Thus, the beneficiaries of Trust 1 do not acquire their interests in the four resulting trusts as a result of the exchange of their interests in Trust 1, but instead by reason of the trustees' exercise of their existing authority to make distributions of Trust income or principal in further trust and to partition Trust 1. The instant case also is analogous to Rev. Rul. 56-437. Therefore, based on the facts submitted and the representations made, the creation of four resulting trusts and the distribution of assets from the Trust 1 will not cause recognition of income or gain or loss by Trust 1, the resulting trusts, or any of the beneficiaries.

Ruling 5

Section 1015(b) provides that if property is acquired by a transfer in trust (other than a transfer in trust by a gift, bequest, or devise), the basis shall be 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 such transfer.

Section 1.1015-2(a)(1) 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 by 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 the taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person, if under Chapter 1 of Subtitle A of the Internal Revenue Code such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person. See also § 1.1223-1(b) of the Income Tax Regulations.

Based upon the information submitted and representations made, we conclude that because § 1001 does not apply to the division of Trust 1 assets, under § 1015 the basis of Trust 1 assets will be the same after the partition as the basis of those assets before the partition. Furthermore, pursuant to § 1223(2) the holding periods of the assets in the hands of the resulting trusts will include the holding periods of the assets in the hands of Trust 1.

Ruling 6

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, revoke, or terminate or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

In order for §§ 2036-2038 to apply, the decedent must have made a transfer of property or any interest therein (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. In the present case, the proposed division of Trust 1 into Trust A, Trust B, Trust C and Trust D does not constitute a transfer within the meaning of §§ 2036-2038. The beneficiaries of the resulting trusts will have the same interest after the division that they had as beneficiaries under Trust 1. We therefore conclude that the division of Trust 1 as proposed will not cause the interest of any beneficiary of Trust 1 or the resulting trusts to be includible in such beneficiary's gross estate under §§ 2036-2038.

Ruling 7

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

Section 2511(a) 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 the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

In this case, the beneficiaries of the resulting trusts will have the same interest after the division that they had as beneficiaries under Trust 1 so there is no direct transfer of assets. 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 division of Trust 1 and the pro rata allocation of assets among the four resulting trusts as proposed is not a transfer, direct or indirect, of property that will be subject to the gift tax consequences under § 2501.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent your attorney.

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.

Sincerely,

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

Enclosure
Copy of this letter for § 6110 purposes