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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:4
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Date: JANUARY 05, 2005

Legend:

Decedent	=
Wife	=
Daughter	=
C	=
D	=
E	=
F	=
C-1	=
C-2	=
C-3	=
C-4	=
D-1	=
D-2	=
Trustee	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=

Year 1 =
Year 2 =
Year 3 =
C Trust =
D Trust =
F Trust =
Trust =
Probate Court =
$x =
y =

Dear ,

This is in response to your request, dated February 3, 2004, for rulings concerning the income, gift, estate, and generation-skipping transfer tax consequences of amendments to certain trusts and divisions of these trusts into subtrusts. Decedent died on Date 4, prior to October 22, 1942, leaving a will dated, Date 1, amended by a first Codicil dated, Date 2, and a second Codicil dated, Date 3. Decedent was survived by his wife (Wife) and daughter (Daughter).

Decedent's will contains several specific bequests. The residue of Decedent's estate is bequeathed in trust to Trustee under Article X.

Under Article X(c), during the life of Wife and Daughter, Trustee is to pay each year over three-quarters of the remaining net income of the trust fund created under Article X to Wife, and one-quarter to Daughter, in monthly payments in nearly equal amounts as is reasonable and convenient.

Article X(d) provides that after the death of either Wife or Daughter, Trustee is, in each year, to pay over the whole of the remaining net income to the survivor of Wife and Daughter, during her life, in monthly payments as provided in Article X(c).

Under Article X(e), upon the death of the survivor of Wife and Daughter, the trust is to be split into separate trusts, one for the benefit of each of Daughter's children or for any issue of a deceased child of Daughter. Daughter died in Year 1. Daughter was survived by her son, C, her daughter, D, and F, the child of Daughter's deceased daughter, E. Accordingly, on Daughter's death in Year 1, the trust was divided into three separate trusts, the C Trust, D Trust, and F Trust (collectively the "Trusts"). The Trusts are the subject of the ruling request.

Under Article X(f), the income from the C Trust, the D Trust and the F Trust is to be paid to the respective beneficiary of each trust, for maintenance, support, and education until the beneficiary reaches age 30. After the beneficiary reaches age 30, all

net income is to be paid to the beneficiary at least twice a year. After reaching age 35, the beneficiary is given a one-time right to withdraw a portion of his or her trust principal in an amount not exceeding the lesser of $x or y of the value of the trust principal valued on the named beneficiary's 35th birthday. After the beneficiary reaches age 45, Trustee has discretion to distribute principal to the beneficiary. Trustee also has the discretion to distribute principal to any issue of Decedent's daughter for their comfortable maintenance and support. On the death of the respective beneficiary, each trust is to continue for the benefit of the issue of C, D, or F, as the case may be, or their spouses. C, D, and F, respectively possess a limited testamentary power to appoint his or her share of the net income from the trust to his or her spouse and/or issue. If this power is not exercised, y of the net income will be paid to the beneficiary's spouse, if living, and the remainder to the named beneficiary's issue.

Article X(f)(4) of the Decedent's will provides that the Trusts are to terminate 21 years after the death of the last to die of Spouse, Daughter, C, D, and E. The last surviving member of the measuring lives, D, died on Date 5. Thus, the Trusts must terminate no later than Date 8. Upon termination, Trustee will distribute all trust principal to the respective beneficiaries of each of the Trusts in accordance with their respective interests in the Trusts.

It is represented that C exercised his power of withdrawal in Year 3 by withdrawing $x from his trust and that F exercised her power of withdrawal in Year 2 by withdrawing $x from her trust. It is also represented that D died after September 25, 1985 and did not exercise her power of withdrawal. C exercised his limited testamentary power to appoint his share of the net income from the trust by an exercise in favor of his spouse. D did not exercise her limited testamentary power of appointment. F is currently living.

F is the current income beneficiary of F Trust. C's children, C-1, C-2, C-3, and C-4, and C's spouse are the current income beneficiaries of C Trust. D's children, D-1 and D-2, are the current income beneficiaries of D Trust. Because each of the three trusts has or will have multiple beneficiaries, and, in order to better address the economic needs and wishes of each family unit in an equitable manner, the Trustee and the beneficiaries wish to further subdivide each of the three separate trusts.

On Date 6, Trustee filed a Complaint for Reformation in Probate Court seeking to amend the provisions of Trust to give the Trustee authority to divide C Trust, D Trust, and F Trust into subtrusts along family lines. Under the proposed division of Trusts and the implementation of the Complaint for Reformation, the C Trust would be divided pro rata into four subtrusts, one for each of C's four children and their respective issue (Trusts C-1, C-2, C-3, C-4). The D Trust would be divided into two subtrusts, one for each of D's two children and their respective issue (Trusts D-1, D-2). The F Trust, upon F's death, would be divided into equal shares for each of F's children then living and the issue of any of F's deceased children. The terms of the subtrusts would remain the

same as the original Trusts except that principal distributions from the subtrusts could only be made to the beneficiary for whom a trust was established and his or her issue.

The assets of the each trust will be allocated to subtrusts on a pro rata basis, and each subtrust will receive a substantially equal share of each asset from the respective trust. The distributions to the subtrusts will be made on a fractional basis. Each subtrust will be held, administered and distributed pursuant to the terms of the Trusts, and in accordance with the proposed amendment to the Trusts.

On Date 7, Probate Court issued a judgment approving the proposed amendments to the Trusts contingent upon the receipt of a favorable ruling from the Service.

The following rulings are requested.

1. Neither the proposed amendments to C Trust, D Trust, and F Trust nor the Trustee's division of C Trust, D Trust, and F Trust into subtrusts pursuant to the proposed amendments will cause such trusts or any future distributions from such trusts, or the termination of such trusts, to lose their exempt status under section 2601.

2. Neither the proposed amendments to C Trust, D Trust, and F Trust nor the Trustee's division of C Trust, D Trust, and F Trust into subtrusts pursuant to the proposed amendments will constitute: (a) a taxable transfer for gift tax purposes or, (b) cause the subtrusts to be included in the gross estate of any beneficiary.

3. Neither the proposed amendments to C Trust, D Trust, and F Trust nor Trustee's division of C Trust, D Trust, and F Trust into subtrusts pursuant to the proposed amendments will constitute a sale, exchange or other disposition that will require the recognition of gain or loss for federal income tax purposes by the C Trust, D Trust, or F Trust or any of the subtrusts or beneficiary thereof under section 61 or section 1001.

4. After the proposed divisions of C Trust, D Trust, and F Trust into subtrusts, the assets of the subtrusts will have the same basis and holding periods as those assets had immediately prior to their disposition.

5. With respect to Trustee's division of C Trust, D Trust, and F Trust into subtrusts pursuant to the proposed modifications, each of the subtrusts will be treated as a separate taxpayer under section 643(f).

Ruling 1. Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST), which is defined under section 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under section 1431(a) of the Tax Reform Act of 1986 (the Act), and section 26.2601-1(a)(1) of the Generation-Skipping Transfer Tax Regulations, the tax is generally applicable to GSTs made after October 22, 1986. Section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i) of the regulations, provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. However, this rule does not apply, to the extent that such transfer was not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). Further, this rule does not apply to the transfer of property pursuant to the exercise, release or lapse of a general power of appointment that is treated as a taxable transfer under chapters 11 or 12 of the Code.

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from the application of chapter 13 by reason of section 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13.

Under section 26.2601-1(b)(1)(v)(A), where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise or lapse.

Section 26.2601-1(b)(1)(v)(B) provides that the post-September 25, 1985, release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in section 2041(b)) is not treated as an addition to a trust if such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under section 26.2601-1(b)(1) and in the case of an exercise, the power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years.

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 section 26.2601-1(b)(1), (b)(2), or (b)(3), will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules of section 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. They 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 section 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust 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, but only if: 1) the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and (2) 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 a 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.

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 section 2651) than the person or persons who held the beneficial interests 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.

Section 2514(a) provides that an exercise of a general power of appointment created on or before October 21, 1942, shall be deemed a transfer of property by the individual possessing such power, but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof.

Section 2041(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which a general power of appointment created on or before October 21, 1942, is exercised by the decedent by will, or by a disposition which is of such a nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under § 2035 to § 2038.

Section 2041(b)(1) provides that the term "general power of appointment" means a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate.

Section 20.2041-1(c)(1) provides that a power of appointment is not a general power if by its terms it is either (a) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent’s estate or

the creditors of the decedent's estate, or (b) expressly not exercisable in favor of the decedent or his or her creditors or the creditors of his or her estate.

The original trust created pursuant to Decedent's will became irrevocable on Date 4, prior to October 21, 1942. Under the terms of the trust, C, D, and F possessed a limited testamentary power to appoint the net income of his or her trust to his or her spouse and/or issue. C exercised his limited testamentary power of appointment in favor of his spouse; D did not exercise her limited testamentary power of appointment; and F is currently living. The exercise of C's power of appointment did not result in a constructive addition to F Trust under section 26.2601-1(b)(1)(v). The original trust was irrevocable prior to September 25, 1985 and C's exercise of his power of appointment in favor of his spouse did not postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years. Similarly, the lapse of D's special power of appointment did not result in a constructive addition to D Trust under § 26.2601-1(b)(v). F has not proposed to exercise F's testamentary special power of appointment. Whether F's exercise of that power, if it is exercised, has any GST tax consequences is dependent on whether the exercise of the power results in a constructive addition under § 26.2601-1(b)(1)(v).

C, D and F's power to withdraw $x or y from his or her respective trust is a general power of appointment under sections 2514 and 2041. C's and F's exercise of the power by appointing the property to themselves does not constitute a GST or a transfer subject to gift tax. Thus, the exercise of the power in this manner does not cause the property subject to the power to be subject to GST tax, under section 26.2601-1(b)(1)(i), or constitute a constructive addition to C Trust or F Trust, respectively, under section 26.2601-1(b)(1)(v)(A). Further, D's power to withdraw $x or y lapsed on D's death, without having been exercised. D's general power of appointment was created prior to October 21, 1942, and, accordingly, under section 2041, the lapse of this pre-October 21, 1942 power does not cause the property subject to the power to be included in the gross estate for estate tax purposes under section 2041. Therefore, the lapse of D's power to withdraw $x or y is not a constructive addition to D Trust under § 26.2601-1(b)(1)(v)(A).

Further, it is represented that no additions have been made to the original trust or the Trusts since September 25, 1985.

Neither the proposed amendments to the Trusts nor the division of the Trusts into subtrusts will result in a shift in a beneficial interest in the Trusts to any beneficiary who occupies a lower generation (as defined in section 2651) and the amendments to the trusts and divisions of the trusts into subtrusts will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trust.

Accordingly, we conclude that neither the amendments to the Trusts nor the Trustee's division of C Trust, D Trust, and F Trust (on F's death), into subtrusts pursuant to the proposed amendments will cause such trusts or any future distributions from such trusts, or the termination of such trusts, to lose their exempt status under section 2601. However, as discussed above, we are not commenting on any GST tax consequences if F exercises the testamentary special power of appointment with respect to F Trust, since the GST tax consequences are dependent on the manner in which F exercises the power.

Ruling 2(a). 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.

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 an adequate 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 a gift, that is included in computing the amount of gifts made during the calendar year.

The division of the C Trust, D Trust, and F Trust (on F's death), into subtrusts, as described above, will not result in any change in the beneficial interests of any of the trust beneficiaries. Accordingly, based on the facts submitted and representations made, neither the proposed amendments to the Trusts nor the Trustee's division of the C Trust, D Trust, and F Trust into subtrusts, will not cause the beneficiaries of C Trust, D Trust, F Trust or the subtrusts to have made a taxable gift for federal gift tax purposes under section 2501.

Ruling 2(b). Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

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 the 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 from the property.

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 or her death to any change through the exercise of a power, by the decedent alone or by the decedent in conjunction with any person, to alter, amend, revoke, or terminate where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

The application of §§ 2036-2038 requires a transfer by the individual possessing the power or right in order for those sections to be operative. In this case, Decedent transferred the property to the trusts. Accordingly, we conclude that neither the proposed amendments to the trusts nor the Trustee's divisions of C Trust, D Trust, and F Trust into subtrusts will constitute a transfer by the beneficiaries of the Trusts within the meaning of sections 2036 through 2038.

Ruling 3. Section 61(a)(3) provides that gross income includes gains derived from dealings in property and, under section 61(a)(15), from an interest in a trust.

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

Section 1001(b) states that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under section 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under section 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that 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 loss sustained.

A partition of jointly owned property is not a sale or other disposition of property if the co-owners of the joint property sever their joint interests but do not acquire a new or

additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

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 section 1001. In Cottage Savings 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 institution.

The Supreme Court of the United States in Cottage Savings, concluded that section 1.1001-1 reasonably interprets section 1001(a) and stated that an exchange of property gives rise to a realization event under section 1001(a) if the properties exchanged are "materially different." Cottage Savings, 499 U.S. at 560-61. In defining what constitutes a "material difference" for purposes of section 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. Cottage Savings, 499 U.S. at 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 interests in the loans. Cottage Savings, 499 U.S. at 566.

Because the court has approved the petition allowing the subdivision, it is consistent with the Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the subtrusts will not differ materially from their interests in the C Trust, D Trust, and F Trust. In the proposed transactions, the C Trust, D Trust , and F Trust will each be divided on a pro rata basis. Except for the changes described above, all other provisions of the subtrusts will remain unchanged. Accordingly, the proposed transactions will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries, and no gain or loss is recognized by the beneficiaries or the trusts on the partition for purposes of section 1001(a).

Ruling 4. 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 section 1.1223-1(b).

In the instant case, the partition of the C Trust, D Trust, and F Trust into subtrusts is a non-taxable event under section 1001. Because section 1001 does not apply, pursuant to section 1015, the basis of the C Trust, D Trust, and F Trust assets will be the same after the partition as the basis of the assets before the partition. Furthermore, pursuant to section 1223(2), the holding period of the assets in the hands of the subtrusts will include the holding period of the assets in the hands of the C Trust, D Trust, and F Trust.

Ruling 5. Section 643(f) provides that, under regulations to be 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 federal income tax.

While Trusts C-1, C-2, C-3, and C-4 will have the same grantor, the trusts will have different primary beneficiaries. Similarly, while Trusts D-1 and D-2 will have the same grantor, the trusts will have different primary beneficiaries. Therefore, based on the facts and representations submitted, we conclude that Trusts C-1, C-2, C-3, and C-4 will be treated as separate trusts for federal income tax purposes under section 643(f). Likewise, we conclude that Trusts D-1 and D-2 will be treated as separate trusts for federal income tax purposes under section 643(f).

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 the appropriate party. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

Except has specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

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

Sincerely,

George Masnik
Branch Chief, Branch 4
(Passthroughs and Special Industries)

cc: Copy for section 6110 purposes