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Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

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Date:
March 26, 2007

Date 1 =
Grantor =
Trust =
Brother =
Sister-in-law =
Sister 1 =
Sister 2 =
Nephew =
Niece =
Year 1 =
Year 2 =
State Statute 1 =
State Statute 2 =

Dear :

This is in response to your authorized representative's letter, dated March 3, 2006, requesting rulings regarding the income, gift, and generation-skipping transfer (GST) tax consequences of a proposed division of a trust.

The facts submitted and representations made are as follows: On Date 1, Grantor established the Trust, an irrevocable inter vivos trust for the primary benefit of his Brother and Sister-in-law and their lawful issue.

The terms of the Trust provide, generally, that until the death of both Brother and Sister-in-law, the children or lawful issue of Brother shall receive one-fourth of the net income of the trust, per stirpes. Upon the death of both Brother and Sister-in-law, the children or lawful issue of Brother shall receive all of the net income of the trust.

The terms of the Trust provide that the Trust shall terminate 21 years after the death of the survivor of Brother, Sister-in-law, Grantor, Sister 1, Sister 2, Nephew, and Niece. Upon termination of the Trust, the principal and corpus of the Trust shall be distributed share and share alike, per stirpes, to the children or surviving lawful issue of Brother.

Nephew died in Year 1 and was the last to die of Brother, Sister-in-law, Grantor, Sister 1, Sister 2, Nephew, and Niece. Accordingly, pursuant to the terms of the Trust, the Trust will terminate twenty-one years later, in Year 2.

It is represented that no additions, actual or constructive, have been made to the Trust after September 25, 1985.

In order to achieve administrative simplicity and allow the trustees to make investment decisions, the trustees of the Trust propose dividing the Trust into two separate trusts. One separate trust would be held for the benefit of the issue of Nephew ("Trust A"), and the other trust would be held for the benefit of the issue of Niece ("Trust B"). Each asset of the Trust will be divided and allocated to Trust A and Trust B (collectively referred to as the "Separate Trusts") on an equal, pro rata basis. The terms of Trust A and Trust B will be identical to those of the Trust except that once the division is executed, Trust A will be held for the benefit of Nephew's issue and Trust B will be held for the benefit of Niece's issue.

State Statute 1 provides, in part, that the fiduciary of any trust shall have discretionary power without need of court approval to divide a trust for purposes of the GST tax or for any other tax, administrative or other purposes. State Statute 2 provides, in part, that the trustee of a trust may divide such trust into two or more separate trusts, with the consent of all persons interested in the trust but without prior court approval, for any reason which is not directly contrary to the primary purpose of the trust.

The trustees of the Trust have requested the following rulings:

1) The proposed division of the Trust into the Separate Trusts will not constitute an addition to either of the Separate Trusts, will not cause the Trust or either of the Separate Trusts to lose their exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(4)(i)(D), and will not subject distributions from either of the Separate Trusts to the GST tax so long as there are no additions to these trusts;
2) The proposed division and pro rata in kind distribution will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries;
3) The proposed pro rata in kind distribution of the assets of the Trust to the Separate Trusts will not cause any beneficiary, the Trust, nor either of the Separate Trusts to recognize any gain or loss from a sale or other disposition of the property under § 61 or § 1001;

4) The basis of each asset received from the Trust by each Separate Trust will be the same as the Trust's basis in that asset pursuant to § 1015; and
5) The holding period of each asset received from the Trust by each Separate Trust will include the Trust's holding period for that asset pursuant to § 1223.

Ruling 1:

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

Section 2611(a) defines the term "generation-skipping transfer" as a taxable distribution, a 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. However, this exemption does not apply if additions (actual or constructive) are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be 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.

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. In general, unless specifically provided otherwise, 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. Unless specifically noted, 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 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)) 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 this section, 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. 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. In addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of § 1.643(b)-1 of the Income Tax Regulations.

Section 26.2601-1(b)(4)(i)(E), Example 5, involves a trust that is irrevocable on or before September 25, 1985. The trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust terms are identical except for the identity of the beneficiaries. 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. In addition, 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. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13 of the Internal Revenue Code.

In the present case, the Trust is considered irrevocable because neither § 2038 nor § 2042 apply and the Trust was irrevocable as of September 25, 1985. In addition, there have been no actual or constructive additions made to the Trust since September 25, 1985. Accordingly, the Trust is exempt from GST tax.

The proposed division of the Trust into Trust A and Trust B is not a modification that will shift a beneficial interest in the Trust to any beneficiary who occupies a lower generation than the person or persons who hold the beneficial interest prior to the division. In addition, the proposed division does not extend the time for vesting of any beneficial interest beyond the period provided for in the Trust. Thus, the proposed division of the Trust into Trust A and Trust B will not constitute an addition to the Trust or to Trust A or Trust B, will not cause the Trust or Trust A or Trust B to lose their exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(2)(i)(A), and will not subject distributions from the Trust, Trust A, or Trust B to the GST tax, provided there are no additions to the Trust, Trust A, or Trust B.

Ruling 2:

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

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 25.2511-1(c)(1) of the Gift Tax Regulations states that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

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 Trust beneficiaries will have the same interests before and after the proposed division of Trust into Trust A and Trust B. Accordingly, there is no direct transfer of assets and no transfer of property will be deemed to occur as a result of the proposed modification. Therefore, based on the facts submitted and the representations made, we conclude that the proposed modification of Trust does not constitute a transfer, direct or indirect, of property that will be subject to gift tax consequences under § 2501.

Rulings 3, 4 and 5:

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 such section for determining loss over the amount realized.

Section 1.1001-1(a) provides that except as otherwise provided in subtitle A, 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.

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 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 by 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 a 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 a 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 a 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 the 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).

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 § 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 in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 of the regulations reasonably interprets § 1001(a) and stated than an exchange of property gives rise to a realization event under § 1001 if the properties exchanged are "materially different." 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" so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. In Cottage Savings, 499 U.S. at 566, 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.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the resultant trusts will not differ materially from their interests in the original trust. The proposed transaction will not change the interests of the beneficiaries. Instead, the beneficiaries will be entitled to the same benefits after the proposed transaction as before. The proposed transaction is similar to the kinds of transactions discussed in Rev. Rul. 56-437, since the original trusts are to be divided, but all other provisions of the trusts will remain substantially identical. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

Based upon the facts submitted and the representations made, we conclude that the division of Trust with the pro rata division of the assets of the trusts among the two separate trusts will not constitute a sale or other taxable disposition of the assets of the trusts under § 1001. Because § 1001 does not apply to the division of the trust assets, under § 1015 the basis of the trust assets will be the same after the partition as the basis of those assets before the partition. Furthermore, pursuant to § 1223, the holding periods of the assets in the hands of the new trusts will include the holding periods of the assets in the original trust.

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. Specifically, no opinion is expressed or implied regarding the income tax consequences of the Trust modification.

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.

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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representatives.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)