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Refer Reply To:
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In Re:

Date:
May 14, 2007

LEGEND:

Grantor	=
Wife	=
Daughter	=
Trust A	=
Trust 1	=
Trust 2	=
Trust 3	=
Date 1	=
Date 2	=
Date 3	=
Grandson 1	=
Grandson 2	=
Grandson 3	=

State =

State Statute =

Court =

Dear :

This is in response to your November 1, 2005 letter and other correspondence requesting rulings concerning the income, gift, estate, and generation-skipping transfer (GST) tax consequences of the proposed division of Trust A.

The facts submitted and representations made are as follows:

Grantor established an irrevocable trust, Trust A, on Date 1 (prior to September 25, 1985). The original co-trustees of Trust A were Grantor's Daughter (Daughter) and Daughter's husband.

Article II, paragraph 1 of Trust A provides that during the lifetime of Grantor's Wife (Wife), the trustees are to pay to Wife so much of the net income of the trust, but in no event to exceed 50 percent of such income, annually or more frequently, as the trustees determine to be required for her health, support and maintenance, taking into consideration her present station in life.

Under Article II, paragraph 1, during the lifetime of Daughter, after making the distributions to Wife described above, the trustees are to distribute all or so much of the remaining net income, annually or more frequently, to or for the benefit of Daughter, at intervals convenient to her, as she requests of the trustees. In addition, the trustees may pay to Daughter, or for her benefit, so much of the remaining net income which is not requested by Daughter as the trustees deem to be required for her health, support, education, and maintenance. All income not so distributed is to be accumulated and added to corpus on an annual basis and, after the end of the trust's fiscal year, shall no longer be subject to Daughter's general power to appoint income to her or for her benefit. In addition, during the life of Daughter, the trustees are to pay to or for the benefit of Daughter and her descendants from time to time from the corpus of the trust, such amounts as the trustees deem to be required for their support, health, education, and maintenance, taking into consideration their stations in life.

Article II, paragraph 2 provides that upon the death of Daughter, the trustees are to distribute the trust to, or in trust for, the benefit of such persons among Daughter's descendants as she appoints pursuant to the exercise of a testamentary power of appointment. To the extent that Daughter does not effectively exercise her power of

appointment, upon her death the trustees are to divide the trust property into separate trusts, equal in value, one for each living child of Daughter and one for the then living descendants, collectively, of each deceased child of Daughter, per stirpes.

Under Article II, paragraph 2(a)(i), each trust set aside for the benefit of a child of Daughter shall be subject to the payment of income to Wife, as set forth in Article II, paragraph 1, above, if Wife survives Daughter. Such payments shall be made on a pro rata basis from each trust established for a child of Daughter.

Article II, paragraph 2(a)(i) further provides that the trustees of each trust set aside for the benefit of a child of Daughter may use for the child's benefit so much of the remaining income of his trust as the trustees determine to be required, in addition to the child's other income from all sources known to the trustees, for the child's reasonable support, maintenance, health, education, or other benefit until the child reaches age 25. Any excess income is to be added to principal. When the child reaches age 25, the trustees shall pay to the child 25 percent of the remaining net income of the child's trust and, when the child reaches age 30, the trustees are to pay the child 50 percent of the remaining net income of his trust, at least quarter-annually

Under Article II, paragraph 2(a)(iii), whenever the trustees determine that the income of any child of Daughter from all sources known to the trustees is not sufficient for the child's support, education, health, maintenance, and happiness, and that of the child's immediate family (other than the trustee), the trustees may pay to the child or use for the child's benefit, so much of the principal or current income not required to be distributed under Article II, paragraph 2(a)(i) as the trustees determine to be required for those purposes.

Article II, paragraph 2(b) provides that each trust set aside for the benefit of a child of Daughter will terminate when the child reaches age 35, at which time the trustees will distribute the trust, as then constituted, to the child. Under Article II, paragraph 2(d), however, if Wife is still living, the principal of the trust shall remain in trust until her death. Upon Wife's death, if the child is still living, the trust is to terminate and the corpus is to be distributed to the child.

Under Article II, paragraph 2(c), if a child of Daughter survives Wife, but dies before reaching age 35, the trustees shall distribute the trust, as then constituted, to, or in trust, pursuant to the child's exercise of a testamentary power to appoint the corpus among the child's descendants. To the extent that the child does not effectively exercise the power of appointment, upon the child's death the trustees are to distribute the trust to the child's then living descendants, per stirpes; except that the share of any beneficiary in default of appointment for whose primary benefit another trust is then held under Trust A shall be added to the other trust.

Under Article III, paragraph 1, if any beneficiary to whom the trustees are directed to distribute any share of trust principal is under the age of 21, and if no other trust is to be held under the provisions of Trust A for that beneficiary's interest, the beneficiary's share shall vest in interest in him/her indefeasibly but the trustees may, in their discretion, continue to hold it as a separate trust until the beneficiary reaches age 21. In the meantime, the trustees may use for his/her benefit so much of the income or principal as the trustees determine to be required, in addition to his/her other income from all sources known to the trustees, for his/her reasonable support, comfort, and education, adding any excess income to principal at the discretion of the trustees.

Under Article III, paragraph 4, no interest in Trust A shall be transferable or assignable by any beneficiary, or be subject during his life to the claims of his creditors. Further, under Article III, paragraph 7, notwithstanding anything to the contrary, the trusts created under Trust A must terminate not later than 21 years after the death of the last survivor of the Grantor's descendants living on the date of the execution of Trust A.

Under Article V, paragraph 1, if Daughter dies, resigns, or refuses or is unable to act as co-trustee, Daughter's husband shall serve as sole trustee and while serving as sole trustee may appoint a successor trustee which shall be a corporation authorized to administer trusts. If Daughter's husband dies, resigns, or refuses or is unable to act as co-trustee, Daughter shall appoint a successor co-trustee which shall be a corporation authorized to administer trusts; further, the corporate co-trustee serving with Daughter shall become the sole trustee upon Daughter's death, resignation, refusal, or incapacity to act as co-trustee. Article V, paragraph 8, provides that whenever the trustees consider it advantageous to the beneficiary of any trust, the trustees may transfer the situs of any trust.

Daughter's husband died on Date 2. In response to a petition by Daughter, on Date 3, Court issued a decree reforming Article V, paragraph 1, authorizing Daughter to appoint Daughter's children, Grandsons 1-3, to serve concurrently with her as co-trustees of Trust A.

At the present time, Grantor and Wife are deceased. Daughter and her sons (Grandsons 1-3) are serving as trustees of Trust A. The trustees and the beneficiaries desire to divide Trust A into three trusts, Trusts 1-3, for the benefit of Daughter and Grandsons 1-3, respectively, and their descendants. Following the division of Trust A, each of Trusts 1-3 will be governed by trust agreements that essentially mirror the terms of Trust A and are identical except that each trust will be established for the benefit of Daughter, a Grandson, and that Grandson's descendants.

Article II, paragraph 1, of each new trust agreement eliminates the income interest of Wife, who is deceased. As under the terms of Trust A, the trustees of each new trust are to distribute all or so much of the income, annually or more frequently, to

or for the benefit of Daughter, at intervals convenient to her, as she requests of the trustees. In addition, the trustees may pay to Daughter, or for her benefit, so much of the remaining net income which is not requested by Daughter as the trustees deem to be required for her health, support, education, and maintenance. All income not so distributed is to be accumulated and added to corpus on an annual basis and, after the end of each trust's fiscal year, shall no longer be subject to Daughter's withdrawal power. The trustees will also have the power to pay corpus, during the lifetime of Daughter, to or for the benefit of Daughter, the Grandson for whom the trust is established and that Grandson's descendants for their support, health, education, and maintenance.

Under Article II, paragraph 2, of Trusts 1-3 Daughter will possess a testamentary limited power to appoint the corpus of each respective trust to or for the benefit of the Grandson for whom the trust is established and his descendants.

To the extent that Daughter does not effectively exercise her power of appointment, and if the named Grandson is then deceased with descendants surviving, upon Daughter's death the trustees of the deceased Grandson's trust are to distribute the trust to the then living descendants of the named Grandson, per stripes. To the extent that Daughter does not effectively exercise her power of appointment, and if the named Grandson is then deceased without descendants surviving, upon Daughter's death the trustees of the deceased Grandson's trust are to distribute the trust to Grantor's living descendants, per stirpes; except that the share of any beneficiary in default of appointment for whose primary benefit another similar trust is then held under either of the other Grandsons' trusts is to be held and distributed as if it had been an original part of the other trust. To the extent that Daughter does not effectively exercise her power of appointment, and if the named Grandsons are then living, the new trust agreements provide that upon the death of Daughter, each trust is to be held and disposed of as provided in Article II, paragraphs 2(a) and 2(b) of Trust A.

Article II, paragraph 2(c) of the new trust agreements provides, in relevant part, that if a named Grandson should die before the age of 35, the trustee is to distribute his trust, as then constituted, to, or in trust for the benefit of, such person or persons among his descendants, upon such conditions and estates, with such powers and in such manner and at such times as he appoints and directs by will specifically referring to this power of appointment. To the extent that he does not effectively exercise his power of appointment, upon his death, the trustee is to distribute his trust to his then living descendants, per stirpes.

Article II, paragraph 3 of the new trust agreements provides, in relevant part, that if there are any later born or adopted children of Daughter a trust will be created for their benefit.

Article V of the new trust agreements provides that Daughter and Grandson 1 will serve as the original trustees of Trust 1; Daughter and Grandson 2 will serve as the original trustees of Trust 2; and Daughter and Grandson 3 will serve as the original trustees of Trust 3. Should Daughter or Grandson 1 be unable or unwilling to serve as a trustee of Trust 1, Grandsons 2 and 3 shall together fill the position of the departing trustee and serve concurrently with the remaining trustee. Should Daughter or Grandson 2 be unable or unwilling to serve as a trustee of Trust 2, Grandsons 1 and 3 shall together fill the position of the departing trustee and serve concurrently with the remaining trustee. Should Daughter or Grandson 3 be unable or unwilling to serve as a trustee of Trust 3, Grandsons 1 and 2 shall together fill the position of the departing trustee and serve concurrently with the remaining trustee. In addition, at such time as a descendant of a Grandson reaches age 30, he or she shall be consulted by the then serving trustees of that Grandson's trust as an advisor on all trust matters and, upon reaching age 35, he or she shall serve as a trustee concurrently with the then serving trustees. In making decisions and in taking actions, the trustees shall be governed by a majority vote. If there are only two trustees serving, any decisions or actions must be by unanimous consent.

The trustees of Trust A represent that no actual or constructive additions have been made to Trust A on or after September 25, 1985.

You have requested the following rulings:

1. The proposed division of Trust A into Trusts 1-3 will not cause the interest of any beneficiary of Trust A or of Trusts 1-3 (or of any successor trust) to be includible in such beneficiary's gross estate under section 2033 of the Internal Revenue Code.

2. The proposed division of Trust A into Trusts 1-3 will not cause the interest of any beneficiary of Trust A or of Trusts 1-3 (or of any successor trust) to be includible in such beneficiary's gross estate under sections 2036, 2037, or 2038.

3. The proposed division of Trust A into Trusts 1-3 will not cause the interest of any beneficiary of Trust A or of Trusts 1-3 (or of any successor trust) to be includible in such beneficiary's gross estate under section 2041, except that: (1) the net income of Trusts 1-3 over which Daughter has a general power of appointment in the year of her death will be included in Daughter's gross estate; and, (2) to the extent that the annual lapse of Daughter's general power of appointment over the net income of Trust A and Trusts 1-3 exceeded the greater of $5,000 or 5% of the aggregate value of Trusts' income, the lapse will cause the amount exceeding $5,000 or 5% of the aggregate value of the income to be included in Daughter's gross estate.

4. The proposed division of Trust A into Trusts 1-3 will not cause Daughter to have made a taxable gift under chapter 12.

5. After the proposed division of Trust A into Trusts 1-3, Trust A and Trusts 1-3 (and any successor trust) will be treated as exempt from the GST tax under section 2601, and no actual or constructive addition to such trusts will result from the proposed division.

6. Transfers from Trust A to Trusts 1-3 pursuant to the proposed division of Trust A into Trusts 1-3 and distributions from Trusts 1-3 (and from any successor trust) to their beneficiaries will not be generation-skipping transfers and will not be subject to the GST tax under section 2601.

7. The proposed division of Trust A into Trusts 1-3 will not cause Trust A, Trusts 1-3, or any of their beneficiaries to recognize gain or loss from the sale or other disposition of property under sections 61 or 1001.

8. Pursuant to section 1015, the tax basis of Trusts 1-3 in each property received from Trust A in the proposed division of Trust A into Trusts 1-3 will be the same as the tax basis of Trust A in such property.

9. Pursuant to section 1223(2), the holding period of Trusts 1-3 in each asset distributed to it from Trust A in the proposed division will be the same as Trust A's holding period of the assets prior to their distribution.

LAW AND ANALYSIS

Ruling 1

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

In the present case, during her lifetime, Daughter will possess the right to withdraw the entire income of the Trusts 1-3 each year. Additionally, during Daughter's lifetime, Daughter and the Grandson for whom the trust is established will have the discretionary authority, as co-trustees, to distribute corpus to themselves and the Grandson's descendants for support, health, education, and maintenance. Daughter will have a testamentary limited power to appoint the corpus of Trusts 1-3 to or for the benefit of the respective Grandson and his descendants. If Daughter does not exercise her power, and the trust corpus is held in further trust as provided in Article II, paragraph 2, the Grandson for whom the trust is established will have the power, as a co-trustee, to distribute trust corpus to himself to provide for his happiness. If the respective Grandson survives to age 35, the trust corpus will be distributed outright to the Grandson. Based on the above, we conclude that the proposed division of Trust A into

Trusts 1-3 will not cause any portion of Trust A or Trusts 1-3 to be included in Daughter's gross estate under section 2033. In addition, we conclude that the proposed division of Trust A into Trusts 1-3 will not cause any portion of Trust A, or Trusts 1-3 to be includible in the respective gross estates of Grandsons 1-3 under section 2033, provided such Grandchild dies prior to termination of the Trusts 1-3.

Ruling 2

Section 2036 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 there from.

Section 2037 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, 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 the case of a bona fide sale for an 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 (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In this case, based on the facts presented and the proposed division of Trust A into Trust 1, Trust 2 and Trust 3, as described above, does not constitute a transfer within the meaning of sections 2036-2038. Accordingly, we conclude that the proposed division of Trust A into Trusts 1-3 will not cause any portion of Trust A or Trusts 1-3 to be included in Daughter's gross estate under sections 2036-2038. In addition, we conclude that the proposed division of Trust A into Trusts 1-3 will not cause any portion

of Trust A, or Trusts 1-3 to be includible in the respective gross estates of Grandsons 1-3 under sections 2036-2038.

Ruling 3

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such 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 sections 2035 to 2038.

Section 2041(b)(1) provides that the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, except that a power to consume invade or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to the health, education support or maintenance of the decedent.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. This rule applies only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of $5,000 or 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

Section 20.2041-3(d)(4) of the Estate Tax Regulations states that the purpose of section 2041(b)(2) is to provide a determination, as of the date of the lapse of the power, of the proportion of the property over which the power lapsed which is an exempt disposition for estate tax purposes and the proportion which, if the other requirements of sections 2035 through 2038 are satisfied, will be considered as a taxable disposition. Once the taxable proportion of any disposition at the date of lapse has been determined, the valuation of that proportion as of the date of the decedent's death is to be ascertained in accordance with the principles which are applicable to the valuation of transfers of property by the decedent under the corresponding provisions of sections 2035 through 2038. For example, if the life beneficiary of a trust had a right exercisable only during one calendar year to draw down $50,000 from the corpus of a trust, which the beneficiary did not exercise, and if at the end of the year the corpus was worth $800,000, the taxable portion over which the power lapsed is $10,000.

Rev. Rul. 85-88, 1985-2 C.B. 201, holds that if the donee's power of withdrawal is limited to annual trust income, the 5 percent test under section 2041(b)(2) is based on the annual trust income, and not the amount of trust corpus. Further, where the donee

has a noncumulative power to withdraw property from two or more trusts, the 5 percent test is applied by aggregating the amount subject to withdrawal with respect to each trust. Similarly, only one $5000 exemption is allowed with respect to the multiple trusts.

Section 2514 and the applicable regulations contained provisions similar to section 2041 governing the gift tax consequences of the exercise, release or lapse of a power of appointment.

In the present case, under the terms of Trust A, Daughter, during her lifetime, possesses the noncumulative right to withdraw the entire income of Trust A each year. Daughter also has a testamentary limited power to appoint Trust A corpus on her death. In addition, Daughter has the discretionary power as a co-trustee, to distribute corpus s to herself for support, health, education, and maintenance. Daughter will possess the same rights and powers with respect to Trusts 1-3.

Daughter's discretionary power to distribute corpus to herself is limited by an ascertainable standard relating to her health, maintenance support and education. Therefore, this power does not constitute a general power of appointment under section 2041(b)(2). Therefore, possession of this power will not cause Trust A, or Trusts 1-3 to be included in Daughter's gross estate.

However, under Trust A, and under Trusts 1-3, Daughter does possess a noncumulative right, exercisable annually, to withdraw trust income. Trust income that is not withdrawn during the calendar year is accumulated. The accumulated income is remains subject to Daughter's testamentary limited power to appoint trust corpus. In accordance with section 2041(a)(2) and section 2041(b)(2), the net income of Trusts 1-3 over which Daughter will have a general power of appointment in the year of her death will be included in the gross estate of Daughter. In addition, a portion of the corpus of Trusts 1-3 will be includible in Daughter's gross estate to the extent the value of the property Daughter failed to withdraw annually with respect to Trust A and after the division, fails to withdraw annually from Trusts 1-3, exceeded (or exceeds) the greater of $5,000 or 5% of the aggregate value of the property, which could have been appointed by exercise of her lapsed powers. The portion of the corpus includible will be the portion attributable to such property. In accordance with Rev. Rul. 85-88, the 5 percent test under section 2041(b)(2) is based on the annual trust income of Trust A, and after the division, Trusts 1-3, and not the amount of trust corpus. Further, after the division, the 5 percent test is applied by aggregating the amount subject to withdrawal with respect to each trust, and only one $5000 exemption is allowed with respect to the multiple trusts.

In addition, each Grandson for whom the trust is established will have the discretionary authority, as co-trustees, to distribute corpus to themselves and the Grandson's descendants for support, health, education, and maintenance. This discretionary power is limited by an ascertainable standard relating to health,

maintenance support and education. Therefore, this power does not constitute a general power of appointment under section 2041(b)(2).Therefore, possession of this power will not cause Trust A, or Trusts 1-3 to be included in the respective gross estates of Grandchild 1-3.

If Daughter does not exercise her testamentary limited powers with respect to Trusts 1-3, the trust corpus of each trust is to be held in further trust. As provided in Article II, paragraph 2, the Grandson for whom the trust is established will have the power, as a co-trustee, to distribute trust corpus to himself to provide for his happiness. This power is not limited by the requisite ascertainable standard under section 2041(b)(1). If the respective Grandson survives to age 35, the trust corpus will be distributed outright to the Grandson. Accordingly, if after Daughter's death, the trust corpus is held in further trust pursuant to Article II, paragraph 2, the Grandchild for whom the trust is established will have a general power of appointment with respect to the trust. The trust corpus will be includible in the Grandchild's gross estate if he dies prior to attaining age 35.

Ruling 4

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year.

Section 2511(a) provides that the gift tax 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, upon the division of Trust A into three equal trusts, Daughter will have substantially the same beneficial interest as she had under Trust A prior to the division. Because the beneficial interests of Daughter are substantially the same both before and after the proposed division, Daughter will not be treated as making a transfer as a result of the division.

Accordingly, we conclude that the proposed division of Trust A into Trusts 1-3 will not cause Daughter to have made a taxable gift under chapter 12.

Rulings 5-6

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST) made by a transferor to a skip person as defined in section 2613.

Under section 1433(a) of the Tax Reform Act of 1986 (Act) and section 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985. However, this exemption does not apply to the extent that such transfer is made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). In addition, this exemption does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12. The transfer is made by the person holding the power at the time the exercise, release, or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided under 26.2601-1(b)(1)(v)(B), 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 that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12.

Section 26.2601-1(b)(1)(v)(B) provides a special rule for certain powers of appointment. Under this section, the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in 2041(b)) will not be treated as an addition to a trust if (1) such power of appointment was created in an irrevocable trust that is not subject to chapter13 under 26.2601-1(b)(1); and (2) 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 plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of 26.2601-1(b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. This section also provides that if a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

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 under section 26.2601-1(b) 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 GST tax if 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 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 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 a 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 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.

Under section 2652(a)(1) and section 26.2652-1(a)(1), the individual with respect to whom the property was most recently subject to federal gift or estate tax is the transferor of that property for GST purposes.

Section 26.2652-1(a)(5), Example 5, considers a situation where T transfers $10,000 to a new trust providing that the trust income is to be paid to T's child, C, for C's life and, on the death of C, the trust principal is to be paid to T's grandchild, GC. The trustee has discretion to distribute principal for GC's benefit during C's lifetime. C has a right to withdraw $ 10,000 from the trust for a 60-day period following the transfer. Thereafter, the power lapses. C does not exercise the withdrawal right. The transfer by T is a completed transfer within the meaning of § 25.2511-2 of this chapter and, thus, T is treated as having transferred the entire $ 10,000 to the trust. On the lapse of the withdrawal right, C becomes a transferor to the extent C is treated as having made a completed transfer for purposes of chapter 12. Therefore, except to the extent that the amount with respect to which the power of withdrawal lapses exceeds the greater of $5,000 or 5% of the value of the trust property, T remains the transferor of the trust property for purposes of chapter 13.

In this case, the proposed division of Trust A by the trustees into Trusts 1-3 will not result in a shift of any beneficial interest in Trust A or Trusts 1-3 to any beneficiary

who occupies a generation lower than the persons holding the beneficial interests in Trust A. Further, the proposed division will not extend the time for vesting of any beneficial interest in Trusts 1-3 beyond the period provided for in Trust A. Thus, the proposed division of Trust A, will not cause Trust A, or Trusts 1-3 to be subject to GST tax under section 2601. However, under section 26.2601-1(b)(1)(i) and section 26.2601-1(b)(1)(v)(A), the annual lapse of Daughter's right to withdraw trust income with respect to Trust A constituted a constructive addition to Trust A, to the extent the property subject to the lapse exceeded the $5000/5% limitation contained in section 2041(b)(2). Similarly, the annual lapse of Daughter's withdrawal power with respect to Trusts 1-3 will also constitute constructive additions to those trusts. Further, as discussed above, on Daughter's death, a portion of Trusts 1-3 will be subject to inclusion in the gross estate to the extent provided in section 2041(b)(2). Under section 2652(a)(1), Daughter will be the transferor of such portion of each trust for GST tax purposes, and such portions will not be exempt from GST tax.

We note that a similar result obtains to the extent Trusts 1-3 are includible in the gross estate of a Grandson, as discussed above, except that the respective Grandson will become the transferor of the property.

Ruling 7

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 there from 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 where 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.

State Statute authorizes trustees to make non-pro rata distributions based on fair market values.

In Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), 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 issue presented was whether the exchange resulted in a realization of gain or loss under section 1001.

The Court 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." 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 Internal Revenue Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings v. Commissioner, 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 v. Commissioner, 499 U.S. at 566.

In the present case, Trust A will be partitioned into Trusts 1-3 on a non-pro rata basis. Under State law, trustees have authority to make non-pro rata distributions. Except for the partition, all of the operating provisions of Trust A will remain unchanged. Accordingly, under the proposed transaction, Trust A will be partitioned but the beneficiaries’ interests in the property will not change in kind or extent and no new interests will be created. It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of Trusts 1-3 will not differ materially from their interests in Trust A.

Therefore, the proposed partition and non-pro rata distribution of Trust A will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries and will not result in recognition of gain or loss under sections 61 or 1001.

Ruling 8

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 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.

Based upon the information submitted and representations made, we conclude that because section 1001 does not apply to the division of the trust assets, under section 1015, the basis of the assets received by Trusts 1-3 from Trust A will be the same as the basis of those assets in Trust A before the proposed division.

Ruling 9

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, 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 the taxpayer's hands as it would have in the hands of such other person.

In the proposed division of Trust A into Trusts 1-3, the tax basis of Trusts 1-3 in each property received from Trust A will be the same as the tax basis of Trust A in such property. Accordingly, based upon the facts submitted and the representations made, we conclude that, pursuant to section 1223(2), the holding period of Trusts 1-3 in each asset distributed to it from Trust A in the proposed division will be the same as Trust A’s holding period of the assets prior to their distribution.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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.

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.

Sincerely yours,

_____
George L. Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy of letter for section 6110 purposes

cc: