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Date:
May 24, 2007

Legend

Trust 1 =

Trust 2 =

Date 1 =
Grantor =
Son =
Beneficiary 1 =
Beneficiary 2 =
Beneficiary 3 =
Beneficiary 4 =
Date 2 =
Beneficiary 5 =
State =
Statute =
Beneficiary 6 =
Beneficiary 7 =
Beneficiary 8 =
Beneficiary 9 =
Beneficiary 10 =
Company =

Dear :

This is in response to your authorized representative's letter, dated May 24, 2006, requesting rulings regarding the income, gift, and generation-skipping transfer (GST) tax consequences of the proposed division of Trust 1 and Trust 2.

The facts submitted and representations made are as follows: Trust 1 was created on Date 1 by Grantor for the benefit of Son and his issue. Article III of the Trust 1 agreement provides that the trustees shall pay the net income of Trust 1 to Son during Son's life. On Son's death, Trust 1 shall be administered for the benefit of Son's surviving widow, if any, and for the benefit of Son's surviving issue. After the death of Son's widow, the Trust 1 income shall be distributed, per stirpes, to the surviving children of Son, and to the living issue of any deceased child of Son. Unless sooner terminated, Trust 1 shall terminate twenty years and eleven months after the death of the last to die of Grantor's three sons and their children living on Date 1. Upon termination, the Trust 1 assets shall be distributed to Son's living issue, per stirpes, in equal shares according to the number of surviving children of Son plus the number of deceased children with living issue. If Son has no living issue, the Trust 1 assets shall be distributed, per stirpes, to the living descendants of Grantor's other two sons.

Son and his widow are both deceased. The current income beneficiaries of Trust 1 are Beneficiary 1, Beneficiary 2, Beneficiary 3, and Beneficiary 4.

The trustees propose to partition Trust 1 into three separate trusts. Trust 1A will be held for the benefit of Beneficiary 1 and his issue. Trust 1B will be held for the benefit of Beneficiary 2 and her issue. Trust 1C will be held for the benefit of Beneficiary 3 and Beneficiary 4 and their issue. The partition will be pro rata as to value and as to each of the trust assets. The partitioned trusts will be administered under the terms of the original Trust 1 except for the named beneficiaries of each resulting trust.

Trust 2 was created under Grantor's last will and testament on her death on Date 2. Article III of the Trust 2 agreement provides that the net income shall be paid, per stirpes, to Grantor's descendants. If a male descendant is survived by a widow, up to one-half of the net income may be paid to the widow until her death.

Beneficiary 5 is the surviving widow of one of Grantor's sons.

Article III, paragraph 4 of the Trust 2 agreement provides that any beneficiary, other than Grantor's three children and any widow of a descendant, of at least 45 years old, may receive a discretionary distribution of trust principal equal to the percentage of the net income to which that beneficiary is entitled. No trustee who is also a beneficiary of the trust shall participate in any discretionary distribution decision with respect to a distribution to that trustee.

Article III, paragraph 5 of the Trust 2 agreement provides that unless otherwise terminated by the distribution of the entire trust principal, Trust 2 shall terminate twenty years after the death of the last to die of Grantor's three sons and any of Grantor's grandchildren living on Date 2. Upon termination, the trust principal shall be distributed to the living descendants of Grantor in the same proportion as income. Widows may not receive distributions of principal on termination.

Article III, paragraph 10(a) of the Trust 2 agreement provides that the trustees have the power to make any division or distribution of the trust assets and to determine the value of the property so allocated, divided, or distributed.

State Statute provides that the trustee(s) of a trust, in addition to the authority otherwise given by law, have discretionary power to acquire, invest, reinvest, exchange, sell, convey, control, divide, partition, and manage the trust property in accordance with the standards provided by law, and in so doing may select any part of the trust estate in satisfaction of any partition or distribution, in kind, in money or both; make non-pro rata distributions of property in kind; allocate particular assets or portions of them or undivided interests in them to any one or more of the beneficiaries without regard to the income tax basis of specific property allocated to any beneficiary and without any obligation to make an equitable adjustment.

The current beneficiaries of Trust 2 are Beneficiary 1, Beneficiary 2, Beneficiary 3, Beneficiary 4, Beneficiary 5, Beneficiary 6, Beneficiary 7, Beneficiary 8, Beneficiary 9, and Beneficiary 10.

The trustees propose to partition Trust 2 into three separate trusts. Trust 2A will be held for the benefit of Beneficiary 1 and his issue. Trust 2B will be held for the benefit of Beneficiary 2 and her issue. Trust 2C will be held for the benefit of Beneficiary 3, Beneficiary 4, Beneficiary 5, Beneficiary 6, Beneficiary 7, Beneficiary 8, Beneficiary 9, Beneficiary 10, and their issue. The partition will be pro rata as to the majority of the trust assets, but it may not be pro rata as to every single asset. The partitioned trusts will be administered under the terms of the original Trust 2 except for the named beneficiaries of each resulting trust.

The current trustees of Trust 1 and Trust 2 are Beneficiary 3, Beneficiary 5, and Beneficiary 6. Date 1 and Date 2 are prior to September 25, 1985. The taxpayers represent that no additions, actual or constructive, have been made to either Trust 1 or Trust 2 after September 25, 1985. Two of Grantor's grandchildren were born prior to Date 1 and are still living: Beneficiary 6 and Beneficiary 8. All of Grantor's grandchildren were living on Date 2 except Beneficiary 4. The trustee of the resulting trusts will be Company.

Rulings Requested

The trustees of the trusts have requested the following rulings: (1) the proposed partitions of Trust 1 and Trust 2 will not cause either trust to lose its status as exempt from the GST under §1433(b)(2)(A) of the Tax Reform Act of 1986 and §26.2601-1(b)(4)(i)(D); (2) the proposed partition of Trust 1 and Trust 2 will not result in the recognition of gain or loss from the sale or other disposition of property under §§61 or 1001; and (3) the basis of and holding period for each asset received from Trust 1 and Trust 2 will be the same as the basis of the original trusts prior to the partition.

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, Trust 1 and Trust 2 are considered irrevocable because neither § 2038 nor § 2042 apply and each trust was irrevocable as of September 25, 1985. In addition, there have been no actual or constructive additions made to either trust since September 25, 1985. Accordingly, Trust 1 and Trust 2 are exempt from GST tax.

The proposed division of Trust 1 and Trust 2 into the resulting trusts is not a modification that will shift a beneficial interest in either 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 divisions do not extend the time for vesting of any beneficial interest beyond the period provided for in the original trust agreements. Thus, the proposed divisions of Trust 1 and Trust 2 into the resulting trusts will not constitute an addition to either trust, will not cause either trust to lose its 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 either the original trusts or any resulting trusts to the GST tax.

Ruling 2

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(c) provides that, except as otherwise provided in subtitle A of the Code, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property must be recognized.

Section 1.1001-1(a) provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). Properties exchanged are materially different if the properties embody legal entitlements "different in kind or extent" or if the properties confer "different rights and powers." Id. at 565. In Cottage Savings, the Supreme 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. Id. at 566. In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 564-65.

A partition of jointly owned property, however, is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests, but do not acquire a new or additional interest as a result thereof. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Rev. Rul. 69-486, 1969-2 C.B. 159, distinguished by, Rev. Rul. 83-61, 1983-1 C.B. 78, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries and was subject to the provisions of § 1001 and 1002.

In this case, Trust 1 will be partitioned into three shares. The distribution of trust assets from Trust 1 to the resulting trusts will be pro rata as to value and as to each of the trust's assets. We therefore conclude that the proposed division of Trust 1 into these three trusts on a pro-rata basis will not cause the interests of the beneficiaries of the separate trusts to differ materially. The beneficiaries will hold essentially the same interests before and after the pro-rata division. Therefore, the proposed partition of Trust 1 will not result in the realization of any gain or loss from a sale or other disposition of property under §§ 61 and 1001. See Rev. Rul. 56-437, 1956-2 C.B. 507.

With respect to the partition of Trust 2, we note that the distribution of trust assets into the resulting trusts will be pro rata as to value, but not as to each and every asset. The Trust 2 agreement clearly contemplates the non-pro rata or unequal division or distribution of the trust estate. In addition, State Statute expressly grants a trustee, or the trustees jointly, of a trust the discretionary power to partition trust property in accordance with the standards provided by law, and in so doing to select any part of the trust estate in satisfaction of any partition or distribution, in kind, in money or both, and to make non-pro rata distributions of property in kind. Consequently, the non-pro rata distribution of assets is permitted by State law and by the trust documents in this case. Therefore, the partition of Trust 2 is distinguishable from the facts in Rev. Rul. 69-486 and thus will not result in the recognition of gain or loss under §§ 61 and 1001.

Based upon the information submitted and representations made, we conclude that the partition of Trust 1 and Trust 2 into the resulting trusts, as provided above, and the distribution of the assets to the resulting trusts will not require the recognition of gain or loss for federal income tax purposes under §§ 61 and 1001.

Ruling 3

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 such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person. See also §1.1223-1(b).

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

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

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

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
Senior Technician Reviewer, Branch 2
(Passthroughs & Special Industries)