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Legend

Exempt Trust One	=
Date 1	=
Husband	=
Trust	=
State	=
Date 2	=
Spouse	=
Date 3	=
Trust One	=
Trust Two	=
Trust Three	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Brother	=

Son 1 =
Son 2 =
Son 3 =
Date 9 =
State Court =
State Statute 1 =
Subtrust One =
Subtrust Two =
Subtrust Three =
State Statute 2 =
State Statute 3 =

Dear :

This responds to your letter dated April 9, 2007, submitted on your behalf by your authorized representative, concerning the income, estate, gift, and generation-skipping transfer (GST) tax consequences of the proposed division and modification of Exempt Trust One.

FACTS

The facts and representations submitted are as follows.

On Date 1, Husband created Trust, a revocable trust the terms of which are governed by the laws of State. Husband and Spouse executed an Amendment in Total to Trust on Date 2, pursuant to which Spouse contributed her separate property and her share of the community property to Trust.

Husband died on Date 3. Upon Husband's death, pursuant to the terms of the instrument, Trust was divided into three trusts, Trust One, Trust Two, and Trust Three. Upon division of the trust estate, Trust One received the separate property of Spouse held in the trust estate and the community property of Spouse held in the trust estate.

Article 5.05 of Trust provides that Spouse, as the surviving settlor, will have the right to revoke, alter, or amend Trust One in whole or in part at any time following the death of Husband. Spouse will additionally have the right to cancel, amend, or revoke, in whole or in part, any revocation, alteration, or amendment previously made.

Spouse exercised the right to amend Trust One on Date 4 (the "First Trust One Amendment"). Spouse revoked the First Trust One Amendment and executed further amendments to Trust One, including a second amendment on Date 5 (the "Second Trust One Amendment"), a third amendment on Date 6 (the "Third Trust One Amendment"), and a fourth amendment on Date 7 (the "Fourth Trust One Amendment").

Spouse died on Date 8. The assets of Trust One were includible in Spouse's gross estate and were reported on a timely-filed United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706). An estate tax closing letter for Spouse's estate was issued by the Internal Revenue Service (Service).

Pursuant to the terms of the Fourth Trust One Amendment, upon the death of Spouse, Trust One was divided on a fractional share basis into two separate trusts, Exempt Trust One and Non-Exempt Trust One, each having the same terms as the original Trust One from which they were derived. Spouse's generation-skipping transfer (GST) tax exemption was allocated to Exempt Trust One such that Exempt Trust One has an inclusion ratio of zero. No GST exemption was allocated to Non-Exempt Trust One, such that Non-Exempt Trust One has an inclusion ratio of one.

Exempt Trust One is the subject of this ruling request. It is represented that there have been no actual or constructive additions to Exempt Trust One for GST purposes since its initial funding following the death of Spouse.

The currently operative distribution provisions of Exempt Trust One are as follows.

Article 8.03 of Trust, as amended by the Second Amendment to Trust One, provides that upon the death of Spouse, the trustee shall distribute so much of the net income of Trust One among all the children, grandchildren, and the issue of the grandchildren of Husband living at the date of each distribution in amounts and at times as the trustee in his sole discretion shall determine, without regard to equality of distribution. Any net income not so applied shall be accumulated and periodically added to principal. If no child, grandchild, or issue of a grandchild is living on the date of any such distribution, then distribution shall be made to the then living issue of Brother, without regard to equality of distribution. Any income not so applied shall be accumulated and periodically added to principal.

Article 8.04 of Trust provides that in the event any beneficiary of Trust One then entitled to income under the provisions of Article 8.03 shall be in need of funds for his or her reasonable health, support, maintenance, and education, the trustee shall pay to or apply for the benefit of any one or more of such beneficiaries so much of the principal of the trust estate as the trustee shall determine necessary or proper for such purposes. The trustee will take into account the income available to such beneficiary from all other sources and resources known to the trustee.

Article 8.05 of Trust, as amended by the Second Amendment to Trust One, provides that the discretionary power to make distributions of income or principal to a trustee who is also a beneficiary or to any person to whom a trustee owes an obligation of support is only exercisable by an independent trustee appointed by a court of competent jurisdiction.

Article 10 of Trust provides that Exempt Trust One shall terminate twenty-one years after the death of the last to die of certain named individuals. Upon the termination of Exempt Trust One, the balance of the trust estate shall be distributed on the principle of representation to the then living issue of Husband, and if none, to the then living issue of Brother.

Article 13.01(Y) of Trust provides that upon any division or partial or final distribution of the trust estate, the trustee has the power to partition, allot, and distribute the trust estate in undivided interests or in kind, or in money, or partly in any of them, at such valuations and according to such method or procedure as the trustee shall determine.

The Third Trust One Amendment amended Article 14 of Trust to substitute Spouse as the sole trustee of Trust One and to provide for the appointment of three successor trustees upon Spouse's death, resignation, or inability to act as Trustee. Article 14 of Trust, as amended, further provides that if Spouse is not the trustee, then there shall at all times be three persons acting as trustee, who shall act by majority rule. A trustee may designate as his successor a person then acceptable to the other two persons acting as trustee. If a trustee dies, resigns, or is unable to continue to serve as a trustee and has not designated a successor, the remaining trustees shall designate a successor.

Spouse acted as sole trustee of Trust One until her death. Currently, Son 1, Son 2, and Son 3, all sons of Husband, are co-trustees of Exempt Trust One.

On Date 9, the trustees of Exempt Trust One petitioned State Court, pursuant to State Statute 1, for an order to divide and modify Exempt Trust One. The trustees seek to modify Exempt Trust One in order to: (1) divide the trust into three separate equal subtrusts, one for the benefit of Son 1 and his issue, one for the benefit of Son 2 and his issue, and one for the benefit of Son 3 and his issue; (2) provide that each of Son 1, Son 2, and Son 3 may serve as sole trustee of the subtrust created for his benefit and the benefit of his respective issue; and (3) modify the distribution provisions affecting trustees that are also beneficiaries.

The original terms of Exempt Trust One will apply to each separate subtrust, with the following modifications or additions.

Article 8.09 shall be added to Trust to provide that the trustee shall divide Exempt Trust One into three equal and separate subtrusts, and administer those separate subtrusts, as follows:

A. One of the separate subtrusts shall be administered for the primary benefit of Son 1 and his descendants (Subtrust One), one for the primary benefit of Son 2 and his descendants (Subtrust Two), and one for the primary benefit of Son 3 and his descendants (Subtrust Three).

B. With respect to each son's subtrust, the trustee of each respective trust shall distribute so much of the net income of the trust estate among that son and all the descendants of that son living at the date of each such distribution in such amounts and at such times as the trustee in his sole discretion shall determine, without regard to equality of distribution. Any net income not so paid or applied shall be accumulated and periodically added to the principal of that subtrust.

C. In the event that at any time during the existence of a son's subtrust, any beneficiary then entitled to income shall be in need of funds for his or her reasonable health, support, maintenance, or education, the trustee shall pay to or apply for the benefit of any one or more of such beneficiaries so much of the principal of that son's subtrust as the trustee shall determine necessary or proper for such purposes. The trustee will take into account the income available to such beneficiary from all other sources and resources known to the trustee.

D. A son's subtrust shall terminate upon the first to occur of (1) the termination date provided in Article 10 or (2) the date on which neither the respective son nor any descendant of son is then living. If a son's subtrust terminates upon the termination date provided in Article 10, then despite the distribution provisions in Article 10, the balance of that son's subtrust shall be distributed on the principle of representation to that son's then living issue. If a son's subtrust terminates on the date on which neither that son nor any descendant of that son is then living, the balance of that son's subtrust shall be distributed as follows:

1. If at any time prior to the termination date provided in Article 10 neither a son nor any descendant of that son is then living, that son's subtrust shall terminate and its remaining assets shall be added equally to the other sons' subtrusts, or, if only one exists, all to that subtrust.

2. If at any time prior to the termination of all the trusts created under this document as provided in Article 10 there should be no then living descendant of Husband, the trustee shall distribute so much of the net income of the last remaining son's subtrust among the then living descendants of Brother, in such amounts and at such times as the trustee in his sole discretion shall determine, without regard to equality of distribution. Any net income not so paid or applied shall be accumulated and periodically applied to the principal of that last remaining son's subtrust. In addition, if the trustee determines that any descendant of Brother shall be in need of funds for his or her reasonable health, support, maintenance, and education, the trustee shall pay to or apply for the benefit of one or more such qualified beneficiaries so much of the principal of the last remaining son's subtrust as the trustee shall determine necessary or proper for such purposes. The trustee will take into account

the income available to such beneficiary from all other sources and resources known to the trustee.

E. The trustee may partition, allot, and distribute the assets of Exempt Trust One in undivided interests or in kind, or partly in money and partly in kind, and the trustee may sell such assets as the trustee deems proper to make such division. The trustee may also distribute a disproportionate share of any assets to a particular subtrust, provided, however, that the fair market value of all assets distributed to a subtrust must equal the fair market value of the proportionate interest that subtrust is entitled to receive in all of the assets available for distribution at that time. The aggregate income tax basis of the assets distributed to each of the separate subtrusts shall be reasonably equal to the aggregate income tax basis of the assets distributed to the others.

Article 14.02 will be added to Trust to provide as follows:

A. Despite the other provisions of this document, Son 1 will be the sole trustee of Subtrust One, Son 2 will be the sole trustee of Subtrust Two, and Son 3 will be the sole trustee of Subtrust Three. A son of Husband may appoint an additional person or persons as a co-trustee of that son's subtrust. He may also remove without cause any additional co-trustee so appointed. If a co-trustee (including the respective son) ceases to serve, the remaining co-trustee or co-trustees may continue to serve and the co-trustee who ceased to serve need not be replaced. Thereafter, any complete vacancy in the trusteeship of a son's subtrust shall be filled by the respective son for which the subtrust is named, if he is then living and has legal capacity, or if not, by that son's descendants.

B. Whenever any son of Husband dies or becomes incapacitated, his descendants shall have the right with respect to that son's subtrust (1) to appoint a trustee to succeed the respective son, (2) to remove without cause any co-trustee appointed by the respective son, and (3) to remove without cause any trustee previously appointed by the descendants.

C. The right to appoint and remove without cause is exercisable by simple majority vote in descending generational orders, and a later generation shall only exercise this right if there are no surviving members of the prior generation.

D. The removal of an acting trustee shall not occur more often than once during any twelve month period.

E. Any trustee may resign at any time. In such event, a successor shall be selected as provided. If all such successors fail to qualify or cease to act, or if no successor trustee is effectively appointed pursuant to the foregoing provisions, a successor trustee shall be appointed by a court of competent jurisdiction upon the petition of the resigning trustee or any beneficiary of the trust.

Article 8.05 of Trust, as amended by the Second Amendment to Trust One, will be amended in its entirety to read as follows.

A. Each individual co-trustee shall be disqualified from exercising any discretionary power to make distributions of income or principal to (or for the benefit of) himself or herself as a beneficiary. Instead, all such discretionary powers shall vest solely in (and be exercisable by) the other co-trustees.

B. Any individual serving as sole trustee who has the power to make discretionary distributions of income or principal for his or her own benefit may exercise that power in his or her favor only for his or her health, education, support, or maintenance within the meaning of §§ 2041 and 2514 of the Internal Revenue Code. A special co-trustee may be appointed for the limited purpose of making any other discretionary distributions to the regular trustee in his or her capacity as a beneficiary that are otherwise permitted under the provisions of trust. Any special co-trustee cannot be a "related or subordinate party" within the meaning of § 672(c) of the Internal Revenue Code with respect to the regular trustee.

C. Each individual trustee or co-trustee shall be disqualified from exercising any discretion given to the trustee to benefit, directly or indirectly, someone he or she is obligated to support. Instead, all such discretionary powers shall vest solely in (and be exercisable by) the other co-trustees and, if there is none, a special co-trustee may be appointed by the then acting regular trustee for this limited purpose. Any special co-trustee cannot be a "related or subordinate party" within the meaning of § 672(c) of the Internal Revenue Code with respect to the regular trustee. In addition, income or principal of the trust shall not be used to discharge in whole or in part any person's legal obligation, under the laws of the state of that person's domicile, to support or educate any beneficiary of the trust.

D. Any trustee or co-trustee who is appointed by any beneficiary, either alone or in conjunction with other beneficiaries, and is a "related or subordinate party" within the meaning of § 672(c) of the Internal Revenue Code with respect to that beneficiary, shall be subject to the same disqualifications or restrictions contained in subparagraphs A through C above with respect to that beneficiary and/or persons whom that beneficiary is obligated to support, in the same manner and with like effect as if that beneficiary were acting as the trustee or co-trustee.

E. The provisions of Article 8.05 will also apply to the administrative and distributive provisions of the separate subtrusts of Exempt Trust One created pursuant to Article 8.09.

State Statute 1 provides that, on petition by a trustee or beneficiary, a court may divide a trust into two or more separate trusts, if the court determines that dividing the trust will not defeat or substantially impair the accomplishment of the purposes or interests of the beneficiaries.

State Statute 2 provides that the trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non pro rata, and may be made pursuant to any written agreement providing for a non pro rata division of aggregate value of the community property assets or quasi-community property assets, or both.

State Statute 3 provides, in part, that if a trust instrument confers "absolute," "sole," or "uncontrolled" discretion on a trustee, the trustee shall act in accordance with fiduciary principles and shall not act in bad faith or in disregard of the purposes of the trust. Moreover, notwithstanding the use of terms like "absolute," "sole," or "uncontrolled" by a settlor or a testator, a person who is a beneficiary of a trust that permits the person, either individually or as trustee or cotrustee, to make discretionary distributions of income or principal to or for the benefit of himself or herself pursuant to a standard, shall exercise that power reasonably and in accordance with the standard. State Statute 3 further provides that unless a settlor or a testator clearly indicates that a broader power is intended by express reference to this subdivision, a person who is a beneficiary of a trust that permits the person, as trustee or cotrustee, to make discretionary distributions of income or principal to or for the benefit of himself or herself may exercise that power in his or her favor only for his or her health, education, support, or maintenance within the meaning of §§ 2041 and 2514 of the Internal Revenue Code.

State Court has determined that the state law requirements for modifying the trust have been met and that dividing Exempt Trust One into separate trusts will not defeat or substantially impair the accomplishment of the purposes of the trust or the interests of the beneficiaries. Accordingly, State Court has granted the trustees' petition to divide and modify the provisions of Exempt Trust One as requested, conditioned on receiving a favorable ruling on the income, estate, gift, and GST tax issues from the Service.

You have requested the following rulings:

1. The division and modification of Exempt Trust One will not alter the inclusion ratio of Exempt Trust One or the successor subtrusts for GST tax purposes so that, after the division and modification, the trusts will have an inclusion ratio of zero under § 2642 of the Internal Revenue Code.
2. The modification of Exempt Trust One will not cause any beneficiary to be treated as having a general power of appointment with respect to any portion of a subtrust within the meaning of § 2041.
3. The division and modification of Exempt Trust One will not cause any portion of the assets of the trust to be includible in the gross estate of any beneficiary of the successor subtrusts under §§ 2035, 2036, 2037, or 2038.
4. The distributions to and allocations among the new subtrusts will not create a transfer of property that is subject to federal gift tax under § 2501.

5. The exercise of discretionary distribution powers by a trustee/beneficiary under the modified provisions of Exempt Trust One will not cause any beneficiary of Subtrust One, Subtrust Two, or Subtrust Three to be deemed to exercise a general power of appointment under § 2514.
6. The division of Exempt Trust One will not be considered a distribution under § 661 of the Code or § 1.661(a)-2(f) of the Income Tax Regulations.
7. The three successor subtrusts will be treated as separate taxpayers for federal income tax purposes pursuant to § 643(f).
8. No gain or loss will be recognized for purposes of § 61 or § 1001 as a result of the division of Exempt Trust One.
9. Pursuant to § 1015, the basis of the assets of the successor subtrusts will be the same after the division of Exempt Trust One as the basis of those assets before the division. Pursuant to § 1223(2), the holding periods of the assets in the successor subtrusts will include the holding periods of those assets in Exempt Trust One.

Ruling 1

Section 2601 imposes a tax on every GST. Under § 1433(a) of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to any GST from a trust if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

Under § 2602, the amount of tax imposed under § 2601 is determined by multiplying the taxable amount (the amount involved in the GST transfer) by the applicable rate. Under § 2641, the term “applicable rate” means the product of the maximum federal estate tax rate in the year that the GST occurs and the inclusion ratio. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a GST is 1 minus the applicable fraction. Under § 2642(a)(2), in general, the numerator of the applicable fraction is the amount of GST exemption allocated to the property transferred and the denominator is the value of the property transferred.

Under § 2631, every individual is allowed a GST exemption amount which may be allocated by the individual or the individual's executor to any property with respect to which the individual is the transferor.

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 § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or

may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument by judicial reformation or nonjudicial reformation that is valid under applicable state law 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 § 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 a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST or the creation of a new GST.

Section 26.2601-1(b)(4)(i)(E), Example 5, provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, 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 for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. 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.

Section 26.2601-1(b)(4)(i)(E), Example 10, provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of Grantor’s issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and 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. In addition, 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. Therefore, the trust will not be subject to the provisions of chapter 13.

In the instant case, Exempt Trust One became irrevocable after September 25, 1985. It is represented that sufficient GST exemption was allocated to Exempt Trust One so that the trust has an inclusion ratio of zero under § 2642. No guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a change that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of such a trust.

With regard to the proposed modifications of Exempt Trust One, we conclude:

1) The proposed division of Exempt Trust One into Subtrust One, Subtrust Two, and Subtrust Three and the modification of Exempt Trust One in order to provide for the trust's division is similar to the facts in Example 5 of § 26.2601-1(b)(4)(i)(E).
2) The modification of Exempt Trust One to provide that each son may serve as the sole trustee of the subtrust created for his benefit and the benefit of his respective issue is viewed as pertaining to the administration of the trust, comparable to the administrative modification in Example 10 of § 26.2601-1(b)(4)(i)(E).
3) The modification of Exempt Trust One to limit the discretion of the trustees in some circumstances is viewed as pertaining to the administration of the trust and is consistent with state law.

We further determine that all of the proposed modifications (i) will not result in a shift of any beneficial interest in Exempt Trust One to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons holding the beneficial interests prior to the division, and (ii) will not extend the time for vesting of any beneficial interest beyond the period provided for under Exempt Trust One.

Accordingly, based upon the facts submitted and the representations made, we rule that the division and modification of Exempt Trust One will not alter the inclusion ratio of Exempt Trust One, Subtrust One, Subtrust Two, or Subtrust Three for GST tax purposes so that, after the division and modification, the trusts will have an inclusion ratio of zero under § 2642.

Rulings 2 - 5

Section 2033 of the Code 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 2035(a) provides that if (1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under § 2036, § 2037, § 2038, or § 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of the decedent's death, then the value of the gross estate shall include the value of any property (or interest therein) that would have been so included.

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

Section 2037 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 after September 7, 1916, 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 (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), 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 decedent's gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (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 on the date of the decedent's death.

Section 2041(a)(2) 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 the decedent has at the time of 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 that 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 §§ 2035 to 2038, inclusive.

Section 2041(b)(1)(A) provides that a general power of appointment is 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. However, 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 shall not be deemed a general power of appointment.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that a donee may have a power of appointment if he has the power to remove or discharge a trustee and appoint himself. For example, if under the terms of the instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and the decedent has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, the decedent is considered as having a power of appointment. However, the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of the fiduciary duties is not a power of appointment.

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect and whether the property is real or personal, tangible or intangible.

Section 2514(c)(1) provides that a general power of appointment is a power that is exercisable in favor of the individual possessing the power (the possessor), his estate, his creditors, or the creditors of his estate. However, a power to consume, invade, or appropriate property for the benefit of the possessor that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor shall not be deemed a general power of appointment.

Section 25.2514-1(b)(1) of the Gift Tax Regulations provides, in part, that a donee may have a power of appointment if he has the power to remove or discharge a trustee and appoint himself. For example, if under the terms of the instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and A, another person, has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, A is considered as having a power of appointment. However, the mere power of management, investment, custody of assets, or the power to allocate receipts and

disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of the fiduciary duties is not a power of appointment.

Rev. Rul. 95-58, 1995-2 C.B. 191, holds that a decedent/grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or corporate successor trustee that is not related or subordinate to the decedent within the meaning of § 672(c), is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus is not included in the decedent's gross estate under §§ 2036 or 2038. The ruling notes that the Eighth Circuit in Estate of Vak v. Commissioner, 973 F.2d 1409 (8th Cir. 1992), concluded that the decedent had not retained dominion and control over assets transferred to a trust by reason of his power to remove and replace the trustee with a party that was not related or subordinate to the decedent. Accordingly, the court held that under § 25.2511- 2(c), the decedent made a completed gift when he created the trust and transferred assets to it.

Section 672(c) defines the term “related or subordinate party” to mean any nonadverse party who is (1) the grantor’s spouse if living with the grantor; or (2) any one of the following: the grantor’s father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

Under the proposed modification of Exempt Trust One, any trustee or co-trustee is restricted from exercising any discretionary authority to make distributions of income or principal to or for the benefit of himself or someone he or she is obligated to support, unless the authority is pursuant to an ascertainable standard. Furthermore, if a beneficiary, either alone or in conjunction with other beneficiaries, appoints a trustee or co-trustee, and that trustee or co-trustee is a “related or subordinate party” within the meaning of § 672(c) with respect to that beneficiary or beneficiaries, then such trustee or co-trustee so appointed is restricted from exercising its full discretionary authority to make distributions of income or principal with respect to that beneficiary or beneficiaries, or any person whom that beneficiary is obligated to support, in the same manner and with like effect as if that beneficiary were acting as the trustee or co-trustee. Given the restrictions on the trustee’s authority to make discretionary distributions, the removal and appointment powers given to the sons of Husband and the sons’ descendants are not the equivalent of the power referred to in the examples in §§ 20.2041-1(b)(1) and 25.2514-1(b)(1). The discretionary authority of any trustee appointed by a son of Husband or the sons’ descendants is restricted so that a trustee will never have unlimited discretion to appoint property (i) to or for the benefit of himself or herself, or someone he or she is obligated to support, (ii) to or for the benefit of a beneficiary appointing such trustee, either alone or in conjunction with other beneficiaries, or (iii) to

or for the benefit of a person such a beneficiary (described in (ii)) is obligated to support. Instead, such discretionary authority either will be (i) limited to an ascertainable standard, (ii) exercised by the remaining trustees that have no similar restriction, or (iii) exercised by a special trustee that is not related or subordinate to any beneficiary and who is appointed for the sole purpose of making such discretionary distributions.

Accordingly, based on the facts submitted and the representations made, we rule that the modification to Exempt Trust One and the division of Exempt Trust One into Subtrust One, Subtrust Two, and Subtrust Three:

a. Will not cause any beneficiary of a subtrust to be treated as having or exercising a general power of appointment with respect to any portion of the subtrust, within the meaning of § 2041;
b. Will not cause any portion of a subtrust to be includible in the gross estate of any beneficiary of any subtrust, for federal estate tax purposes under § 2035, § 2036, § 2037, or § 2038;
c. Will not create a transfer of property that is subject to federal gift tax under § 2501; and
d. Will not cause any trustee/beneficiary who exercises a discretionary distribution power under the modified provisions of trust to be deemed to exercise a general power of appointment under § 2514.

Ruling 6

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

Section 1.661(a)-2(f) of the Income Tax Regulations provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

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

Based solely on the facts and representations submitted, we rule that the division of Exempt Trust One to create Subtrust One, Subtrust Two, and Subtrust Three is not a distribution under § 661 or § 1.661(a)-2(f).

Ruling 7

Section 643(f) of the Code provides that, for purposes of subchapter J, under regulations prescribed by the Secretary, two or more trusts shall be treated as one trust if (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1.

Subtrust One, Subtrust Two, and Subtrust Three will each have different beneficiaries. Therefore, based solely on the facts and representations submitted, we rule that Subtrust One, Subtrust Two, and Subtrust Three will be treated as separate taxpayers for income tax purposes.

Rulings 8 and 9

Section 61(a)(3) of the Code 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(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 § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 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.

Rev. Rul. 56-437, 1956-2 C.B. 507, provides that 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.

In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee, 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 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, an exchange that required recognition of gain under § 1001.

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.

In Cottage Savings, the Supreme Court of the United States concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different." 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. 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.

Section 1015(b) provides that if property is acquired by a transfer in trust (other than a transfer in trust by 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 by the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. In addition, the principles in § 1.1015-1(b) concerning the uniform basis are applicable in determining the basis of property where more than one person acquires an interest in property by transfer in trust. Section 1.1015-1(b) provides that property acquired by gift has a single uniform basis although more than one person may acquire an interest in the property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included in the period for which such property was held by any other person, if the property has the same basis in the taxpayer's hands as it would have in the hands of that other person.

In the present case, it is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the subtrusts will not differ materially from the interests of the beneficiaries in Exempt Trust One. Under the proposed division, the beneficiaries are severing their joint interests in Exempt Trust One. However, because State law and the terms of the trust authorize non pro rata divisions, the proposed division into the separate subtrusts with substantially identical terms and provisions will not result in the beneficiaries acquiring any new or additional interests. Therefore, the division of Exempt Trust One is not a sale or other disposition of property under Rev. Rul. 56-437 and does not result in a material difference in the legal entitlements enjoyed by the beneficiaries under Cottage Savings. Accordingly, no gain or loss is recognized on the division of Exempt Trust One for purposes of § 61 or § 1001.

Additionally, because § 1001 does not apply to the division of Exempt Trust One, under § 1015 the basis of the assets will be the same after the division as the basis of those assets before the division. Furthermore, pursuant to § 1223(2) the holding periods of the assets in the hands of separate trusts will include the holding periods of the assets in the hands of Exempt Trust One.

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.

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.

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

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

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)