LEGEND:

Year 1 =
A =
B =
C =
Trust A =
Trust B =
Trust C =
Child 1 =
Child 2 =
Child 3 =
Individual =
Trust D =
Trust E =
Trust F =
Trust G =
Trust H =
Trust I =

Dear :

This responds to your April 17, 2009 letter and other correspondence requesting rulings under §§ 1001, 2501, and 2601 of the Internal Revenue Code concerning the income, gift, and generation-skipping transfer (GST) tax consequences of a proposed division and subsequent merger of certain trusts.

You have requested the following rulings:

1. The proposed transaction will not constitute a sale or other taxable division of assets under § 1001.

2. The proposed transaction will not result in a transfer that is subject to gift tax under § 2501.

3. The proposed transaction will not affect the status of the trusts as exempt from the GST tax under § 2601.

The facts submitted are as follows:

In Year 1 (prior to September 25, 1985), A created Trust A, B created Trust B, and C created Trust C (collectively, the "Trusts"). A and B were husband and wife and had three children, Child 1, Child 2, and Child 3 (collectively, the "Children"). TheTrusts were created for the benefit of the Children of A and B and their respective families.

Under the provisions of Paragraph 2 of Trusts A and B, as long as any of the Children are living, the Trustee is directed to divide all of the income of each Trust into equal parts, one part for each living child and one part for each deceased child survived by issue. With respect to a living child, the Trustee has the discretion to pay to that child his/her share of the income or to accumulate it in whole or in part. With respect to a deceased child, the Trustee is directed to pay to the living issue of such child, per stirpes, the accumulated income of such deceased child's share, the income on the accumulated income, and the current undistributed income of the deceased child's share.

Under the provisions of Paragraph 2 of Trust C, as long as any of the Children are living, the Trustee is directed to divide the Trust's income into equal parts, one part for each living child and one part for each deceased child survived by issue. The Trustee is directed to apply each living child's share of the income to the education, maintenance, and support of that child or, in the Trustee's discretion, accumulate such income in whole or in part. Upon the death of a child, the Trustee is directed to pay to the living issue of such child, per stirpes, the accumulated income of such deceased child's share, the income on the accumulated income, and the current undistributed income of the deceased child's share.

Under the provisions of Paragraph 3 of Trusts A, B, and C, upon the death of the last survivor of Child 1, Child 2, and Child 3, the Trustee is directed to pay over the principal of the Trusts to the then living issue, per stirpes, of Child 1, Child 2, and Child 3.

Each Trust is currently being administered as a single fund with two parts: one part consists of the primary Trust assets and the other part contains the accumulated income. No distributions have ever been made from either part.

Child 1, Child 2, and Child 3 are still living. Child 1, Child 3, and Individual are serving as the Trustees of the Trusts. Trustees propose to divide each Trust into three separate trusts, one for the benefit of Child 1 and his issue, one for the benefit of Child 2 and her issue, and one for the benefit of Child 3 and his issue. Following the division, the trust for the benefit of Child 1 and his issue under Trust A and the trust for the benefit of Child 1 and his issue under Trust B will be merged into Trust D. The trust for the benefit of Child 2 and her issue under Trust A and the trust for the benefit of Child 2 and her issue under Trust B will be merged into Trust E. The trust for the benefit of Child 3 and his issue under Trust A and the trust for the benefit of Child 3 and his issue under Trust B will be merged into Trust F. The trusts created from the division of Trust C will each continue to be held as separate trusts, one for the benefit of Child 1 and his issue (Trust G), one for the benefit of Child 2 and her issue (Trust H), and one for the benefit of Child 3 and his issue (Trust I). The Trustees have petitioned the local court for an order approving the division and merger of the trusts, subject to favorable rulings by the Service.

It is represented that under the proposed restructuring of the Trusts, the assets of Trust A, Trust B, and Trust C will be divided equally on a pro rata basis. Each asset of each Trust will be divided into three parts, one part for each new trust. If an asset cannot be divided, it will be sold, and the proceeds will be divided among the new trusts.

Each of the new trusts (Trust D, Trust E, Trust F, Trust G, Trust H, and Trust I) will be governed by the same provisions as the original Trusts (Trust A, Trust B, and Trust C) except for the provisions of Paragraph 3 in each original Trust. As noted above, Paragraph 3 of the original Trusts provides that the principal of each Trust is to be distributed, per stirpes, to the then living issue of Child 1, Child 2, and Child 3 after the death of the survivor of Child 1, Child 2, and Child 3. Under the new trusts, distributions of principal are to be made, per stirpes, to the issue of a deceased child upon that child's death rather than at the death of the survivor of Child 1, Child 2, and Child 3.

LAW AND ANALYSIS

Ruling 1

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) of the Income Tax Regulations 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 pro rata 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 thereof. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In this case, the Trusts will be partitioned and merged into six trusts. The distribution of assets from the Trusts into the new trusts will be pro rata as to value and as to each of the assets. The payments and legal entitlements of the beneficiaries will not be changed. The modification of the terms and conditions of the new trusts to provide for the early termination of the trusts and the early distribution of assets to the remaindermen is a change from the terms and conditions of the Trusts. However, this change modifies only the timing of the receipt of trust assets by the remaindermen. Except for this change, all other provisions of the Trusts will remain unchanged.

We thus conclude that the division of each of Trust A, Trust B, and Trust C into three separate trusts, one for the benefit of each child and his/her family; the merger of the two trusts created for the benefit of each child and his/her family under Trusts A and B into Trust D, Trust E, and Trust F; and the creation of Trusts G, H, and I under Trust C with the approval of the state court on a pro rata basis will not cause the legal entitlements and interests of the beneficiaries of these separate trusts to differ materially from their legal entitlements and interests under the Trusts. The beneficiaries will hold essentially the same interests before and after the pro rata division. Therefore, this transaction will not result in the realization of any gain or loss from a sale or other disposition of assets of any of the Trusts under § 1001.

Ruling 2

Section 2501 imposes a tax on the transfer of property by gift by any individual.

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.

In this case, the beneficial interests in the original Trusts (Trust A, Trust B, and Trust C) will be identical to the beneficial interests in the new trusts (Trusts D, E, F, G, H, and I). Therefore, no interests in the original Trusts will be passed gratuitously to the new trusts. Accordingly, based upon the facts submitted and representations made, we conclude that the transaction will not be subject to gift tax under § 2501.

Ruling 3

Section 2601 imposes a tax on every generation-skipping transfer. The term Ageneration-skipping transfer@ is defined in § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer (GST) Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 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, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

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.

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 § 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. A modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust.

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 § 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 GST tax.

In this case, the original Trusts will be partitioned and merged into six trusts. The transaction will not result in a shift of any beneficial interest in the Trusts to any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed division will not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for in the Trusts. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed transaction will not adversely affect the Trusts' status as exempt from the GST tax and that the new trusts will remain exempt from the GST tax.

In accordance with the Power of Attorney on file with this office, copies of this letter are 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 requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Katherine A. Mellody
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures
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