Internal Revenue Service

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Person To Contact:
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Date:
March 22, 2010

In re:

Legend

Decedent	=
Trust	=
Date 1	=
Date 2	=
Wife	=
Son	=
Daughter	=
State	=
Court	=
Statute 1	=
Statute 2	=

Dear :

This responds to your authorized representative's letter dated September 21, 2009, in which you request rulings concerning the generation-skipping transfer (GST) tax consequences of the proposed division of Trust.

The facts submitted and representations made are as follows:

Decedent died testate on Date 1, survived by his wife, Wife, and his children, Son and Daughter. Decedent's Will was admitted to probate on Date 2 in State Court.

Pursuant to the paragraph A of Article VIII of the Will, Decedent's residuary estate passed to Trust, to be held and administered as a separate trust. Paragraph B of Article VIII further provides that the trustee shall distribute to or for the use and benefit of Wife such amounts from the trust estate as may be reasonably necessary to provide for the health, maintenance and support of Wife, taking into consideration her accustomed manner of living and the availability to her of funds from other sources.

Under paragraph C of Article VIII, upon the death of Wife, Trust is to be divided into the number of shares or portions, in undivided interests and of equal value, as there may be children surviving Decedent and deceased children represented by issue surviving Decedent. Each such share or portion is to be a separate trust to and for the benefit of each surviving child or the surviving issue of each deceased child. Any trust allotted for the benefit of a child is to continue for and during the life of the child. If the child should die prior to termination of the trust with surviving issue, the trust is to continue for the benefit of the child's issue.

Paragraph D of Article VIII further provides that the trustee shall distribute to or for the use and benefit of the child or any one or more of the issue of a living or deceased child, amounts from the trust estate reasonably necessary to provide for the health, maintenance, support, and education of the beneficiaries, taking into consideration their respective accustomed manner of living and the availability to them, respectively, of funds from other sources. The phrase "for the use and benefit of" shall be deemed broad enough to encompass not only the direct needs of the specified beneficiary but also those of any one or more of his or her issue.

Paragraph H of Article XVI provides that no provision of the Will is intended to be construed to allow an individual Trustee to apply or distribute any portion of the trust estate of any trust created under the Will to discharge the legal obligation of any person in his individual capacity to support or maintain any other person or persons.

Under paragraph E of Article VIII, following Wife's death, each of the trusts allotted under paragraph C shall terminate twenty-one years after the death of the Decedent's child for whom or for whose issue it was created, and is to be distributed per stirpes among the surviving issue of the child. If a child dies without surviving issue, the trust shall terminate and the trust estate shall be distributed per stirpes among Decedent's surviving issue. However, the share for any beneficiary that is to continue in trust, under Article VIII, shall be distributed to the trustee of the trust and held subject to all of the terms and conditions of the trust. Further, no distribution under paragraph E can be made and no interest disposed of under the terms of the trust shall vest during the life of Wife.

Paragraph A of Article XV appoints Wife as the trustee of each of the trusts created under the Will. If Wife dies, resigns, refuses or for any reason fails to serve in such capacity, then Son and Daughter, or either of them if one fails or ceases to act in such capacity, shall act as alternate or successor trustee of each of the trusts created under the Will. Further, each of Son and Daughter shall serve as sole trustee of any trust exclusively for the primary benefit of that child and the child's issue, and if the child fails or ceases to act, then the other child shall serve as sole trustee. Accordingly, Wife is currently the sole trustee of Trust, and upon Wife's death, Son and Daughter are to serve as sole trustee of their respective trust.

Paragraph E, subparagraph k, of Article XVI provides the trustees with all of the rights, powers, privileges and authorities (except where they are inconsistent with any provision of the Will) conferred upon trustees by the State Trust Code.

Trust became irrevocable after September 25, 1985. It is represented that sufficient GST exemption was allocated to Trust so that Trust has an inclusion ratio of zero under § 2642.

State Statute 1 provides that a trustee may, unless expressly prohibited by the terms of the instrument establishing the trust, divide a trust into two or more separate trusts without a judicial proceeding if the result does not impair the rights of any beneficiary or adversely affect achievement of the purposes of the original trust. State Statute 2 provides that when dividing a trust, a trustee may (1) make distributions in divided or undivided interests, (2) allocate particular assets in proportionate or disproportionate shares, (3) value the trust property for purposes of acting under subdivisions (1) and (2), and (4) adjust the division for resulting differences in value.

The current remainder beneficiaries of Trust, Son and Daughter, have differing investment goals and personal financial situations. Accordingly, Wife, as trustee of Trust, proposes to divide Trust into two separate trusts at this time (and not at Wife's death) such that Son and his issue will be the remainder beneficiaries of one subtrust (Son's Trust) and Daughter and her issue will be the remainder beneficiaries of the second subtrust (Daughter's Trust), with all other terms of Trust remaining the same. Wife will remain the trustee and sole lifetime beneficiary of both Son's Trust and Daughter's Trust. Any income or principal distributions to Wife will be made equally out of Son's Trust and Daughter's Trust. Neither Son nor Daughter (nor their respective issue) will have a present interest in any of Son's Trust or Daughter's Trust. Trust's assets will be divided equally but not on a pro rata basis. Specifically, Trust's real estate assets will pass to Son's Trust while Trust's liquid assets of an equal value will pass to Daughter's Trust, and the remaining assets, if any, will be distributed equally to Son's Trust and Daughter's Trust. At Wife's death, if the child and all of the issue who are descendants of the child for whom the subtrust is allotted are then deceased, the subtrust shall merge into the other subtrust as currently provided in the Will on the death of all of such issue, or if all of the remainder beneficiaries of both subtrusts are then deceased, the subtrusts shall pass as currently provided in the Will on the death of all such issue. The proposed division is conditioned on a favorable ruling on the income, estate, gift and GST tax ruling requests from the Internal Revenue Service.

You are requesting the following rulings:

1. The division and modification of Trust will not alter the inclusion ratio of Trust or the successor subtrusts for GST tax purposes so that, after the division and modification, the successor subtrusts will have an inclusion ratio of zero under § 2642.

2. The division and modification of Trust will not cause any portion of the assets to be includible in the gross estate of any beneficiary of the successor subtrusts under §§ 2035, 2036, 2037, or 2038.

3. The distributions to and allocations among the successor subtrusts will not result in a transfer of property that is subject to federal gift tax under § 2501.

4. The division of Trust will not be considered a distribution under § 661 or § 1.661(a)-2(f) of the Income Tax Regulations.

5. The two successor subtrusts will be treated as separate taxpayers for federal income tax purposes pursuant to § 643(f).

6. No gain or loss will be recognized for purposes of §§ 61 or 1001 as a result of the division of Trust. Next, pursuant to § 1015, the basis of the assets of the successor subtrusts will be the same after the division of Trust as the basis of those assets before the division. Finally, pursuant to § 1223(2), the holding periods of the assets in the successor subtrusts will include the holding periods of those assets in Trust.

Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), 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) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

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 generation-skipping transfer 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 generation-skipping transfer 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)(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) of this section) 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.

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.

In the instant case, Trust became irrevocable after September 25, 1985. It is represented that sufficient GST exemption was allocated to Trust so that 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 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.

Based on the facts presented and the representations made, the division of Trust into Son’s Trust and Daughter’s Trust, as described above, will not result in a shift of any

beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division. Further, the proposed division will not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for under the original Trust. Accordingly, the division and modification of Trust will not alter the inclusion ratio of Son's Trust or Daughter's Trust for GST tax purposes so that, after the division and modification, the trusts will have an inclusion ratio of zero under § 2642.

Ruling 2

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.

In the present case, Wife will continue to be the sole lifetime beneficiary of Son's Trust and Daughter's Trust. Further, the distribution, management, and termination provisions of Son's Trust and Daughter's Trust will be identical to the current distribution, management, and distribution provisions of Trust. Accordingly, based on the facts presented and the representations made, the division of Trust into Son's Trust and Daughter's Trust will not cause any portion of the assets to be includible in the gross estate of any beneficiary of Son's Trust and Daughter's Trust under §§ 2035, 2036, 2037, or 2038.

Ruling 3

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

Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed a gift that is included in computing the amount of gifts made during the calendar year.

The division of Trust into Son's Trust and Daughter's Trust, as described above, will not result in any change in the beneficial interests of any of the trusts' beneficiaries. Accordingly, based on the facts presented and representations made, the distributions and allocations among Son's Trust and Daughter's Trust will not create a transfer of property that is subject to federal gift tax under § 2501.

Ruling 4

Section 661(a) 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 conclude that the division of Trust to create Son's Trust and Daughter's Trust is not a distribution under § 661 or § 1.661(a)-2(f).

Ruling 5

Section 643(f) 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.

The Son's Trust and the Daughter's Trust will each have different beneficiaries. Therefore, based solely on the facts and representations submitted, we conclude that Son's Trust and Daughter's Trust will be treated as separate taxpayers for federal income tax purposes.

Ruling 6

Section 61(a) defines gross income as "all income from whatever source derived." Under § 61(a)(3), gross income includes "[g]ains derived from dealings in property."

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

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.

Under § 1.1001-1(h)(1), the severance of a trust, occurring on or after August 2, 2007, is not an exchange of property for other property differing materially either in kind or in extent, if (i) an applicable state statute or the governing instrument authorizes or directs the trustee to sever the trust; and (ii) any non-pro rata funding of the separate trusts resulting from the severance, whether mandatory or in the discretion of the trustee, is authorized by an applicable state statute or the governing instrument.

In the present case, Trust will be divided into Son's Trust and Daughter's Trust on a non-pro rata basis. The same provisions of the Will govern Trust, Son's Trust, and Daughter's Trust. It is represented that State Statute 2 permits the division of Trust on a non-pro rata basis. The Will does not address the division of Trust before Wife's death. The proposed division is consistent with the criteria set forth in § 1.1001-1(h)(1) of the regulations. Accordingly, the proposed division of Trust does not constitute an exchange of property for other property differing materially in kind or in extent under §§ 61 and 1001.

Section 1015 provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss recognized.

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 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by a transfer in trust (other than a transfer in trust by gift, bequest or devise), the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor under the law applicable to the year in which the transfer was made.

Section 1.1015-2(a)(2) provides that the principles in § 1.1015-1(b) concerning the uniform basis are applicable in determining basis of property where more than one person acquires an interest in property by transfer in trust.

In this case, because neither § 1001 nor § 61 applies to the proposed transaction, the basis of the assets in each of Son's Trust and Daughter's Trust will be the same as the basis of the assets in Trust.

Under § 1223(2), the taxpayer's holding period for property, however acquired, includes the period for which the property was held by any other person, if, for the purpose of determining gain or loss from a sale or exchange, the property has the same basis in whole or in part in the taxpayer's hands as it would in the hands of the other person.

We conclude that under § 1223(2) the holding period for each of Son's Trust and Daughter's Trust in each asset received from Trust will include the respective holding period of Trust for each such asset.

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 ruling(s) in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

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. 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.

Sincerely,

James F. Hogan
Branch Chief, Branch 4
(Passthroughs & Special Industries)

Enclosures (2)
Copy for section 6110 purposes
Copy of this letter

cc: