Internal Revenue Service

Number: **201102007**
Release Date: 1/14/2011

Index Number: 61.00-00, 1001.00-00, 2501.01-00, 2601.04-01, 2036.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:04
PLR-105036-10
Date:
July 29, 2010

In re:

LEGEND
Testator =
Child A =
Child B =
Child C =
Stock =
Stock Trust =
Residuary Trust =
Children's Agreement =

State =
State A =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
A =
B =
C =
D =
Stock Trust A =
Residuary Trust A =
Cite 1 =

Cite 2 =

Cite 3 =
Cite 4 =

Cite 5 =

Cite 6 =

Cite 7 =
Cite 8 =

Highest Court =
Highest Court of State A =
State Court =
State Statute =

State Governing Statute A =
State Governing Statute B =
State A Statute =
q =
r =
s =
t =
u =
v =
x =
y =
z =

Dear :

This responds to the January 28, 2010 letter from your authorized representative requesting rulings on the income, gift, estate, and generation-skipping transfer (GST) tax consequences of a proposed settlement agreement.

The facts and representations are as follows. Testator died a resident of State on Date 1. He was survived by three children, Child A, Child B, and Child C (the Children). Five grandchildren (the Five Grandchildren) were then living. There were no great-grandchildren at the time.

Under Articles Third and Eighth of Testator's will (the Will), his shares of Stock were to be held in trust (the Stock Trust). Trust income was to be divided equally among the Children. On a Child's death, the Child's income share was to be divided equally among the Child's then living children (Testator's grandchildren). The Stock Trust was to terminate twenty-one years after the death of Testator's last surviving grandchild, when the principal would be divided equally (per capita) among Testator's then living great-grandchildren and deceased great-grandchildren (whose then living descendants would take by representation).[1]

Under Article Twenty-Second of the Will, the residue of Testator's estate was to be held in another trust (the Residuary Trust). The Residuary Trust provisions were identical to those of the Stock Trust except that the Residuary Trust was to terminate when Testator's youngest great-grandchild reached age twenty-one.

The rule against perpetuities

Under the State rule against perpetuities in effect at Testator's death, a bequest of a future interest was void if, considered prospectively at the testator's death, there was a possibility that the interest would not vest by the end of twenty-one years after the death of a life or lives in being at the testator's death (the Permissible Period). A bequest to a class was void if there was a possibility that all the members of the class would not be ascertained and take vested interests within the Permissible Period. A void specific bequest passed to the testator's residuary estate. If the testator's disposition of the residuary estate was void as well, the residuary estate passed (as a reversion) by intestacy. Cite 1.

In this case, at Testator's death, it was possible for the Children to have additional children so that there could be grandchildren whose lives were not then in being. This was the pivotal factor in determining whether his bequests of Stock Trust and Residuary Trust income and remainders to his grandchildren and great-grandchildren violated the rule against perpetuities.

Testator's bequest of lifetime income interests to the grandchildren was to <u>all</u> of his grandchildren as a class. A grandchild born after Testator's death would be part of the grandchildren's class and would receive Stock Trust income for life. Based on this, it was considered possible that not all of the grandchildren's income interests would vest during lives in being at Testator's death.

Testator's bequests of remainders to his great-grandchildren were to vest only after <u>all</u> of Testator's grandchildren died.[2] The life of a grandchild born after Testator's death would also be a measuring life. Therefore, at Testator's death, it was possible that the time for vesting of the great-grandchildren's remainders would be based on a life not in being at Testator's death. Accordingly, the validity of these bequests was in doubt. The bequests in the Stock Trust, if void, passed to the Residuary Trust at Testator's death.

---

[1] Certain annuities were also created that have since terminated.

[2] Each trust considered herein (i.e., Stock Trust and Residuary Trust in the Will and Stock Trust A and Residuary Trust A under the Children's Agreement) provided for distribution of the remainder at the end of twenty-one years following the death of the last survivor of the persons whose lives measured the duration of that trust. Because the perpetuities issue in this case centers on the lives measuring a respective trust's duration, and not on the twenty-one year period following the death of the last survivor, the twenty-one year period is hereafter assumed to be a part of each trust's duration even though it is not specifically stated.

The bequests in the Residuary Trust, if void, passed to Testator's intestate estate as a reversionary interest.

The Children's Agreement

The Children were Testator's heirs at law. They acquired his property passing by intestacy. Consequently, on Date 2, shortly after Testator died, the Children entered into an agreement (the Children's Agreement) revising the time when the great-grandchildren's remainders were to vest. Under the Children's Agreement, the trusts were to terminate (and the great-grandchildren's remainders were to take effect) on the death of the survivor of the Children and Five Grandchildren (that is, lives in being at Testator's death).

The Children's Agreement also changed the Will's pro rata distribution of the Stock Trust (and Residuary Trust) remainder to a per stirpes distribution. On termination, trust principal would be divided into three equal parts and distributed per stirpes. Under this revision, the great-grandchildren descended from Child A would share one third of the principal per stirpes, those descended from Child B would share a second third per stirpes, and those descended from Child C would share the last third per stirpes.

In all other respects, the terms of the revised Stock Trust (Stock Trust A) and Residuary Trust (Residuary Trust A) were the same as those provided in Testator's Will. On a date before September 25, 1985, Testator's shares of Stock were transferred to Stock Trust A. Residuary Trust A was not funded. It is represented that no additions have been made since then.

The Litigation

Over more than x decades, the trust beneficiaries and others have instituted actions for State court determinations regarding Testator's Will and the Children's Agreement. Specifically, in Cite 2, the highest court of State (Highest Court) considered Testator's bequests of income interests to the grandchildren. The court reasoned that under Testator's Will, a grandchild's income interest would vest when his or her parent (Child A, Child B, or Child C) died. Thus, the grandchildren's class would necessarily close at the death of the last survivor of the Children, who were in being at Testator's death. Highest Court held that, therefore, the bequest of lifetime income interests to the grandchildren, as a class, did not violate the rule against perpetuities. The court held the Stock Trust created in the Will to be valid through the lives of the grandchildren.[3]

Highest Court then considered Testator's bequest of remainders to his

---

[3] Testator's bequest to the grandchildren, though valid, did not provide for distribution of a grandchild's income share when the grandchild died before the trust ended. On the death of the first grandchild to die on Date 3, the trustees petitioned the State Court for instructions. The State Court held that, based on Testator's intent, a deceased grandchild's children succeeded to the income share for the duration of the trust. Cite 6.

great-grandchildren.[4] The court reasoned that the grandchildren's life estates preceded the remainders, and the grandchildren's class was not limited to lives in being at Testator's death. Because the remainders would take effect only after all of those (including afterborn) grandchildren died, it was possible that the remainders would not vest within lives in being at Testator's death. Therefore, Highest Court held the Stock Trust remainders to be void and illegal as violating the rule against perpetuities. Cite 7.[5]

State Statute: the "wait and see" rule

Nearly y decades after Highest Court rendered its decision in Cite 2, the State legislature enacted State Statute. State Statute provides a "wait and see" rule in determining whether a future interest satisfies the rule against perpetuities or is void. Under the "wait and see" rule, a future interest does not violate the rule against perpetuities if actual events demonstrate that the interest did, in fact, vest by the end of the Permissible Period. State Statute applies retroactively "to all interests heretofore . . . created."

Following the enactment of State Statute, Highest Court considered the statute's retroactivity. Cite 3. In the case before the court, the trust was created many decades before State Statute was enacted. At the time of creation, certain interests were void as violating the rule against perpetuities. However, Highest Court applied State Statute's "wait and see" rule to conclude, in retrospect, that the interests were not void and did not violate the rule against perpetuities.

As a result, the courts of State now apply the "wait and see" rule retroactively to conclude that a future interest that was void, when created many years before State Statute was enacted, is not void because, in hindsight, it vested before the Permissible Period ended. Accordingly, such otherwise void interests are retroactively sustained as not violating the rule against perpetuities. Cite 4. However, Highest Court has not yet addressed due process issues that may be presented.[6]

---

[4] By inference, Highest Court also considered Testator's bequest of the Residuary Trust remainders.

[5] Highest Court, in effect, confirmed that the Stock Trust remainder (and Residuary Trust remainder) passed by intestacy to the Children. However, the court did not rule on how the remainder would pass to the great-grandchildren.

[6] In contrast, the legislature of State A enacted State A Statute, which (like State Statute) retroactively applies a "wait and see" rule to determine whether a future interest, that was void at the time it was created before the State A Statute was enacted, did, in fact, vest during the Permissible Period. Highest Court of State A refused to apply the "wait and see" rule retroactively despite the relevant language in State A Statute. Instead, that court addressed issues of constitutionality and held that State A Statute could not be applied retroactively to destroy vested or substantive rights created before State A Statute was enacted. Cite 5.

The actualities in this case

No additional grandchildren were born after Testator's death. The lives of the Children and the Five Grandchildren were all in being at Testator's death. All of the Children have died. The last survivor of the Five Grandchildren died on Date 4. At the time, there were z great-grandchildren of Testator. The trust will terminate twenty-one years after Date 4, which is Date 5.

Of Testator's z great-grandchildren, A descended from Child A, B descended from Child B, and C descended from Child C. If the "wait and see" rule is applied to validate Testator's bequest of remainders to his great-grandchildren, the principal would be divided into z equal shares and distributed under the Will. Alternatively, if Testator's disposition of the remainders is considered void, the principal would be divided into three equal shares and distributed per stirpes under the Children's Agreement. The portion of a one-third share distributable to a great-grandchild would depend on the framework of the family line (i.e., Child A's, Child B's, or Child C's) to which that great-grandchild belongs.

Great-grandchildren's litigation

There is a substantial difference between what a great-grandchild would receive in a per capita distribution and what he or she would receive in a per stirpes distribution. On Date 6, the great-grandchildren benefitting from a per capita distribution (the Per Capita Parties) instituted their action in State Court for adjudication on the distribution of the Stock Trust remainder. The great-grandchildren benefitting from a per stirpes distribution (the Per Stirpes Parties) opposed the suit and also requested adjudication. In addition, an action was instituted concerning the distribution of income during the twenty-one year period. State Court combined the proceedings to consider the income and principal issues together. Cite 8.

Over a D-year period, guardians ad litem were appointed, there was extensive discovery, counsel filed three voluminous sets of briefs, and the court heard two days of oral arguments. The Per Capita Parties argued that the wait and see test of State Statute now applies. Under that test, Testator's (the Will's) disposition of the Stock Trust remainder does not violate the rule against perpetuities. Therefore, the Stock Trust principal is distributable per capita to Testator's living great-grandchildren and deceased great-grandchildren (whose living descendants would take by representation).

The Per Stirpes Parties argued that the Highest Court's determinations were final, and those rulings can not now be constitutionally impaired by a later-in-time State Statute or judicial ruling. Because Highest Court determined the remainders in the Will to be void, they passed as reversionary interests (by intestacy) to the Children. As such, the remainders passed per stirpes under the Children's Agreement.

Some parties argued that trust income should be distributed per stirpes through the roots of the Children for the duration of the Stock Trust. Others argued that the income is distributable per capita.

The court encouraged the parties to explore ways to resolve their differences through negotiation and compromise rather than through continued litigation. Among the potential outcomes regarding trust principal was a judicial ruling that:

(i) Principal is distributable per capita on Date 5 under the terms of the Stock Trust in the Will; or

(ii) Principal is distributable per stirpes on Date 5 under the terms of the Children's Agreement; or

(iii) Principal was distributable as of the last surviving grandchild's death under the Residuary Trust in the Will, which vested or will vest in the takers under the Residuary Trust.

Among the potential outcomes regarding trust income was a judicial ruling that:

(iv) Income is distributable per stirpes from the death of the last surviving grandchild to Date 5 under either the Will or the Children's Agreement; or

(v) Income is distributable per capita from the death of the last surviving grandchild to Date 5 under the Will or the Children's Agreement; or

(vi) All rights to receive Stock Trust income terminated when the last surviving grandchild died, at which time the Stock Trust principal was distributable under the Residuary Trust of the Will.

The great-grandchildren's settlement agreement

The parties negotiated extensively. At the outset, they agreed that the issues could be settled using a fractional difference settlement based on an assessment of the relative strengths of their adverse positions.

Under the general framework of the compromise, the great-grandchildren's settlement agreement (the GGC Agreement) provides for the Stock Trust principal to be divided into z separate shares based on the number of Testator's then living great-grandchildren and deceased great-grandchildren (with then living children).[7] The share of a deceased great-grandchild will be divided per stirpes among that great-grandchild's living descendants.

---

[7] For purposes of describing the GGC Agreement, the Stock Trust and Stock Trust A are considered to be the same trust.

The Stock Trust assets will be divided in accordance with certain percentages. The formula of the compromise provides for a q% per stirpes/r% per capita fractional difference as to income, and an s% per stirpes/t% per capita fractional difference as to principal. After the division into separate shares, u% of each great-grandchild's share will be distributed outright to the great-grandchild, if living, or, if the great-grandchild is deceased, to his or her living descendants per stirpes. The remaining v% of each share will continue in trust for such great-grandchild (or such descendants) until the termination date, Date 5. Each share will be a separate trust. The respective great-grandchild (or deceased great-grandchild's descendants) will be the sole beneficiary of the share for distributions of income and principal.

A sophisticated algorithm taken to thirteen decimal places will be used in the pro rata division and outright distributions. The division will take into account both the market value and respective tax bases of the assets.

The GGC Agreement was presented to State Court for consideration. The State Court approved the settlement and ordered the division and distribution of the Stock Trust as set forth in the GGC Agreement. The GGC Agreement is subject to a favorable ruling from the Internal Revenue Service.

You have asked for the following rulings:

(1) The terms of the GGC Agreement will not cause distributions from the Stock Trust or the continuing separate settlement trusts to become subject to the generation-skipping transfer tax.

(2) The terms of the GGC Agreement will not cause any party to the agreement to make a gift to any other party to the GGC Agreement.

(3) The terms of the GGC Agreement will not cause any party to the agreement to be required to include trust assets in his or her gross estate unless such assets are distributable or have been distributed to such party prior to his or her death.

(4) The terms of the GGC Agreement will not cause any party to the agreement to realize income from the sale or exchange of any trust assets or interests.

Ruling 1: GENERATION-SKIPPING TRANSFER (GST) TAX

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.

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)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to chapter 13 if (1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

In this case, the Stock Trust was irrevocable on September 25, 1985. Further, it is represented that there have been no actual or constructive additions to the Stock Trust after September 25, 1985. Accordingly, the Stock Trust is exempt from GST tax under § 26.2601-1(b)(1).

The terms of the GGC Agreement, including the proposed division of the Stock Trust into separate shares and partial distributions of principal, are the result of a settlement of substantial issues between the Per Capita Parties and the Per Stirpes Parties. These issues have been tenaciously litigated over more than x decades. Highest Court rendered opinions regarding these trusts many years ago. However, State Statute has since been enacted with retroactive effect, and Highest Court has affirmed State Statute's retroactive application to a similarly-created trust. In light of this, that court's earlier determinations of the issues in this case are now in question.

We conclude that the GGC Agreement constitutes a settlement of bona fide issues concerning the provisions of the Stock Trust and its administration. We also conclude that the terms of the GGC Agreement are the product of arm's length negotiations. They represent a compromise between the positions of the parties and reflect the parties' assessments of the relative strengths of their positions. We further conclude that the GGC Agreement is within the range of reasonable outcomes under the governing instruments and the applicable State law addressing the issues resolved in the GGC Agreement.

Accordingly, based upon the facts submitted and the representations made, we rule that the division of the Stock Trust (into the z separate great-grandchildren's trusts) and the distributions (to the living great-grandchildren and the descendants, by representation, of a deceased great-grandchild) made in accordance with the GGC Agreement will not cause the Stock Trust, the continuing separate Stock Trusts, or the distributions, as described above, to be subject to the generation-skipping transfer tax.

Ruling 2: GIFT TAX ISSUE

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

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(b) of the Gift Tax Regulations provides that, as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him or her no power to change its disposition, whether for his or her own benefit or for the benefit of another, the gift is complete.

Section 25.2511-1(c)(1) provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Whether an agreement settling a dispute is effective for gift tax purposes depends on whether the settlement is based on a valid enforceable claim asserted by the parties and, to the extent feasible, produces an economically fair result. See Ahmanson Foundation v. United States, 674 F.2d 761, 774-75 (9th Cir. 1981) (citing Commissioner v. Estate of Bosch, 387 U.S. 456 (1967)). Thus, state law must be examined to ascertain the legitimacy of each party's claim. If it is determined that each party has a valid claim, the Service must determine that the distribution under the settlement reflects the result that would apply under state law. If there is a difference, it is necessary to consider whether the difference may be justified because of the uncertainty of the result if the question were litigated.

The proposed settlement is a mediated settlement and is based on arm's length negotiations among all the parties. All interested parties who hold or may hold an interest in the trusts, including any minors and unborn heirs, have been represented in the negotiations.

As discussed above, the GGC Agreement represents the resolution of a bona fide controversy between the parties. The terms of the GGC Agreement are the product of arm's length negotiations and represent (i) a compromise between the positions of the Per Capita Parties and the Per Stirpes Parties, and (ii) reflect the parties' assessments of the relative strengths of their positions.

We further conclude that the GGC Agreement is within the range of reasonable outcomes under the governing instruments and applicable State law. Accordingly, based on the facts submitted and representations made, we conclude that the terms of the GGC Agreement as described above, will not cause any of the beneficiaries to have made a taxable gift for purposes of the federal gift tax under § 2501.

Ruling 3: ESTATE TAX ISSUE

Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

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

Section 2035(a) provides that (1) if the decedent transferred an interest in property or relinquished a power with respect to any property, during the 3-year period ending on the date of death, and (2) the value of the property (or interest therein) would have been included in the gross estate under §§ 2036, 2037, 2038, or 2042 if the interest or power had been retained by the decedent on the date of death, then the value of the gross estate includes the value of the property (or interest) 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 the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period that does not in fact end before his death, (1) 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 from the property.

Section 2037(a) provides that the value of the gross estate includes the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate includes 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 fine 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, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power during the 3-year period ending on the date of the death.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property with respect to which the decedent possessed a general power of appointment at the time of death. Section 2041(b)(1) defines the term "general power of appointment" as 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.

In order for §§ 2035 through 2038 to apply, a decedent must have made a transfer of property or an interest therein (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property.

As discussed above, the GGC Agreement represents the resolution of a bona fide controversy between the parties. It is a settlement of bona fide issues and is the product of arm's length negotiations. It reflects the parties' assessments of the relative strengths of their positions. No great-grandchild (or deceased great-grandchild's descendants by representation) has made a transfer to the Stock Trust or to any other great-grandchild by reason of the settlement agreement. Accordingly, based upon the facts submitted and representations made, we conclude that the terms of the GGC Agreement will not cause any party to the agreement to have made a transfer within the meaning of §§ 2035 through 2038.

However, once the GGC Agreement becomes effective, any trust property actually distributed (or receivable by) a beneficiary (or his or her assignee) would generally be included in the beneficiary's federal transfer tax base. See, e.g., §§ 2033, 2041, 2501.

Ruling 4: INCOME TAX ISSUE

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 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) provides 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.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), addresses the issue of whether a sale or exchange that has taken place results in the 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. The Supreme Court in Cottage Savings, 499 U.S. at 560-61, 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.

In the present case, State Governing Statute A allows the court, for cause shown, to authorize the division of a trust into two separate trusts on such terms and conditions and with such notice as the court directs. In addition, State Governing Statute B gives trustees the power to distribute in cash or in kind or partly in each and allocate particular assets in proportionate or disproportionate shares.

In this case, the court order approving the GGC Agreement orders the division and distribution of the Stock Trust as set forth in the GGC Agreement. Accordingly, the court approved the non-pro rata distributions called for in the GGC Agreement and further authorized the trustees "to make the necessary transfers and assignments of the unconverted investment securities [t]herein awarded in kind." Accordingly, the submission concludes that the distribution scheme in this case is authorized by State law. We agree.

The Stock Trust will be divided into z trusts on a non pro-rata basis. Under the State statutes cited above, the court has the authority to authorize the trustees to make this type of non pro-rata apportionment. Thus, the proposed division and distribution of the Stock Trust assets among the z trusts will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries within the meaning of Cottage Savings. Accordingly, based upon the facts submitted and representations made, we conclude that the division of the Stock Trust into the z great-grandchildren's trusts will not result in the recognition of gain or loss under § 1001(a) by the Stock Trust, any beneficiary of the Stock Trust, or any separate great-grandchild's trust.

The rulings 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.

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.

Sincerely yours,

Leslie H. Finlow
Acting Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:
Copy for 6110 purposes