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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B04 – PLR-129842-11
Date:
January 06, 2012

Re:

Date 1 =
Date 2 =
Date 3 =
Grantor =
Trust =

State =
Trustees =
Divided Trust 1 =

Divided Trust 2 =

Divided Trust 3 =

Divided Trust 4 =

Child 1 =
Child 2 =
Child 3 =
Child 4 =
Court =
A =
B =
State Statute 1 =

State Statute 2 =
State Statute 3 =

Dear :

This is in response to correspondence, dated July 12, 2011, requesting rulings regarding the gift, estate, generation-skipping transfer (GST), and income tax consequences of a proposed division and modification of Trust.

The facts submitted and representations made are as follows. Grantor created an irrevocable trust, Trust, on Date 1, a date prior to September 25, 1985. Trust primarily benefits Grantor's issue, the spouses of his issue, and charitable beneficiaries. Trust is governed by the laws of State. Trustees have the absolute discretion to distribute assets among the individual beneficiaries in the applicable class as well as to charitable beneficiaries on an equal or unequal basis, to divide the trust, and to allocate assets on a pro rata or non-pro rata basis. The Trust Agreement provides as follows.

Section 3.02 provides that the payment of any benefits of income, principal or otherwise, will be vested in the sole discretion of the trustees. Any net income, capital gains or other proceeds or principal not paid to a beneficiary will be accumulated and added to principal. Payments among the members of a class of individual beneficiaries and charitable beneficiaries need not be equal either at the time of payment or at any future time and may be made to one, to all or to any number of members of the class determined by the trustees, in their sole discretion.

Section 3.03 provides that payments of income, principal or otherwise may be made to any one or more members of the lowest numbered classes of individual beneficiaries described in Section 3.03(1) which has one or more representatives then living and/or to any one or more members of the class of charitable beneficiaries described in Section 3.03(2).

Section 3.03(1) provides that the Class One potential individual beneficiaries consist of the issue of Grantor who are then living, all spouses of then living issue and all spouses the deceased issue of Grantor. Section 3.03(1) also provides for several other classes of potential individual beneficiaries. Classes Two through Four include certain relatives and spouses of those relatives. Class Five consists of any heirs-at-law of the last survivor of all members of Class One who leaves heirs then living.

Section 3.03(2) provides for named potential charitable beneficiaries as well as charitable beneficiaries consisting of corporations, associations and institutions which are described in § 501(c)(3).

Section 3.03(4) provides that the discretionary powers of distribution of principal and income shall be broad enough to permit complete distribution of all the trust assets at any time, and in the event final distribution should be determined on by the trustees or required under paragraph 4.01 or otherwise, distribution shall be made by the trustee to any or all members of the class of individual beneficiaries and charitable beneficiaries then eligible under the other provisions of Article 3, as determined by the trustees, in their sole discretion.

Section 4.01 provides that if Trust is not sooner terminated, Trust will terminate twenty-one years after the death of the survivor of all persons described as potential individual beneficiaries in all of Classes One through Four, as such persons would be determined on Date 1.

Paragraph 4.05 provides that all determinations to make, apply, withhold or accumulate any discretionary payments or distributions of income or principal from any trust hereunder shall be made only by the trustees then acting who are not “related or subordinate parties” as to the Grantor within the meaning of § 672(c) and who are not within the definition of individual beneficiaries and charitable beneficiaries eligible at the time of the determination. Further, any trustee, by written instrument, may disqualify himself with regard to the exercise of any power, duty, privilege, or discretion otherwise granted to or imposed upon him.

Article 5 authorizes Trustees to divide the trust and to allocate assets among divided trusts on a pro rata or non-pro rata basis. Specifically, section 5.04(9) authorizes Trustees “[t]o divide the trust, determining values and designating particular assets for my beneficiaries, to assign like or unlike properties to different beneficiaries or trusts, to create or hold undivided interests in any property of the trust, and to make distributions and payments in cash or in kind or both.”

Trustees are not beneficiaries of the trust. On Date 2, Court authorized Trustees to participate in a split-off transaction to provide shareholders of a closely-held corporation with a liquidity opportunity. The order authorized Trustees to exchange an amount of the Trust’s A stock for shares of B stock.

Upon receipt of a favorable private letter ruling, Trustees will divide Trust’s assets and liabilities into four shares. Subject to adjustment for prior distributions to certain individual beneficiaries, Trustees will divide Trust into four separate trusts; Divided Trust 1 for the benefit of Child 1, his spouse, his issue, and the spouses of his issue; Divided Trust 2 for the benefit of Child 2, her spouse, her issue, and the spouses of her issue; Divided Trust 3 for the benefit of Child 3, his spouse, his issue, and the spouses of his issue, and Divided Trust 4 for the benefit of Child 4, his spouse, his issue, and the spouses of his issue.

Trust's assets will be distributed to the Divided Trusts on a pro rata basis to the extent practical. Shares from the split-off will be distributed to the Divided Trusts on a strictly pro rata basis. Partnership interests held by Trust for the benefit of each child will be distributed to that child's Divided Trust.

Each of the Divided Trusts will be governed by a new trust agreement, the provisions of which are materially the same as the dispositive provisions of the Trust, except that each individual trust is for the benefit of that child, his spouse, his issue, and the spouses of his issue. Each Divided Trust will continue to provide for the remaining classes of beneficiaries, as provided for in the original trust.

If Grantor has additional children, Trustees of each Divided Trusts will distribute to a new trust for the new child's benefit a fraction of its assets and liabilities equal to one divided by the number of Divided Trusts plus one.

On Date 3, Court issued an order authorizing Trustees to effect the transaction described above, including the division of Trust on a pro rata or non-pro rata basis and the modification of Trust Agreement, subject to the receipt of a private letter ruling on each of the rulings requested.

It is represented that no additions have been made to trust after September 25, 1985.

You have requested the following rulings:

1. After the proposed division and modification of Trust, each Divided Trust will be exempt from the generation-skipping transfer tax.
2. The proposed division and modification of Trust will not cause any of Grantor's issue or any member of their respective family lines to be treated as having made any transfer subject to the gift tax.
3. The proposed division and modification of Trust will not cause any portion of the assets of each Divided Trust to be includible in the gross estate of any of the Grantor's issue or any member of their respective family lines.
4. The allocation of the assets and liabilities of Trust in the shares described, whether done on a pro rata or non-pro rata basis, will not cause Trust, Divided Trusts, Grantor's issue or any member of their respective family lines to recognize any ordinary income or loss or capital gain or loss.

5. The adjusted basis of the assets received by each Divided Trust will be the same as the respective adjusted basis of the assets held by Trust pursuant to § 1015 of the Internal Revenue Code.
6. The holding periods of the assets received by each Divided Trust will be the same as the holding periods of the assets in Trust pursuant to § 1223(2).

Ruling 1

Section 2601 imposes a tax on each generation-skipping transfer. Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 Act and § 26.2601-1(b)(1)(I) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the 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)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

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 will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its 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) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph (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 provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, considers a situation in which, 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.

State Statute 1 provides that the “trustee may, without the approval of any court, divide a trust, before or after it is funded, into two or more separate trusts if the trustee determines that dividing the trust is in the best interests of all persons interested in the trust and will not substantially impair the accomplishment of the trust purposes.”

Based on the facts presented and representations made, we conclude that the judicial division and modification of Trust, discussed above, will not shift any beneficial interest in 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 addition, the division and modification of Trust will not extend the time for vesting of any beneficial interest in Divided Trusts beyond the period provided for in the original trust.

Accordingly, based on the facts submitted and the representations made, if, under an order of Court and pursuant to State Statute 1, Trustees of Trust exercise their discretion to divide and modify Trust, the division and modification of Trust into Divided Trusts will not cause Divided Trusts to be subject to the generation-skipping transfer tax imposed by chapter 13.

Ruling 2

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 and full 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.

In this case, the beneficiaries of each Divided Trust will have substantially the same interests after the proposed division that they had as beneficiaries under Trust prior to the division. Because the beneficial interests, rights, and expectancies of the beneficiaries are substantially the same, both before and after the proposed division and modification, no transfer of property will be deemed to occur as a result of the division. Accordingly, based on the facts submitted and the representations made, we conclude that the division and modification of Trust, as described above, will not result in a transfer by any beneficiary of Trust or Divided Trusts that will be subject to federal gift tax under § 2501.

Ruling 3

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, the value of the gross estate shall include the value of any property (or interest therein

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.

In the present case, the distribution, management, and termination provisions of each Divided Trust will be substantially similar to the current distribution, management, and distribution provisions of Trust. Accordingly, based on the facts submitted and the representations made, the division and modification of Trust will not cause any property of Trust or Divided Trusts to be includible in the gross estate of any beneficiary of any such trust under § 2035, 2036, 2037, or 2038.

In addition, no beneficiary who is acting as a trustee has any power to participate in discretionary distributions of income or principal. Discretionary distributions can only be made by trustees who are not related or subordinate to Grantor. No beneficiary has a power to appoint trust assets to themselves, their estates, their creditors, or the creditors of their estates under either Trust or Divided Trusts. Accordingly, the proposed division and modification will not cause any portion of the assets of Divided Trusts to be includible in the gross estate.

Ruling 4

Section 61(a)(3) provides that gross income includes gains derived from dealings in property and, under § 61(a)(15), from an interest in a trust.

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 pursuant to state law 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. Thus, neither gain nor loss is realized on a partition.

State Statute 1 authorizes a trustee to divide any trust, whenever created, into two or more separate trusts if the trustee determines that dividing the trust is in the best interests of all persons interested in the trust and will not substantially impair the accomplishment of the purposes of the trust.

State Statute 3 authorizes trustees to distribute property and money in divided or undivided interests and adjust resulting differences in valuation.¹

Trustees have authority under Trust, State law, and Court order to divide Trust and to allocate assets on a pro rata or non-pro rata basis. The beneficiaries do not acquire their interest in Divided Trusts as a result of the exchange of their interests in Trust, but by reason of the trustees' exercise of their existing authority to allocate Trust assets on a pro rata or non-pro rata basis in further trust. The proposed transaction is analogous to the partition of a joint interest under Rev. Rul. 56-437.

The division of Trust and the allocation of Trust assets to each Divided Trust in approximately equal shares will not cause the recognition of ordinary income or loss or capital gain or loss by Trust, Divided Trusts, or the Grantor's issue or any member of their respective family lines.

Accordingly, based on the facts provided and the representations made, the allocation of the assets and liabilities of Trust, whether done on a pro rata or non-pro rata basis, will not cause Trust, Divided Trusts, the Grantor's issue or any member of their respective family line to recognize any ordinary income or loss or capital gain or loss under §§ 61 and 1001.

Rulings 5 and 6

¹ State Statute 2 provides that by a clear expression in a written instrument of the intention of the grantor, one or more of the powers in State Statute 3, as they exist at the time of the signing of the written instrument, may be incorporated by reference as though that language were set forth verbatim in the instrument. Because the Trust Agreement predates the adoption of State Statute 2, (which was enacted in 1989), it does not specifically incorporate State Statute 3 by reference. Nonetheless, the Trust Agreement expressly authorizes non-pro rata distributions and State Statute 2 reflects that State public policy is not inconsistent with non-pro rata in-kind distributions.

Section 1015(b) provides that if property is acquired after December 31, 1920, by a transfer in trust (other than a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on such transfer.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by transfer in trust by gift, bequest, or devise), the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether the property is in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Section 1223(2) provides that in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which the property was held by any other person, if under Chapter 1 of the Code such property has, for the purposes of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person.

Based on the facts submitted and representations made, we conclude that because § 1001 does not apply to the division of Trust, under § 1015, the basis of the assets received by each Divided Trust from Trust will be the same after the division as the basis of those assets in the hands of Trust before the division. Likewise, the holding period of each Divided Trust in each asset received from Trust will include the holding period of Trust in that asset.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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 who requested it. Section 6110(k)(3) 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 yours,

Lorraine E. Gardner, Senior Counsel
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy for section 6110 purposes

cc: