Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201238004**
Release Date: 9/21/2012

Index Number: 61.00-00, 643.00-00, 661.00-00, 1001.00-00, 1015.00-00, 2033.00-00, 2035.00-00, 2036.00-00, 2037.00-00, 2038.00-00, 2601.04-01

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

Refer Reply To:
CC:PSI:B04
PLR-100664-12
Date:
June 15, 2012

Re:

LEGEND

Trust =

Settlor =
Son =
Daughter =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Grandchild 5 =
Grandchild 6 =
Grandchild 7 =
Grandchild 8 =
Trustees =
Date 1 =
Date 2 =
State =
Court =

Dear :

This letter responds to a letter from your authorized representative dated December 20, 2011, and subsequent correspondence, requesting rulings on the income, gift, generation-skipping transfer (GST), and estate tax consequences resulting from the proposed division of a trust.

You represent the facts to be as follows. On Date 1, Settlor created an irrevocable trust, Trust, for the benefit of Settlor's two children and their issue. Settlor's son, Son, has four minor children, Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4. Settlor's daughter, Daughter, has four minor children, Grandchild 5, Grandchild 6, Grandchild 7, and Grandchild 8. Date 1 is a date after September 25, 1985. You represent that Settlor allocated Settlor's GST exemption to Trust and that Trust has an inclusion ratio of zero. Trust is governed by the laws of State. Trustees currently serve as trustees of Trust.

Article 4, § 4.1 of Trust provides Trustees with the power to distribute to the beneficiaries, in equal or unequal proportions, as much of Trust's net income and principal as Trustees deem advisable for the support of Settlor's descendants, with priority to be given to distributions to Son and Daughter over distributions to Settlor's other descendants. Section 4.3 provides that, upon Settlor's death, Trust assets are to be divided into equal shares for each of Settlor's then living children and one such share for the then living descendants of each deceased child of Settlor. Article 7, § 7.6 provides that Trustees shall have the power to divide Trust into two or more trusts.

Due to the differing economic needs of Son and Daughter, Trustees have found it difficult to invest and administer Trust as a single trust. Trustees propose dividing Trust into two separate trusts, one trust for Son and Son's descendants and one trust for Daughter and Daughter's descendants. Each resulting trust will be funded with one-half of each asset currently held by Trust and each resulting trust will be subject to the same terms and conditions as Trust. Settlor is still living and has consented to the proposed division of Trust.

Trustees petitioned Court to divide Trust and, on Date 2, Court issued an Order granting the petition to divide Trust. Court's Order is contingent on receipt of a favorable private letter ruling from the Internal Revenue Service.

You have requested the following rulings:

1. The division of Trust constitutes a qualified severance as described in § 26.2642-6 and therefore the division of Trust will not affect the GST tax inclusion ratio of Trust or cause any distributions from or termination of any interest in Trust or any of the two resulting trusts to be subject to the GST tax.

2. The division of Trust will not result in a taxable gift to any Trust beneficiary for federal gift tax purposes.

3. The division of Trust will not cause any portion of Trust or the resulting trusts to be includible in a beneficiary's gross estate under § 2036, 2037 or 2038.

4. After the division of Trust, each resulting trust will be treated as a separate taxpayer under § 643(f).

5. The division of Trust to create the resulting trusts is not a distribution under § 661 or § 1.661(a)-2(f).

6. The division of Trust does not result in the realization of income, gain or loss under § 61 or 1001 to Trust or any Trust beneficiary, and the holding period of the assets that the resulting trusts receive from Trust includes the period that Trust held those assets.

7. After the division of Trust, the basis of the assets in the resulting trusts will be the same as the basis of the assets in Trust.

Ruling No. 1

Section 2601 of the Internal Revenue Code imposes a tax on every GST which is defined under § 2611(a) as a taxable distribution, a taxable termination, and a direct skip.

Section 2642(a)(1) provides that the inclusion ratio with respect to any property transferred in a GST is the excess (if any) of one over the "applicable fraction" determined for the trust from which the transfer is made.

Section 2642(a)(2) provides that the applicable fraction is a fraction the numerator of which is the amount of the GST exemption allocated to the trust and the denominator of which is the value of the property transferred to the trust, reduced by the sum of the federal estate tax or state death tax actually recovered from the trust attributable to such property and any charitable deduction allowed under § 2055 or 2522 with respect to such property.

Section 2631(a), as in effect for decedents dying and generation-skipping transfers before January 1, 2004, provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of $1,000,000 (adjusted for inflation under § 2631(c)) which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a) provides that any allocation by an individual of his GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Section 2642(a)(3)(A) provides that if a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of the GST tax.

Section 2642(a)(3)(B) provides that the term “qualified severance” means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of two or more trusts if: (1) the single trust was divided on a fractional basis, and (2) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

Section 2642(a)(3)(C) provides that a severance pursuant to § 2642(a)(3) may be made at any time.

Section 26.2642-6(d) of the Generation-Skipping Transfer Tax Regulations provides that a qualified severance must satisfy each of the following requirements:

(1) The single trust is severed pursuant to the terms of the governing instrument or pursuant to applicable local law.

(2) The severance is effective under local law.

(3) The date of the severance is either the date selected by the trustee as of which the trust assets are to be valued in order to determine the funding of the resulting trusts, or the court-imposed date of funding in the case of an order of the local court with jurisdiction over the trust ordering the trustee to fund the resulting trusts on or as of a specific date. For a date to satisfy the definition in the preceding sentence, however, the funding must be commenced immediately upon, and funding must occur within a reasonable time (but in no event more than 90 days) after, the selected valuation date.

(4) The single trust (original trust) is severed on a fractional basis, such that each new trust (resulting trust) is funded with a fraction or percentage of the original trust, and the sum of those fractions or percentages is one or one hundred percent, respectively. For this purpose, the fraction or percentage may be determined by means of a formula (for example, that fraction of the trust the numerator of which is equal to the transferor's unused GST exemption, and the denominator of which is the fair market value of the original trust's assets on the date of severance). The severance of a trust based on a pecuniary amount does not satisfy this requirement. For example, the severance of a trust is not a qualified severance if the trust is divided into two trusts, with one trust to be funded with $1,500,000 and the other

trust to be funded with the balance of the original trust's assets. With respect to the particular assets to be distributed to each resulting trust, each resulting trust may be funded with the appropriate fraction or percentage (pro rata portion) of each asset held by the original trust. Alternatively, the assets may be divided among the resulting trusts on a non-pro rata basis, based on the fair market value of the assets on the date of severance. However, if a resulting trust is funded on a non-pro rata basis, each asset received by a resulting trust must be valued, solely for funding purposes, by multiplying the fair market value of the asset held in the original trust as of the date of severance by the fraction or percentage of that asset received by that resulting trust. Thus, the assets must be valued without taking into account any discount or premium arising from the severance, for example, any valuation discounts that might arise because the resulting trust received less than the entire interest held by the original trust.

(5) The terms of the resulting trusts must provide, in the aggregate, for the same succession of interests of beneficiaries as are provided in the original trust. This requirement is satisfied if the beneficiaries of the separate resulting trusts and the interests of the beneficiaries with respect to the separate trusts, when the separate trusts are viewed collectively, are the same as the beneficiaries and their respective beneficial interests with respect to the original trust before the severance. With respect to trusts from which discretionary distributions may be made to any one or more beneficiaries on a non-pro rata basis, this requirement is satisfied if—

(i) The terms of each of the resulting trusts are the same as the terms of the original trust (even though each permissible distributee of the original trust is not a beneficiary of all of the resulting trusts);

(ii) Each beneficiary's interest in the resulting trusts (collectively) equals the beneficiary's interest in the original trust, determined by the terms of the trust instrument or, if none, on a per-capita basis. For example, in the case of the severance of a discretionary trust established for the benefit of A, B, and C and their descendants with the remainder to be divided equally among those three families, this requirement is satisfied if the trust is divided into three separate trusts of equal value with one trust established for the benefit of A and A's descendants, one trust for the benefit of B and B's descendants, and one trust for the benefit of C and C's descendants;

(iii) The severance does not shift a beneficial interest in the trust to any beneficiary in a lower generation (as determined under § 2651) than the person or persons who held the beneficial interest in the original trust; and

(iv) The severance does not extend the time for the vesting of any beneficial interest in the trust beyond the period provided for in (or applicable to) the original trust.

(6) In the case of a qualified severance of a trust with an inclusion ratio defined in § 26.2642-1 of either one or zero, each trust resulting from the severance will have an inclusion ratio equal to the inclusion ratio of the original trust.

In this case, you represent that Settlor's GST exemption was allocated to Trust and that Trust has an inclusion ratio of zero. It is represented that Trust will be severed in accordance with the governing instrument and applicable State law. Trust will be severed on a fractional basis, and each resulting trust will be funded pro-rata with one-half of each of the assets held by Trust. The resulting trusts will provide for the same succession of interests and beneficiaries as are provided in the original trust instrument. The proposed severance does not shift a beneficial interest in Trust to any beneficiary in a lower generation (as determined under § 2651) than the person or persons who held the beneficial interest in Trust prior to the severance. Further, the proposed severance does not extend the time for the vesting of any beneficial interest in Trust beyond the period provided for in (or applicable to) the original trust instrument.

Accordingly, based on the facts presented and the representations made, we conclude that the proposed division of Trust constitutes a qualified severance as described in § 26.2642-6. The two resulting trusts will be treated as separate trusts for purposes of the GST tax. Pursuant to § 26.2642-6(d)(6), because Trust has an inclusion ratio of zero, each resulting trust will have an inclusion ratio of zero. Accordingly, based on the facts presented and the representations made, the proposed division will not cause any distributions from or termination of any interest in Trust or in any of the resulting trusts to be subject to the GST tax.

Ruling No. 2

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

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.

Following the division of Trust into the resulting trusts, each beneficiary has the same rights to the same property as the beneficiary did prior to the division of Trust, and no other individual has any additional rights with respect to the income or corpus of Trust. Therefore, no transfer of property is deemed to occur as a result of the division of Trust into the resulting trusts. Accordingly, the proposed division does not result in a taxable gift for federal gift tax purposes by any beneficiary of Trust.

Ruling No. 3

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 his 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 the decedent's 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 any property (or interest therein) that would have been so included. Under § 2035(b), the gross estate shall be increased by the amount of any gift tax paid by the decedent or his estate on any gift made by the decedent or his spouse during the three year period ending on the date of decedent's death.

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 the 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 decedent's death.

In order for §§ 2035 through 2038 to apply, a decedent must have made a transfer of property or any 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.

In the present case, the proposed division of Trust does not constitute a transfer by any beneficiary within the meaning of §§ 2035 through 2038. The beneficiaries of the resulting trusts have the same interests after the division as they had prior to the division. We therefore conclude that the division does not cause any of the value of Trust, or the resulting trusts, to be includible in any beneficiary's estate under § 2033, 2036, 2037, or 2038.

Ruling No. 4

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.

Upon division, the resulting trusts will each have different beneficiaries. Therefore, based solely on the facts and representations submitted, we conclude that the resulting trusts will be treated as separate taxpayers for federal income tax purposes.

Ruling No. 5

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 the resulting trusts is not a distribution under § 661 or § 1.661(a)-2(f).

Ruling No. 6

Section 61(a)(3) provides that gross income includes gain 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) provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for cash or 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, holds that the conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature and the partition of a joint tenancy in stock are not sales or exchanges. Similarly, divisions of trusts are also not sales or exchanges of trust interests where each asset is divided pro rata among the new trusts. *See* Rev. Rul. 69-486, 1969-2 C.B. 159 (pro rata distribution of trust assets not a sale or exchange).

In this case, Trust's assets will be distributed equally between the resulting trusts. Each new trust contains a proportionate share of the assets of Trust equal to the beneficial interest of each beneficiary in Trust's assets. Accordingly, the modification and severance of Trust does not result in the realization of gain or loss under §§ 61 and 1001. In addition, because the modification and severance of Trust is not a taxable event under § 1001, the holding period of the assets that the resulting trusts receive from Trust include the period that Trust held those assets.

Ruling No. 7

Section 1015(b) provides that if property is acquired by a gift, the basis is the same as it would be in the hands of the donor, except that if such basis (adjusted for the period before the date of the gift under § 1016) is greater than the fair market value of the property at the time of the gift, then for purposes of determining loss the basis shall be such fair market value.

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 the 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 upon such transfer 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 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 § 61 nor § 1001 applies to the proposed division, the basis of the assets in each resulting trust are the same as the basis of the assets in Trust.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statements executed by the appropriate parties. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

This ruling is directed only to the taxpayers 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 ruling is being sent to your authorized representative.

Sincerely yours,

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

Enclosure
Copy for section 6110 purposes

cc: