

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
December 22, 1999

LEGEND:

Trust =

Decedent =

a =

b =

c =

d =

e =

f =

g =

h =

i =

Grandson 1 =

Granddaughter 1 =

Grandson 2 =

Granddaughter 2 =

j =

Court =

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k =

l =

Company =

Dear Sir or Madam:

In a letter, dated June 1, 1999, you requested rulings concerning the income and generation-skipping transfer (GST) tax consequences of dividing the Trust, a grandfathered trust. This letter responds to your request.

The information submitted and the representations made are summarized as follows: The Trust was created under Article Ninth of Decedent's will, dated a, as amended by a First Codicil, dated b, and as further amended by a Second Codicil, dated c. Decedent's will was admitted to probate on d.

Article Ninth of Decedent's will provides that the Trust is to continue during the lives of Decedent's wife (Spouse) and of all of those descendants of Decedent who are living at the time of Decedent's death and for e years after the death of that one of those descendants of Decedent living at the time of Decedent's death who dies last (unless prior to the expiration of the e years, Decedent's issue becomes extinct, in which event the Trust term is to terminate upon the extinction of the issue or upon Spouse's death, whichever event happens last).

Article Ninth, Paragraph 1 of Decedent's will provides that if Spouse is living and if and whenever there is no issue of Decedent living, the trustees are to pay over quarterly, or more often if convenient, all of the net income of the Trust to Spouse

Article Ninth, Paragraph 2 of Decedent's will provides that if Spouse is living and there is any issue of Decedent living, the trustees are to pay over f of the net income to Spouse and are to pay the remaining g, and if and whenever Spouse is dead and there is issue of Decedent living all the net income during the continuance of the Trust, as follows:

(a) if and as long as both Decedent's children are living in equal shares between them;

(b) if and when one child only is living and there is no issue of the deceased child living, to the living child;

(c) if and whenever either child of Decedent is dead, leaving issue then living and the other child is living, to divide the income so to be paid into as many

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shares as there are from time to time grandchildren of Decedent living or deceased leaving issue then living, and so to pay over to Decedent's living children as many of the shares as there are from time to time children of the child living or deceased leaving issue then living, or $\frac{1}{2}$ of the income, whichever amount is greater, and to pay the remainder of the income in equal shares to and among the children of the deceased child of Decedent from time to time living and the issue by right of representation from time to time living of any deceased child of the deceased child of Decedent.

(d) if and whenever neither of Decedent's children is living, then to pay the income in equal shares to and among all Decedent's grandchildren *per capita* and not *per stirpes* from time to time living and the issue by right of representation from time to time living of any deceased grandchild.

Paragraph 2 of Article Ninth of Decedent's will further provides that any sums that would be payable under clauses (c) and (d) of Section 2 of Article Ninth of Decedent's will to any minor are to be applied by the trustees to the maintenance, education, and support of the minor in such manner as they from time to time think fit, with power in their discretion to withhold any income not in their judgment necessary or desirable to be so used and accumulate the same and thereafter in their discretion so to use the same or pay to over to the minor when of age or to hold and deal with the same as hereinafter provided in Paragraph 10 of Article Ninth of Decedent's will with the same powers and discretion.

Paragraph 4 Article Ninth of Decedent's will provides that $\frac{1}{2}$ years after the death of Spouse or of that one of Decedent's lineal descendants living at the time of Decedent's death who dies last, whichever event last occurs, after making provision for the support of any annuity or annuities charged on the Trust not then fallen, the trustees are to pay over and distribute the principal then remaining of the Trust fund together with any accumulations of income therefrom then in their hands, to and among Decedent's grandchildren then living and the issue then living of all grandchildren then dead leaving issue, each grandchild to take an equal share *per capita* and not *per stirpes*, and the issue then living of each deceased grandchild to take by right of representation the share that the deceased grandchild would have taken if then living.

Article Ninth, Paragraph 9 of Decedent's will provides that in case and whenever any child or more remote issue of Decedent dies leaving issue to whom any income is payable and also leaving a surviving husband or wife, the trustees have the uncontrolled discretion, to be exercised from time to time, to pay as long as they think fit to the surviving husband or wife during his or her life or until the termination of the Trust any part not exceeding $\frac{1}{2}$ of the net income from time to time payable to the issue of the deceased.

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Paragraph 10 of Article Ninth of Decedent's will authorizes the trustees in their discretion to accumulate such part as they from time to time think fit of any income at any time payable under Decedent's will to a person under e years of age. Any income so accumulated is to be held for the benefit of the particular person who was entitled to the income, and on his or her death for the benefit of the person or persons who become entitled to the share that the individual would have received if living, and the net income of any such accumulation is to be paid accordingly. On the final distribution, the accumulation is to be paid over to the person or persons to whom the income thereof is then payable. The trustees further are authorized as to any income accumulated, at their discretion, at any time or from time to time thereafter to pay all or that part or parts as they think fit of the accumulation to or for the benefit of the person or persons to whom the income thereof is at the time payable.

Article Ninth, Paragraph 12 of Decedent's will authorizes the trustees, subject to the approval of Spouse, if living and competent to act, and otherwise in their discretion, or at Spouse's request in writing if they approve the request, anything contained in the Trust notwithstanding, after any child or more remote issue of Decedent to whom any income is for the time being payable, has reached the age of e years, to pay to him or her that part of the principal as in the opinion of the trustees is necessary for the comfortable maintenance and support of that person, and to make the payments whenever and as often as in their opinion the circumstances require. Any payments made under the provisions of this paragraph are to be charged against and deducted from that share of the principal to the income of which the beneficiary is then entitled, and in no event is to exceed in the aggregate that proportionate part of the fund the income of which at the time the advance is made is payable to or for the benefit of the beneficiary, nor exceed in the aggregate i. After each such advance, the proportion of the income of the Trust payable to or for the benefit of the beneficiary is to be reduced according to the proportion that the amount paid bears to the whole fund.

Spouse and Decedent's children are deceased. There currently are 3 grandchildren of Decedent surviving, Grandson 1, Granddaughter 1, and Grandson 2. Decedent's fourth grandchild, Granddaughter 2 recently died survived by j children. The principal of the Trust currently is being held for the benefit of Grandson 1, Granddaughter 1, Grandson 2, and the children of Granddaughter 2.

Granddaughter 1, Grandson 2, and the children Granddaughter 2 all reside in the United States, while Grandson 1 and his issue reside abroad. There has been disagreement among the beneficiaries residing in the United States and the beneficiaries residing outside of the United States as to the management of the Trust assets. Granddaughter 1, who currently serves as the individual co-trustee of the Trust wishes to resign. Although Granddaughter 1, Grandson 2, and the children of Granddaughter 2 desire that an individual trustee continue to act with the corporate trustee, Grandson 1 and his issue do not wish an American individual to administer assets held for their benefit. In order to resolve this disagreement, the trustees have

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petitioned the Court to divide the Trust into two separate trusts: (1) Trust A for the benefit of Granddaughter 1 and her issue, Grandson 2 and his issue, and the children of Granddaughter 2 and their issue; and (2) Trust B for the benefit of Grandson 1 and his issue.

Trust A will receive k of the principal and accrued income of the Trust on the date of the division and Trust B will receive the remaining l. The division of the assets will be based on the fair market value of the assets on the date of division. The division of assets will be made pro rata to the extent possible. Where a pro rata division is not possible, the asset or assets will be sold and the proceeds divided pro rata.

Trust A and Trust B will be administered under the terms of Article Ninth of Decedent's will, except that the income and principal of Trust A will be payable solely to and among Granddaughter 1 and her issue, Grandson 2 and his issue, and the children of Granddaughter 2 (who will receive collectively the income previously payable to Granddaughter 2) and their issue. The income and principal of Trust B will be payable solely to and among Grandson 1 and his issue. In the event that prior to termination there is a failure of issue in any one of the four lines of descent, the share of the principal allocable to that line will be reallocated pro rata for the benefit of the surviving members of the other three lines of descent. Each of Trust A and Trust B will terminate e years after the death of the survivor of the issue of Decedent who were living at his death.

The Company, the current corporate trustee of the Trust, will continue to serve as a trustee of Trust A and Trust B. Granddaughter 1 will resign as individual co-trustee. The trustees have petitioned the Court to have a new individual co-trustee appointed for Trust A. No co-trustee will be appointed to act with the Company as trustee of Trust B.

It is represented that the terms of the Trust have never been modified and no additions (Actual or constructive) have been made to it since its initial funding

You have requested the following rulings:

1. The Trust is not subject to the GST tax pursuant to § 1433(b)(2)(A) of the Tax Reform Act of 1986.

2. The proposed division of the Trust into Trust A and Trust B will not cause either Trust A or Trust B, or future distributions from Trust A or Trust B, to be subject to the GST tax.

3. Granddaughter's resignation as co-trustee, the appointment of a new individual co-trustee for Trust A, and the appointment of no individual co-trustee for Trust B will not cause Trust A or Trust B to be subject to the GST tax.

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4. The proposed division of the Trust into Trust A and Trust B will not result in the realization of gain or loss under § 1001 of the Internal Revenue Code.

Rulings No. 1, 2, and 3:

Section 2601 imposes a tax on every generation-skipping transfer made by the "transferor" to a "skip-person."

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that the tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a *pro rata* portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust.

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 26.2611-1 provides that a generation-skipping transfer is an event that is either a direct skip, a taxable distribution, or a taxable termination. The determination as to whether an event is a generation-skipping transfer is made by reference to the most recent transfer subject to the estate or gift tax.

Section 2612(c)(1) defines the term "direct skip" to mean a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613(a) defines the term "skip person" to mean --

(1) a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor, or

(2) a trust --

(A) if all interests in such trust are held by skip persons, or

(B) if --

(i) there is no person holding an interest in the trust, and

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(ii) at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

The Trust is a generation-skipping trust because it provides for distributions to more than one generation of beneficiaries below Decedent's generation. The Trust, however, has been exempt from the GST tax pursuant to § 26.2601-1(b)(1)(i) because it was irrevocable on September 25, 1985, and there have been no additions to it since that date. You have requested a ruling that the proposed division of the Trust into Trust A and Trust B will not cause either Trust A or Trust B, or future distributions from Trust A or Trust B, to be subject to the GST tax. In addition, you have requested a ruling that the resignation of the co-trustee, the appointment of a new individual co-trustee for Trust A, and the appointment of no individual co-trustee for Trust B will not cause Trust A or Trust B to be subject to the GST tax.

An amendment to an exempt trust that modifies or otherwise changes the quality, value, or timing of any of the powers, or beneficial interests, rights, or expectancies originally provided under the terms of the trust will cause the trust to lose its exemption from the GST tax. A trust's exemption from the GST tax is not affected, however, by amendments relating to the administration of a trust.

Based on the information submitted and the representations made, we conclude that the interests of the income beneficiaries under the proposed division of the Trust into Trust A and Trust B, will remain the same. In addition, the timing of the termination of Trust A and Trust B will remain the same. Consequently, the value of the income or corpus interest of each beneficiary will not change materially as a result of the division of the Trust. Therefore, the proposed division of the Trust into Trust A and Trust B will not change the quality, value, or timing of any powers, beneficial interests, rights, or expectancies originally provided for under the terms of the Trust. In addition, the resignation of the co-trustee, the appointment of a new individual co-trustee for Trust A, and the appointment of no individual co-trustee for Trust B relate to the administration of the Trust and will not modify or otherwise change the quality, value, or timing of any of the powers, beneficial interests, rights, or expectancies originally provided under the terms of the Trust. Accordingly, the proposed division of the Trust into Trust A and Trust B will not cause either Trust A or Trust B, or future distributions from Trust A or Trust B, to be subject to the GST tax.

We further conclude that the resignation of the co-trustee, the appointment of a new individual co-trustee for Trust A, and the appointment of no individual co-trustee for Trust B relate to the administration of Trusts and, therefore, will not cause Trust A or Trust B to be subject to the GST tax.

Ruling No. 4:

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Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

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 extent is treated as income or loss sustained.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), concerns whether a sale or exchange results in realization of gain or loss under § 1001. In that case, 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 mortgage loans were considered "substantially identical" by the agency that regulated the financial institution. The Supreme Court 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 a sense that is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. 499 U.S. at 564-565. The Court held that mortgage loans made to different obligors and secured by different homes embodied distinct legal entitlements and, therefore, that the taxpayer realized losses when it exchanged the loans. Id. at 566.

In this case, there is no material difference between the interests of the Grandchildren or their issue before and after the proposed division because, after they exchange their interests in the Trust for interests in Trust A or Trust B, they will not enjoy any legal entitlements that are different in kind or extent from before the exchange. Under the terms of the Trusts both before and after the exchange, all of the income of the trust property is payable in equal shares to the Decedent's grandchildren or their issue per capita. Similarly, both before and after the exchange, the principal is to be paid over in equal shares per capita to the Decedent's grandchildren or their issue e years after the death of the survivor of Spouse or Decedent's descendants living on the date of the Decedent's death. Moreover, if there is a failure of one line of descent before Trust A and Trust B terminate, the share of principal allocable to the failed line will be reallocated pro rata to the other three lines of descent.

In addition, the trustees plan to distribute the assets to Trust A and Trust B on a pro rata basis, but where this is not possible the Trustees may distribute some of the assets on a non-pro rata basis. Because the terms of the Trust give the trustees power

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to make non-pro rata distributions, the proposed transaction will not be treated as pro rata distributions followed by an exchange of assets among the beneficiaries. Compare Rev. Rul. 69-486, 1969-2 C.B. 159.

Therefore, based on the information submitted and the representations made, we conclude the proposed division of the Trust into Trust A and Trust B will not result in the realization of gain or loss to any of the trusts or beneficiaries under § 1001.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code.

This letter ruling is directed only to the taxpayer who requested it. Section 6110(j)(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,
Joseph H. Makurath
Senior Technician Reviewer, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)