

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:7 / PLR-116064-99
Date:
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Legend

- Trust 1 =
- Trust 2 =
- Grantor =
- Year 1 =
- Year 2 =
- Trustee =
- Grandson =
- Year 3 =
- Date 4 =
- Great-Grandchild 1 =
- Great-Grandchild 2 =
- Great-Grandchild 3 =
- State =

Dear Sir:

We received your letter, dated September 27, 1999, requesting rulings on the proper income, gift and generation-skipping transfer (GST) tax treatment of the proposed partition of a trust into separate trusts. This letter responds to your request.

You represent that Trust 1 was established under paragraph B of Item VI of the Last Will and Testament ("Will") of Grantor who died in Year 1. In Year 2, pursuant to a court order, Trust 1 was divided into three separate trusts, one of which is Trust 2. The Internal Revenue Service issued a private letter ruling to Trustee, in its capacity as

PLR-116064-99

trustee of Trust 1, concerning the income and GST tax consequences of the division of Trust 1. The letter ruling determined that the division of Trust 1 into separate trusts would not cause the separate trusts to lose their exempt status for GST tax purposes. The letter ruling also determined that non-pro rata distributions from Trust 1 to the separate trusts would be treated as a pro rata distribution from Trust 1 followed by an exchange between the trustees of the new trusts subject to § 1001.

Pursuant to the court order, Trust 2 is administered as a single fund under paragraph B of Item VI of the Will as applied separately to Trust 2. In accordance with subparagraph (3) of paragraph B of Item VI of the Will, Trust 2 will terminate twenty-one years after the death of the last of Grantor's daughters. During the twenty-one year period, the Trustee shall pay the net income from the trust over to the children of the Grantor's deceased daughters, per capita, with the share of the income of any deceased child of one of Grantor's daughters being distributed per stirpes to the children of the deceased grandchild of Grantor. In addition, subparagraph (4) of that paragraph states that twenty-one years after the death of the last survivor of Grantor's daughters the Trustee shall convey the corpus of the trust, share and share alike, to the then living children of Grantor's deceased daughters, with the children then living of any then deceased grandchild taking per stirpes its parent's share.

Grantor's last surviving daughter died in Year 3. Under the terms of Grantor's Will, Trust 2 will terminate on Date 4.

At the time of the court order dividing Trust 1 into three separate trusts, Grandson was the sole income beneficiary of Trust 2. When Grandson died, his three children, Great-Grandchild 1, Great-Grandchild 2 and Great-Grandchild 3 (individually an "Income Beneficiary" and collectively the "Income Beneficiaries"), succeeded to Grandson's interest in Trust 2. Income from Trust 2 is currently distributed equally to the three Income Beneficiaries. Upon termination, the assets of Trust 2 will be distributed as required in Paragraph B(4) of Item VI of the Will to Great-Grandchild 1, Great-Grandchild 2 and Great-Grandchild 3 in accordance with Grantor's Will.

The three Income Beneficiaries have different financial needs and investment objectives. The Trustee cannot implement one investment program for Trust 2 to meet these different financial objectives. This inability to satisfy the investment objectives of each Income Beneficiary separately is causing conflict among the beneficiaries. This conflict is likely to exacerbate if Trust 2 continues to be managed as a single fund. At the request of the Income Beneficiaries, Trustee has filed a petition in the appropriate court seeking permission to partition Trust 2 into three separate equal trusts (the "Separate Trusts"), one for each Income Beneficiary. The partition will permit the Trustee to pursue different investment objectives for each Separate Trust.

Each Separate Trust will be of equal value and shall have terms identical to the terms of Trust 2, except that the beneficial interests in each Separate Trust will be determined by the family lineage of the Income Beneficiary with respect to whom the

PLR-116064-99

Separate Trust is established. Each Separate Trust will be separately managed and administered. Each Separate Trust will terminate on Date 4. Except as remote contingent beneficiaries under subparagraph (5) of paragraph B of Item VI of the Will, the Income Beneficiaries and their respective descendants will have no interest in a Separate Trust established in respect of another Income Beneficiary. Most of the assets in Trust 2 will be divided among the Separate Trusts on a pro rata basis. To the extent necessary to assure that each separate trust receives equal value, there will be an immaterial non-pro rata division of assets in Trust 2. The three Separate Trusts may pursue different investment objectives.

Neither the Will nor State law grants the Trustee power to make non-pro rata distributions from Trust 2. However, the court before which the petition seeking permission to divide Trust 2 is pending is a court of general jurisdiction in State with equity jurisdiction, and the court has the power to divide Trust 2 on a non-pro rata basis.

You represent that no additions, actual or constructive, have been made to Trust 2 after September 25, 1985.

You have requested the following rulings:

(1) The partition of Trust 2 into three Separate Trusts and the division of Trust 2 assets among the Separate Trusts will not cause Trust 2 or the Separate Trusts to lose their exempt status for GST tax purposes and will not subject Trust 2, the Separate Trusts, or distributions from any such Trust to the GST tax under § 2601;

(2) The partition of Trust 2 into three Separate Trusts and the division of Trust 2 assets among the Separate Trusts will not be a transfer by the Income Beneficiaries that will be subject to gift tax under § 2501;

(3) To the extent that the division of Trust 2 assets among the Separate Trusts is made on a pro rata basis, the division will not be considered a sale, exchange, or other disposition of property and will not cause Trust 2, the Separate Trusts, or any of the Income Beneficiaries to realize gain or loss under § 1001 and will not cause Trust 2, the Separate Trusts, or any of the Income Beneficiaries to realize income under § 61;

(4) After the partition of Trust 2 into three Separate Trusts, each of the Separate Trusts will be treated as a separate taxpayer under § 643(f); and

(5) After the partition of Trust 2 into three Separate Trusts, the assets of the

Separate Trusts received from Trust 2 will have the same basis and same holding periods as such assets had in Trust 2.

Ruling Request 1.

PLR-116064-99

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term “generation-skipping transfer” to include a taxable distribution, taxable termination, and a direct skip.

Section 2612(a)(1) provides that the term “taxable termination” means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that the term “taxable distribution” means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Section 2612(c) provides that the term “direct skip” means a transfer subject to a tax imposed by Chapters 11 or 12 of an interest in property to a skip person.

Section 2613(a) defines the term “skip person” as (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 if all interests in the trust are held by skip persons, or if there is no person holding an interest in such trust, and at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 2613(b) provides that, for purposes of the GST tax, the term “non-skip person” means any person who is not a skip person.

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that the generation-skipping transfer 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(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust.

An amendment to a trust, which was irrevocable on September 25, 1985, and thus, is exempt from the GST tax, will cause the trust to lose its exemption if the amendment modifies or otherwise changes the quality, value or timing of any of the powers, beneficial interests, rights, or expectancies originally provided under the terms of the trust. A trust’s exemption from the GST tax is not affected, however, by amendments relating to the administration of the trust.

PLR-116064-99

Based on the information submitted and the representations made, Trust 2 is a generation-skipping trust because it provides for distributions to more than one generation of beneficiaries below the grantor's generation. Trust 2 was irrevocable on September 25, 1985 and there have been no additions, actual or constructive, since that date. Therefore, Trust 2 is exempt from the GST tax pursuant to § 26.2601-1(b)(1)(i).

Based on the information submitted and the representations made, we conclude that the proposed partition of Trust 2 relates 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 **Trust 2**. Thus, the proposed partition of Trust 2 will not affect the exempt status of the trust for purposes of Chapter 13. Accordingly, neither distributions to skip persons nor terminations of interests of non-skip persons will be subject to the GST tax.

Ruling Request 2.

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

Section 2511(a) provides that the tax imposed by section 2501 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 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 adequate and full consideration in money or in money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

Based on the information submitted and the representations made, we conclude that the partition of Trust 2 will not result in a transfer by any beneficiary of Trust 2 that is subject to the gift tax under § 2501.

Ruling Request 3.

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.

PLR-116064-99

Section 1.1001-1(a) of the Income Tax Regulations provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

In Rev. Rul. 69-486, 1969-2 C.B. 159, distinguished by, Rev. Rul. 83-61, 1983-1 C.B. 78, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries and was subject to the provisions of § 1001 and § 1002 of the Code.

The present case is distinguishable from Rev. Rul. 69-486 to the extent that assets of Trust 2 are divided on a pro rata basis. To the extent that the assets are divided on a non-pro rata basis, such distribution will be treated in accordance with Rev. Rul. 69-486.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991) concerns the issue of when a sale or exchange has taken place that results in realization of gain or loss under § 1001 of the Code. 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 of the regulations 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. In Cottage Savings, 499 U.S. at 566, 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.

To the extent that Trust 2 is divided into the Separate Trusts, it is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the three Separate Trusts will not differ materially from their interests in Trust 2, because the beneficiaries will have the same rights and entitlements under the Separate Trusts that they had under Trust 2. The proposed transaction will not change the interests of the beneficiaries. Instead, the beneficiaries will be entitled to the same benefits after the proposed transaction as before. The three Separate Trusts will

PLR-116064-99

terminate on the same date that Trust 2 would terminate. As with Trust 2, income distributions will be made in accordance with Grantor's Will. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries. Further, to the extent that the assets are divided on a pro rata basis the distribution of the assets to the Separate Trusts will not be viewed as a pro rata distribution followed by an exchange of assets and will not give rise to a realization event as described in Rev. Rul. 69-486. As discussed above, to the extent that the assets are divided on a non-pro rata basis, the transaction will be treated in accordance with Rev. Rul. 69-486.

Therefore, to the extent that the division of Trust 2 assets among the Separate Trusts is made on a pro rata basis, the division will not be considered a sale, exchange, or other disposition of property and will not cause Trust 2, the Separate Trusts, or any of the Income Beneficiaries to realize gain or loss under § 1001 and the division of Trust 2 into the Separate Trusts will not cause Trust 2, the Separate Trusts, or any of the Income Beneficiaries to realize income under § 61 or gain or loss under § 1001.

Ruling Request 4.

Section 643(f) provides that 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 federal income tax.

Although the Separate Trusts will have the same grantor, each Separate Trust will have a different primary beneficiary. Therefore, based upon the facts and representations submitted, we conclude that each of the Separate Trusts will be treated as a separate trust for federal income tax purposes.

Ruling Request 5.

Section 1015(a) provides that if property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss, the basis shall be such fair market value.

Section 1015(b) provides that if property is acquired 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

PLR-116064-99

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 be 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 upon the information submitted and representations made, we conclude that because § 1001 does not apply to the pro rata division of Trust 2 assets, the basis of Trust 2 assets divided pro rata will be the same after the partition as the basis of those assets before the partition. We also conclude that the assets in the Separate Trusts received from Trust 2 on a pro rata basis will have the same holding periods as those assets had in Trust 2. Finally, to the extent that the assets are divided on a non-pro rata basis, we conclude that the transaction will be treated in accordance with Rev. Rul. 69-486.

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

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.

Sincerely,
Christine E. Ellison
Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure
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