

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:P&SI:4-PLR-122322-01  
Date: December 28, 2001

Re:

Legend

Settlor A	=
Settlor B	=
Trust	=
Group A Beneficiaries	=
	=
Group B Beneficiaries	=
	=
Date 1	=
Date 2	=
State	=
Court	=
Agreement	=
State law	=

Dear :

This is in response to your letter dated November 27, 2001, and prior correspondence requesting several rulings concerning the partition of Trust.

Settlor A and Settlor B established an irrevocable trust, Trust, on Date 1. The beneficiaries of the Trust are the grandchildren and great-grandchildren of the Settlers. The Trust was established to provide for at least 60 percent of the support of each beneficiary under the age of 21. Trust provides for two classes of beneficiaries, Group A beneficiaries and Group B beneficiaries. Each class has four beneficiaries. Group A beneficiaries shared equal fractional interests in the Trust from its inception and, starting in calendar year 1985, received support payments from the Trust. The interests of the Group B beneficiaries vested on Date 2. Since Date 2, all Group A and B beneficiaries under the age of 21 have been entitled to receive support payments from the Trust and all provisions of Trust have been equally applicable to both Group A and B beneficiaries. Under the terms of Trust, support obligations are borne equally by all beneficiaries whose vested interest in the Trust has not been terminated. Each beneficiary has a 1/8 fractional share in Trust.

Under paragraph 5 of the Trust, each vested beneficiary is entitled to demand

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distribution and termination of that beneficiary's entire share upon reaching the age of 35. At such time, the beneficiary's share of corpus, as well as any accumulated or undistributed income, is to be distributed free of trust.

Paragraph 6 of the Trust provides that if a beneficiary dies prior to distribution and is survived by issue, that beneficiary's share is retained in the Trust and distributed outright to the issue on the date the deceased beneficiary would have attained the age of 35. The share of a beneficiary who dies prior to age 35 and without issue is to be divided equally among the surviving Group A and Group B beneficiaries and is to be held in trust for the remaining Trust beneficiaries or distributed out right to those surviving beneficiaries persons who have withdrawn their share prior to the death of such deceased beneficiary.

Paragraph 9 of the Trust provides that the Trustee shall have the power to partition, allot, and distribute the Trust estate in kind, or partly in money and partly in kind, as the Trustee deems necessary. Paragraph 12 provides that the Trustee shall not waive, renounce, or reduce any right under State law to partition Trust property.

Three of the Group A beneficiaries have reached the age of 21 and are no longer entitled to support from the Trust. The remaining Group A Beneficiary and the four Group B beneficiaries are under age 21 and are still entitled to support from the Trust.

The primary Trust asset is real property some of which it leases to persons or entitles aligned with the three adult Group A Beneficiaries (Group A Leases), while certain other real property is leased to persons or entities aligned with the five minor Trust beneficiaries (Group B Leases). These two groups have differing objectives concerning the management and operation of the real property held by the Trust.

Pursuant to State law, the Trustee proposes to execute Agreement and divide the Trust into separate trusts, Trust A and Trust B. After the division, the three adult Group A beneficiaries will be the trust beneficiaries of Trust A and the five minor beneficiaries will be the Trust B beneficiaries. In order to ensure that each beneficiary receives equal value, the trust property will be divided accordingly, on a non-pro rata basis. The trust real property will be partitioned so that the real property subject to Group A Leases will be held in Trust A, and will ultimately be distributed to the current three adult beneficiaries upon termination of Trust A. Likewise, the real property subject to the Group B leases will be held in Trust B, and will upon termination of Trust B pass to the current minor Trust beneficiaries.

After the division of Trust property, 3/8 of the fair market value of all Trust property will be held in Trust A and 5/8 of all property will be held in Trust B. In addition, both trusts will share support obligations on a prorata basis, i.e, 3/8 paid by Trust A and 5/8 paid by Trust B. If in any year net income of either divided trust is not sufficient to discharge its support obligation, the Agreement provides that principal of that Trust will be invaded to the extent necessary to meet the obligation.

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As part of the Agreement, there will be a cross purchase of contingent remainder interests. Each beneficiary will assign his or her remainder interests in the other trust to the beneficiaries of that trust. The contingent remainder value of each beneficiary's interest has been calculated and the parties agree that the contingent remainder interests which the three adult Group A beneficiaries have to Trust B has an aggregate fair market value greater than the fair market value of the contingent remainder interests which the remaining Group A beneficiary and four Group B beneficiaries have in Trust A. Pursuant to the Agreement, the remaining Group A beneficiary and four Group B beneficiaries will pay the three adult Group A beneficiaries the difference in cash.

Under the Agreement, the terms governing the divided trusts with respect to the distribution of income and principal during the lifetime of the beneficiaries, as well as upon the death or withdrawal of a beneficiary or upon termination of the trusts will be identical to the terms of the Trust. Each divided trust will be separately managed and administered. The parties plan to petition Court for approval of the proposed division of Trust and cross purchases of remainder interests upon issuance of a favorable ruling by the Internal Revenue Service.

The Trust was irrevocable on September 25, 1985 and it is represented that no additions have been made to the trust after that date.

You have requested the following rulings:

1. The proposed division of Trust does not constitute a sale, exchange, or other disposition of property either by the Trust or any of its beneficiaries, in which any gain or loss is realized under § 61 or § 1001 of the Internal Revenue Code, with the exception of the amount to be paid pursuant to the Agreement for the cross purchase of the remainder interests.
2. The proposed division of Trust will neither cause a beneficial interest to be shifted to a beneficiary who occupies a generation lower than the beneficiaries who held the interests prior to the division, nor extend the time for vesting of any beneficial interest in Trust beyond the period originally provided for in Trust.
3. The proposed division of Trust will not be a constructive addition to Trust, Trust A, or Trust B; and will not otherwise cause Trust, Trust A, or Trust B to lose their exempt status under § 2601.

#### RULING REQUEST No. 1

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 will be the excess of the amount realized from the sale over the adjusted basis provided in § 1011 for determining gain, and the loss will be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

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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 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 as loss sustained.

State law allows a court to divide a trust into two or more separate trusts, if the court determines that dividing the trust will not defeat or substantially impair the accomplishment of the trust purposes or the interests of the beneficiaries.

A pro rata partition of jointly owned property 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 thereof. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Rev. Rul. 69-486, 1969-2 C.B. 159, 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, the beneficiaries were viewed as having an absolute right to a ratable in-kind distribution. Accordingly, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries, an exchange that required recognition of gain under the provisions of § 1001.

The present case is distinguishable from Rev. Rul. 69-486 because the trust instrument expressly provides the trustee with the power to distribute property on a non-pro rata basis. Thus the reformed trusts are not required to receive pro rata distributions of each asset of Trust. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of Trust.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). In defining what constitutes a "material difference" for purposes of § 1001(a), the Court concluded that regulation § 1.1001-1 reasonably interprets § 1001(a) and concluded that properties are "different" in the sense that is "material" to the Code if their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The Court held that mortgage loans made to different obligors and secured by different homes embodied distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of Trust A and Trust B will not differ materially from their interests in Trust. The proposed transaction is similar to the kinds of transactions

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discussed in Rev. Rul. 56-437, since Trust is to be partitioned, but all other provisions of the trusts will remain unchanged. The assets of Trust will be allocated to Trust A and Trust B in proportion to the current interests of the beneficiaries. The same substantive provisions of the Trust continue to control the interests of the beneficiaries after the division. The beneficiaries will be entitled to the same income, principal distributions, non-contingent termination rights and distribution of assets as before the creation of the divided trusts.

We conclude that the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries. Therefore, under Cottage Savings, the properties exchanged are not materially different and the proposed division of the Trust, except as to the cross purchase of the remainder interests, will not be treated as a sale or disposition that would require any trust or any beneficiary to recognize gain or loss under §§ 61(a)(3) or 1001.

#### RULING REQUEST Nos. 2 and 3

Section 2601 imposes a tax on every generation-skipping transfer. Section 1433 of the Tax Reform Act of 1986, P.L. 99-514, 1986-3 (Vol. 1) C.B. 1, and § 26.2601-1(a) of the Generation-Skipping Transfer Tax (GSTT) Regulations provide that the tax will apply to any generation-skipping transfer made after October 22, 1986.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) provide that the generation-skipping transfer tax will not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of principal added to the trust after September 25, 1985 (or out of income attributable to principal 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)(ii)(B) or (C), which relate to property includible in a decedent's gross estate under §§ 2038 and 2042. In the present case, the Trust is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 apply.

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GSTT under § 26.2601-1(b)(1), (2), or (3) (an exempt trust) will not cause the trust to lose its exempt status. Section 26.2601-1(b)(4)(D) provides that a modification of the governing instrument of an exempt trust 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.

In the present case, the Trust was created and became irrevocable on Date 1,

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and there have been no additions made to Trust after September 25, 1985. Accordingly, Trust is exempt from GSTT under § 26.2601-1(b)(1).

Under the facts as presented, the division of the Trust into successor trusts pursuant to the proposed partition will 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.

Accordingly, we conclude that Trust, Trust A, and Trust B will be treated as trusts which were irrevocable on September 25, 1985, for purposes of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) and will remain exempt from the generation-skipping transfer tax.

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Except as specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions of the Code or under any other provisions of the Code. Nor do we express an opinion on the computation or methodology of valuing the contingent remainder interests.

Sincerely yours,  
Lorraine E. Gardner  
Assistant to the Branch Chief, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

Copy of letter for section 6110 purposes

cc: