

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B04-PLR-138761-01
Date:

JUNE 18, 2002

Re:

Legend:

- Father =
- Mother =
- Daughter =
- Trust 1 =

- Trust 2 =

- Date 1 =
- Date 2 =
- Child 1 =
- Child 2 =
- Child 3 =
- Trustee 1 =
- Trustee 2 =
- Trustee 3 =
- Corporate Trustee 1 =
- Corporate Trustee 2 =
- County Court =
- State =
- State Statute 1 =
- State Statute 2 =

Dear :

This is in response to your July 6, 2001 letter and other correspondence requesting a ruling concerning the income and generation-skipping transfer tax consequences of the proposed merger and division of two trusts.

You have requested the following rulings:

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1. The proposed merger of Trust 1 into Trust 2, followed immediately by the division of the combined trust into the new trusts, will not violate the transition rules under section 1433(b)(2)(A) of the Tax Reform Act of 1986 and, thus, the new trusts will continue to be exempt from the generation-skipping transfer (GST) tax.
2. The proposed merger of Trust 1 into Trust 2, followed immediately by the division of the combined trust into the new trusts, will not be considered a sale, exchange, or other taxable disposition of property and will not cause Trust 1, Trust 2, the combined trust, the new trusts, or the beneficiaries thereof to realize a gain or loss for purposes of section 1001 of the Internal Revenue Code.

The facts submitted are as follows:

Father and Mother executed Trust 1 on Date 1 for the benefit of Daughter. Father executed Trust 2 on Date 2 for the benefit of Daughter. Both trusts (to be known collectively as the Original Trusts) were irrevocable on the date of execution (before September 25, 1985). The two trusts are basically identical, except as to the identity of the Donor and the differences outlined below.

Section 2 of each trust provides that the trustee is authorized to make payments of net income and/or corpus to or for the benefit of Daughter and any one or more of Daughter's issue.

Section 3.1 of Trust 1 provides that the trust will terminate on the death of the last to die of Donors and Daughter. Section 3.1 of Trust 2 provides that the trust will terminate upon the death of Daughter.

Section 3.2 of each trust provides that upon termination of the trust, the corpus of the trust shall be distributed among the issue of the Donor(s) in such proportions and upon such terms as Daughter shall appoint in her will by making specific reference to this special power of appointment.

Section 3.3 of each trust provides that if Daughter fails to exercise her special testamentary power of appointment, then upon the termination of the trust, the corpus will be distributed among Daughter's issue per stirpes, or if Daughter has no issue then living, per stirpes among the issue of the Donor(s). The share of any beneficiary of the unappointed corpus of the trusts who has not attained the age of thirty years will not be distributed to him or her, but will be retained in a separate trust by the trustee until the distributee attains the age of thirty.

Section 3.4 of each trust provides that the separate trust provided in section 3.3 shall terminate at the earliest of the following dates: (i) the date that the beneficiary attains the age of thirty; (ii) the date of death of the beneficiary; or (iii) 21 years after the death of the last survivor of the Donors' issue who were living on the date that the trust

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was executed. Upon termination, the entire corpus of the separate trust shall be distributed to the beneficiary, unless the beneficiary dies before attaining the age of thirty. Section 3.4 of Trust 1 provides that if the beneficiary of the separate trust dies before attaining the age of thirty, the corpus of the trust will be distributed among beneficiary's issue per stirpes, or if beneficiary has no issue then living, among the issue of Daughter per stirpes, or if Daughter has no issue then living, to the issue of Donors. Section 3.4 of Trust 2 provides that if the beneficiary of the separate trust dies before attaining the age of thirty, the corpus of that trust should be distributed to whomever the beneficiary appointed by general power of appointment in her will. If the beneficiary fails to exercise the power of appointment, the corpus shall be distributed among the issue of the beneficiary, per stirpes, or if the beneficiary has no living issue, then to the beneficiary's heirs at law.

Section 4 of each trust provides that Trustee 1, Trustee 2, and Trustee 3 shall be the original trustees of each trust. In the event of the death, resignation or inability to act on the part of any of the trustees, the remaining two shall appoint a successor trustee so that at all times there shall be three trustees. In the event of a complete vacancy in the trusteeship of any trust herein created the Donors nominate and appoint Corporate Trustee 1, its successors and assigns as trustee.

Father and Mother died, survived by Daughter and Daughter's three children, Child 1, Child 2, and Child 3. Corporate Trustee 2, a successor to Corporate Trustee 1, serves as the trustee of both trusts. Currently, the trustee is distributing the income from both trusts equally to the three children of Daughter.

Child 1, Child 2, and Child 3 reside in different parts of the country and have distinct investment objectives and distribution needs. The trustee of the Original Trusts proposes to merge the two trusts and then to immediately divide the combined trust, pro rata, into three equal trusts (new trusts). This division is proposed in order to separate the interests of each of Daughter's three children and their respective families.

Each new trust will be for the benefit of Daughter, a designated child, and the issue of the designated child. The proposed terms for each of the new trusts are substantially identical to the terms of Trust 1 and Trust 2. The trustees of each of the new trusts are authorized to make payments of income and corpus to or directly for the benefit of the beneficiaries. Each new trust will terminate at the death of Daughter. The corpus shall be distributed to the designated child and designated child's issue as Daughter shall appoint by making reference to a special power of appointment in her will. If the designated child dies without issue, Daughter may appoint the corpus to her other issue. If Daughter fails to exercise her power of appointment, the corpus will pass to the designated child in fee simple if the designated child survives Daughter, or if not, to designated child's living issue per stirpes, or if none, to Daughter's living issue per stirpes, or if none, to Donor's living issue per stirpes. The share of any distributee who has not attained the age of thirty will be held in a separate trust, until the distributee

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attains the age of thirty. If the distributee dies before attaining the age of thirty, the corpus of that trust should be distributed to whomever the distributee appointed by general power of appointment. If the distributee failed to exercise the power of appointment, the corpus shall be distributed among the issue of the beneficiary, per stirpes, or if the beneficiary has no living issue, then to the Donor's living issue.

Corporate Trustee 2 will serve as the initial trustee for each of the new trusts. Daughter will be given a power to remove the trustee of each of the new trusts in favor of another corporate trustee. Upon Daughter's death, each succeeding primary income beneficiary will have a similar removal power.

State Statute 1 provides that a trustee has the power to perform, without court authorization, every act which a prudent man would perform for the purposes of the trust. State Statute 2 provides that a court of competent jurisdiction has the power to relieve a trustee from any restrictions on his power that would otherwise be placed upon him by the trust or by State's trust law. The trustees petitioned County Court for approval of the merger and division.

LAW AND ANALYSIS

Ruling 1

Section 2601 imposes a tax on every generation-skipping transfer. The term "generation-skipping transfer" is defined in section 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (Act) and section 26.2601-1(a) of the Generation-Skipping Transfer (GST) Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such 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)(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 GST tax under section 26.2601-1(b) will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 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

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interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. A modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from the GST tax is divided into two trusts. Under the facts presented, the division of a trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the division, and 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. Accordingly, the two partitioned trusts will not be subject to the provisions of chapter 13.

Section 26.2601-1(b)(4)(i)(E), Example 6, illustrates a situation where two trusts with identical terms, that were exempt from the GST, were merged with the approval of the appropriate local court. Under the facts presented, the merger of the two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the merger, and the merger does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trusts. Accordingly, the merged trust will not be subject to the provisions of chapter 13.

Section 26.2601-1(b)(4)(i)(E), Example 10, illustrates a modification of a trust that decreases the number of trustees. The modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification. In addition, 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. Therefore, the trust will not be subject to the provisions of chapter 13.

For purposes of the present case, it is represented that no additions (actual or constructive) have been made to the Original Trusts after September 25, 1985. The proposed merger of Trust 1 and Trust 2, followed immediately by division of the combined trust into three new trusts will not result in a shift of any beneficial interest in Trust 1, Trust 2, the combined trust, or the new trusts to any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed merger and subsequent division will not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for in Trust 1 and Trust 2.

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Accordingly, based on the facts submitted and representations made, we conclude that the proposed merger of Trust 1 into Trust 2, followed immediately by the division of the combined trust into the new trusts, will not violate the transition rules under section 1433(b)(2)(A) of the Act, and the new trusts will continue to be exempt from the GST tax.

Ruling 2

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 section 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 in extent, is treated as income or as loss sustained.

A 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 and extinguish their survivorship 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, 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 sections 1001 and 1002.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that the assets of the Original Trusts will be allocated among the three new trusts in a pro rata manner and each new trust will receive its proportionate part of each of the assets of the Original Trusts. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of the original trusts.

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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 section 1001. 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 section 1.1001-1 reasonably interprets section 1001(a) and stated that an exchange of property gives rise to a realization event under section 1001(a) if the properties exchanged are "materially different."

In defining what constitutes a "material difference" for purposes of section 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.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the three new trusts will not differ materially from their interests in the Original Trusts. 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 proposed transaction is similar to the kinds of transactions discussed in Rev. Rul. 56-437, since the Original Trusts are to be partitioned, but all other provisions of the Original Trusts will remain substantially identical. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

Therefore, the merger of Trust 1 into Trust 2 and the subsequent pro rata division of the merged trust into three new trusts will not constitute a sale, exchange, or other taxable disposition of the assets under section 1001.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to the taxpayer and the other authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

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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(s) requesting it. Section 6110(k)(3) of provides that it may not be used or cited as precedent.

Sincerely yours,

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

Enclosure:

Copy of letter for section 6110 purposes