Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200438026**
Release Date: 9/17/04
Index Number: 2601.04-00, 61.00-00,
1001.00-00, 2501.01-00,
2511.00-00

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B09 – PLR-120900-03

Date:
May 11, 2004

In Re:

Legend

Trust =

Child 1 =
Child 2 =
Settlors =

State =
Court =
Trust 1 =

Trust 2 =

Date 1 =

Dear :

This responds to a letter dated March 19, 2003, and subsequent correspondence, requesting rulings regarding the income, gift, and generation-skipping transfer (GST) tax consequences of the proposed division of a trust.

The facts submitted and representations made are as follows. Prior to September 25, 1985, on Date 1, Settlors established an irrevocable trust (Trust) for the benefit of Child 1 and Child 2.

Article 2.01 of Trust provides that trustees are to make distributions of net income (up to the whole thereof) to Child 1 and Child 2 for their support, maintenance, or education.

Income not distributed may be accumulated and added to principal. There is no requirement to equalize payments between Child 1 and Child 2.

Article 2.02 provides that in the event Child 1 or Child 2 is deemed incompetent, trustees may make discretionary payments of principal (up to the whole thereof) for support or maintenance.

Article 2.03 provides that trustees may distribute principal (up to the whole thereof) to Child 1 and Child 2 to provide for care, maintenance, support, or education.

Article 2.04 provides that trustees may make distributions of net income (up to the whole thereof) to a child of Child 1 or Child 2 (grandchild) to provide for care, maintenance, support, or education; provided, however, that distributions made in a calendar year do not exceed the total income distributed to Child 1 and Child 2 under Article 2.01. There is no requirement to equalize distributions among grandchildren and any payments made to a grandchild are not to be deducted from the grandchild's distributive share of Trust's assets when Trust terminates.

Article 2.05 provides that after Child 1 and Child 2 die, trustees may make distributions of principal (up to the whole thereof) to grandchildren under age 21 to provide for maintenance, support, or education.

Article 2.06 provides that Trust will terminate after Child 1 and Child 2 die when the last grandchild turns 21. Upon termination, Trust assets are to be distributed to the surviving grandchildren, share and share alike.

Article 2.07 provides that if all of the grandchildren die without surviving issue prior Trust's termination as provided in Article 2.06, then Trust will terminate when the last to survive of Child 1, Child 2, and the grandchildren die. Upon termination, Trust's assets will be divided into two equal shares, one for Child 1 and one for Child 2, and distributed as Child 1 and Child 2 appoints in an unrevoked written instrument other than a will. Assets not effectively appointed are to be distributed to the then living heirs at law (other than a surviving spouse) of Child 1 or Child 2 as determined by State's then existing laws of intestate succession.

Article 2.10 provides that on any division or partial or final distribution of Trust's property, trustees may divide and distribute Trust's property in kind, may divide or distribute undivided interests in Trust's property, or may sell all or any part of Trust's property and divide or distribute the property in cash or partly in cash and partly in kind.

Trustees and Trust's beneficiaries intend to petition Court to obtain an order dividing Trust into two separate trusts, Trusts 1 and 2. Trust's assets will divided equally between Trusts 1 and 2 on a pro-rata basis. The terms of Trusts 1 and 2 will be identical to the terms of Trust. Upon the establishment of Trusts 1 and 2, Child 1 will be appointed as the sole trustee of Trust 1 and Child 2 will be appointed as the sole trustee

of Trust 2. It has been represented that no additions, actual or constructive, have been made to Trust since September 25, 1985.

Trustees are requesting rulings that the division of Trust into Trusts 1 and 2 in accordance with the representations made (1) will not cause Trusts 1 and 2 or the beneficiaries of Trusts 1 and 2 to recognize gain or loss under §§ 61 and 1001, (2) will not result in a taxable gift under § 2501, and (3) will not cause Trust to forfeit its status as a trust exempt from the GST tax.

LAW AND ANALYSIS

Ruling 1

Section 61 provides that gross income includes all income from whatever source derived. Section 61(a)(3) specifically includes gains 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 therefrom over the adjusted basis provided in § 1011, and the loss is the excess of the adjusted basis provided in § 1011 over the amount realized. Section 1001(c) provides that, except as otherwise provided in Subtitle A, the entire amount of gain or loss determined under § 1001 on the sale or other exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides, as a general rule, that 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 loss sustained. For purposes of § 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional interest. Such an exchange is a disposition under § 1001(a).

An exchange of property results in the realization of gain only if the properties exchanged materially differ. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565. The critical determination is whether there is a change in the actual legal entitlements. Compare Rev. Rul. 56-437, 1956-2 C.B. 507 (pro-rata severance of jointly owned property not an exchange for purposes of recognizing gain or loss under § 1001) with Rev. Rul. 69-486, 1969-2 C.B. 159 (distribution that was not pro-rata, effected as result of a mutual agreement among beneficiaries and trustee, was required to recognize gain or loss because neither the trust instrument nor the local law gave authority to the trustee to make such a disproportionate distribution; consequently, the transaction was treated as a pro-rata distribution with a subsequent taxable exchange between the beneficiaries).

In this case, it has been represented, and the underlying documents support the representation, that the trusts being formed, Trusts 1 and 2, will have identical terms to Trust's terms. Therefore, the primary and any subsequent beneficiaries of Trusts 1 and 2 will possess the same income and remainder interests both before and after the pro-rata partition of Trust. Consequently, the beneficiaries' interests in Trusts 1 and 2 will not materially differ from their interests in Trust. Accordingly, based upon the facts submitted and the representations made, there will be no gain or loss under §§ 61 and 1001 realized on the pro-rata division and transfer of Trust's entire assets into Trusts 1 and 2.

Ruling 2

Section 2501 imposes a tax on the transfer of property by gift by an individual.

Section 2511 provides that the tax imposed by § 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 a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

In this case, the interest of each beneficiary will remain the same after the proposed division as it was prior to the division. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division will not cause any beneficiary to be considered as having made a taxable gift under § 2501.

Ruling 3

Section 2601 imposes a tax on every generation-skipping transfer (within the meaning of Subchapter B).

Under § 1433(a) of the Tax Reform Act of 1986, GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would cause the trust to be included in his or her gross estate under §§ 2038 or 2042, if the settlor had died on September 25, 1985.

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 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 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. 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 GST transfer or the creation of a new GST transfer.

In the present case, Trust was irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, have been made to Trust after that date. Trust will be divided on a pro-rata basis into Trusts 1 and 2 and Trusts 1 and 2 will have the same terms as Trust. Therefore, the proposed division of Trust will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the proposed division. In addition, the proposed division will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in Trust, and the proposed division will not constitute an addition to Trust within the meaning of § 1433(b)(2)(A).

Accordingly, based on the facts submitted and the representations made, the proposed division of Trust into Trusts 1 and 2 will not subject Trusts 1 and 2 to GST tax by reason of §§ 1433(b)(2)(A) and 26.2601-1(b)(4)(i)(D). As a result, after the division, Trusts 1 and 2 will be exempt from the GST tax imposed under § 2601 provided there are no additions, actual or constructive, to Trusts 1 and 2 after September 25, 1985.

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.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(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.

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 the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James F. Hogan
Acting Branch Chief, Branch 9
Office of Associate Chief Counsel

(Passthroughs and Special Industries)

Enclosure: Copy for § 6110 purposes
Copy of this letter