

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200441018**

Release Date: 10/8/04

Index Number: 2601.00-00, 1001.00-00

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B09 – PLR-137142-03

Date:

June 17, 2004

Legend:

Trust =  
Decedent =  
Date 1 =  
Trustee =  
Bank =  
Child 1 =  
Child 2 =  
Child 3 =  
Grandchild 1 =  
Grandchild 2 =  
Grandchild 3 =  
Grandchild 4 =  
Date 2 =  
Court =  
A =  
B =  
Daughter-in-Law =  
State =  
State Statute =

Dear :

This is in response to your authorized representative's letter, dated June 12, 2003, and subsequent correspondence, requesting rulings on your behalf as trustee of the Trust on the income and generation-skipping transfer (GST) tax consequences of the proposed reformation and partition of the Trust.

The facts and representations submitted are summarized as follows: Decedent died on Date 1, a date prior to September 25, 1985, survived by three children, four

grandchildren, and four great-grandchildren. Pursuant to Article Seventh of Decedent's last will and testament ("Will"), the Trust was established to provide for the health, support, maintenance, welfare and education of Decedent's grandchildren.

Article Seventh, paragraph B of Decedent's Will provides, generally, that the trustees shall pay to or apply for the benefit of each grandchild so much income as the trustees in their sole and absolute discretion may elect. If the income from the trust is insufficient to fully realize the purposes of the trust, the trustees may pay to or apply for the benefit of each grandchild so much of the principal as the trustees in their sole and absolute discretion may determine is necessary to fully realize the purposes of the trust.

Article Seventh, paragraph C of Decedent's Will provides that the class of beneficiaries (grandchildren) shall remain open until the date when the first of Decedent's grandchildren reaches the age of thirty-five, or until the first of Decedent's grandchildren should die, leaving a child or children surviving, whichever event occurs first ("the Division Date"). On the Division Date, all of the principal and any accumulated income of the trust shall be divided into as many equal shares as there are then living grandchildren of Decedent, plus, if applicable, a share for the deceased grandchild who is survived by a child or children. One share shall be distributed in fee simple and absolutely to the grandchild who has reached age thirty-five, or if applicable, to the children of the deceased grandchild in equal shares. As each succeeding grandchild reaches age thirty-five, his or her share shall be distributed in fee simple and absolutely in a like manner.

Article Seventh, paragraph D of Decedent's Will provides that if the shares of the beneficiaries shall have vested and a grandchild dies prior to reaching age thirty-five leaving a child or children, that grandchild's share of the trust shall be distributed in fee simple and absolutely to said child or children in equal shares. If a grandchild dies prior to reaching age thirty-five without children, that grandchild's share shall be distributed to those of Decedent's then living grandchildren, share and share alike, the share of any grandchild who has reached the age of thirty-five to be distributed outright and absolutely, and the share of any grandchild who has not yet reached the age of thirty-five years to be added to the share of such grandchild presently held in trust and to be administered in accordance with all of the terms of the trust.

Article Seventh, paragraph F of Decedent's Will provides that the trustees, in exercising their discretion as to whether to make distributions of income or principal, shall take into consideration the other income and resources available to the beneficiary, and may rely upon financial statements supplied by the beneficiary for information as to said income and resources.

Article Seventh, paragraph G of Decedent's Will provides, in part, that the trustees are directed to generally treat the beneficiaries equally with respect to the distribution of income and principal, but the trustees may favor one beneficiary over the others if such action is deemed reasonably warranted by the trustees. If compelling

reasons related to the health of a beneficiary warrant it, that beneficiary may be preferred with income and principal distributions even to the complete exclusion of the other beneficiaries.

Article Ninth of Decedent's Will provides, in part, that Trustee, hereinafter called "Individual Trustee," shall serve as trustee of any and all trusts provided for in Decedent's Will. If Trustee predeceases Decedent or for any reason fails to qualify, resigns or becomes incapable of acting as trustee, Decedent appoints Bank, hereinafter called "Corporate Trustee," as substitute trustee. Decedent appoints his children, Child 1, Child 2, and Child 3, hereinafter called "Co-Trustees," as trustees of any and all trusts provided for in Decedent's Will.

Article Eleventh of Decedent's Will provides, in part, that the day-to-day operation and management of the trust shall be conducted by the Individual Trustee (or Corporate Trustee, as the case may be). All other powers and all discretions of the trustees shall be exercised only after appropriate consultation between the Co-Trustees and the Individual Trustee (or Corporate Trustee). In the event of any disagreement, the decision of a majority of the Co-Trustees shall be controlling.

Article Twelfth of Decedent's Will provides the trustees with all the powers granted by law and by the laws of State and by State Statute. The Will provides that the exercise of such powers shall be in the sole and absolute discretion of the trustees and without order or license of court.

The trustees represent that they have kept records of all expenditures made to or for the benefit of each grandchild. All of the payments to the grandchildren have been made out of the general trust estate ("the Common Fund"). Grandchild 1 and Grandchild 2, who are siblings, have required and received substantial distributions from the Trust over the years, while Grandchild 3 and Grandchild 4, who are also siblings, have required less support from the Trust. The trustees sought to balance the disparate needs of the grandchildren by establishing four sub-accounts of the Trust, one for each grandchild. Periodically, the trustees have equalized the Common Fund payments among the grandchildren by making distributions in varying amounts to the four sub-accounts. Each time the trustees made equalizing distributions, they distributed compensating amounts to the sub-accounts established for the grandchildren who received smaller distributions during that particular period so that the total amount the trustees distributed to or for the benefit of each grandchild was equal to the total amount distributed to or for the benefit of each of the other grandchildren. Certain disagreements, however, arose among the grandchildren and their families regarding the proper construction of Decedent's Will and administration of the Trust.

On Date 2, the trustees and Decedent's grandchildren executed a settlement agreement. Upon receipt of a favorable letter ruling from the Service, the parties will petition the Court to reform the Trust pursuant to the terms of the settlement agreement. Pursuant to the settlement agreement, the Trust will be modified, generally, to provide

as follows: The trustees will determine the cumulative Common Fund distributions to or for the benefit of each grandchild made since the last previous equalizing distribution and shall make a final equalizing distribution to the sub-accounts so that the total amount paid or distributed over the entire term of the Trust to or for the benefit of each grandchild is equal to the total amount paid or distributed over the entire term of the Trust to or for the benefit of each other grandchild. The trustees shall distribute to Grandchild 1's sub-account the sum of \$A from the principal of the Common Fund to compensate her in full for certain medical expenses. The remaining balance of the trust estate shall then be added equally to each sub-account. Each asset constituting the trust estate shall be fractionalized and allocated pro-rata to each sub-account. Each sub-account shall thereupon become a separate "Grandchild's Trust."

Each Grandchild's Trust shall be administered for the primary benefit of the particular grandchild for whom it is created. The purpose of each Grandchild's Trust shall be to provide for the health, support, maintenance, welfare and education of the beneficiary grandchild. The trustees of the particular Grandchild's Trust shall have the power and authority described in Article Seventh, Paragraph B of Decedent's Will, except that: (i) payments shall be made exclusively to or for the benefit of the beneficiary grandchild (and not to or for the benefit of any of the other grandchildren); (ii) distributions of principal out of each trust prior to the Division Date shall not exceed \$B per trust; and (iii) trust accounting income shall, to the extent not distributed, be accumulated as income and not added to principal.

When the beneficiary grandchild attains age thirty-five, the assets then constituting his or her trust shall be distributed to the beneficiary grandchild and his or her trust shall then terminate. If the beneficiary grandchild dies before the Division Date without one or more surviving children, the assets then constituting his or her trust shall be added equally to the other Grandchildren's Trusts then in existence including the Grandchildren's Trusts (if any) then in existence for after-born grandchildren. If a beneficiary grandchild dies after the Division Date before attaining the age of thirty-five and without one or more surviving children, the assets then constituting his or her trust shall be distributed in equal shares to those of Decedent's grandchildren who are born or adopted prior to the Division Date who are then living; provided, however, that the share of a grandchild born or adopted prior to the Division Date who is then less than age thirty-five shall be added to the Grandchild's Trust for that grandchild. If a beneficiary grandchild dies before attaining age thirty-five with one or more surviving children, the assets then constituting his or her trust shall be divided into a sufficient number of separate equal shares to provide one such share for each of his or her surviving children. Each such share shall be allocated to a separate trust for the benefit of a child of the beneficiary grandchild so that a separate trust (a "Great-Grandchild's Trust") is created for each of them.

If, prior to the Division Date, a child is born or adopted by Child 1, Child 2, or Child 3, a Grandchild's Trust shall be established for the after-born grandchild. Each

pre-existing Grandchild's Trust shall contribute a percentage of its value toward the funding of the new Grandchild's Trust.

Each Great-Grandchild's Trust shall be administered for the primary benefit of the particular great-grandchild for whom it is created. The purpose of each Great-Grandchild's Trust is to provide for the health, support, maintenance, welfare and education of the beneficiary great-grandchild. The trustees shall pay to or apply for the benefit of the beneficiary great-grandchild as much of the net income and principal of the trust as the trustees deem necessary or appropriate to accomplish the trust purpose. When the beneficiary great-grandchild attains age thirty-five, the assets then constituting his or her trust shall be distributed to the beneficiary great-grandchild and his or her trust shall then terminate. Each beneficiary grandchild shall have the right, exercisable by his or her duly probated will, and exercisable solely with respect to each Great-Grandchild's Trust created for his or her children, to accelerate the date of the terminating distribution as to all or any part of the trust.

If the beneficiary great-grandchild dies prior to complete distribution of the trust, the remaining trust estate shall, upon the death of the beneficiary great-grandchild, be distributed in the following manner: (i) the beneficiary great-grandchild shall have a testamentary general power of appointment to direct the distribution of his or her trust upon his or her death to any one or more persons or entities including his or her estate, provided, however, specific reference must be made to this power of appointment to effectively exercise it; and (ii) if the beneficiary great-grandchild fails to effectively appoint some part or all of his or her trust, the unappointed part shall be distributed to the estate of the beneficiary great-grandchild.

Each Grandchild's Trust shall have two trustees, one of whom shall be the "Administrative Trustee" and the other of whom shall be the "Family Member Trustee." Trustee shall be the initial Administrative Trustee of each Grandchild's Trust. If Trustee, for any reason, ceases to act as the Administrative Trustee of any Grandchild's Trust, Bank shall, upon acceptance of this nomination, become the successor Administrative Trustee for that trust. If, for any reason, Bank or any subsequent successor Administrative Trustee ceases to act as the Administrative Trustee of any Grandchild's Trust or declines to accept its nomination, or if a successor Administrative Trustee is removed, the incumbent Family Member Trustee shall designate a bank or trust company as the next successor Administrative Trustee of that particular trust. Each successor Administrative Trustee, other than Bank, shall be subject to removal by the incumbent Family Member Trustee of the particular trust.

Child 2 shall be the initial Family Member Trustee of the Grandchild's Trust for Grandchild 3 and the Grandchild's Trust for Grandchild 4. Daughter-in-Law shall be the initial Family Member Trustee of the Grandchild's Trust for Grandchild 1 and the Grandchild's Trust for Grandchild 2. If a Grandchild's Trust is created for an after-born grandchild, the initial Family Member Trustee shall be appointed by Child 2 if the after-born grandchild is her child; by Child 3 if the after-born grandchild is his child; and by

Child 1 if the after-born grandchild is her child. The person making the appointment may appoint herself or himself.

If, for any reason, the Family Member Trustee of a Grandchild's Trust ceases to serve as trustee, Child 2 may appoint a successor Family Member Trustee if the vacancy arises in a Grandchild's Trust for one of her children. Daughter-in-Law may appoint a successor Family Member Trustee if the vacancy arises in the Grandchild's Trust for Grandchild 1 or Grandchild 2. Child 3 may appoint a successor Family Member Trustee if the vacancy arises in a Grandchild's Trust for a child of his, other than Grandchild 1 or Grandchild 2. Child 1 may appoint a successor Family Member Trustee if the vacancy arises in a Grandchild's Trust for a child of hers. The parent making the appointment may appoint any person (including him or herself) whether or not a member of his or her family. If an appointment is not effectively made, the beneficiary grandchild of the Grandchild's Trust in which the vacancy arises may make the appointment. The beneficiary grandchild making the appointment may appoint any person older than age thirty-five whether or not a member of his or her family.

Prior to the Division Date, all other power and authority of the trustees shall be exercised only by joint action of the Administrative Trustee and the Family Member Trustee of the particular trust. After the Division Date, all other power and authority of the trustees shall be exercised by joint action of the Administrative Trustee and the Family Member Trustee of the particular trust if they are able to agree, but if they are unable to agree, then by the sole action of the Family Member Trustee of the particular trust.

Each beneficiary grandchild shall have the right, exercisable by his or her duly probated will, and exercisable solely with respect to each Great-Grandchild's Trust created for his or her children to: (i) designate the initial trustees of each such trust; (ii) designate the successor trustees or a method of selecting successor trustees of each such trust; and (iii) designate the manner in which the duties and responsibilities of the trustees are to be shared between or among them if there are multiple trustees designated. To the extent that the parent of a great-grandchild fails to exercise these rights, the following default provisions shall apply.

Each Great-Grandchild's Trust shall have two trustees, one of whom shall be the Administrative Trustee and the other of whom shall be the Family Member Trustee. Trustee shall have the right to be the initial Administrative Trustee of each Great-Grandchild's Trust. If, for any reason, Trustee does not act as the initial Administrative Trustee, or once having commenced acting should later cease to act, Bank shall, upon acceptance of this nomination become the initial (or successor, as the case may be) Administrative Trustee for that trust. If, for any reason, Bank or any subsequent successor Administrative Trustee ceases to act as the Administrative Trustee of any trust or declines to accept its nomination in the first instance, or if a successor Administrative Trustee is removed, the incumbent

Family Member Trustee shall designate a bank or trust company as the initial (or successor) Administrative Trustee of that particular trust. Each successor Administrative Trustee (other than Bank) shall be subject to removal by the incumbent Family Member Trustee of the particular trust.

The initial Family Member Trustee shall be appointed by Child 2 if the great-grandchild is her descendant; by Daughter-in-Law if the great-grandchild is her descendant; by Child 3 if the great-grandchild is a descendant of a child of his, other than Grandchild 1 or Grandchild 2; and by Child 1 if the great-grandchild is her descendant. The person making the appointment may appoint him or herself. If for any reason, the Family Member Trustee of a Great-Grandchild's Trust ceases to serve as trustee, a successor Family Member Trustee shall be appointed in the following manner. Child 2 may make the appointment if the vacancy arises in a Great-Grandchild's Trust for one of her descendants. Daughter-in-Law may make the appointment if the vacancy arises in a Great-Grandchild's Trust if the beneficiary is a child of Grandchild 1 or a child of Grandchild 2. Child 3 may make the appointment if the vacancy arises in a Great-Grandchild's Trust for a descendant of his who is neither a child of Grandchild 1 nor a child of Grandchild 2. Child 1 may make the appointment if the vacancy arises in a Great-Grandchild's Trust for a descendant of hers. The person making the appointment may appoint any person (including him or herself) whether or not a member of his or her family. If an appointment is not effectively made, the beneficiary of the Great-Grandchild's Trust in which the vacancy arises may make the appointment. The beneficiary making the appointment may appoint any person older than age thirty-five whether or not a member of his or her family.

The day-to-day operation and management of each Great-Grandchild's Trust shall be conducted by the Administrative Trustee. All other power and authority of the trustees shall be exercised by joint action of the Administrative Trustee and the Family Member Trustee of the particular trust if they are able to agree, but if they are unable to agree, then by the sole action of the Family Member Trustee of the particular trust.

Trustee requests the following rulings: (1) the Trust, the Grandchildren's Trusts to be established upon the partition of the existing trust, and any resulting successor Great-Grandchildren's Trusts will not forfeit their exemption from the GST tax imposed under § 2601 as a result of the proposed reformation of the Trust; (2) the proposed reformation of the Trust will not constitute an addition to the Trust or a change in the substance of the Trust that will cause it to lose its exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986; and (3) neither the partition of the Trust nor the distribution of its assets to the newly created Grandchildren's Trusts on a fractional share basis will require the recognition of gain or loss for federal income tax purposes.

#### Ruling Requests 1 and 2:

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

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

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply if additions (actual or constructive) are made to the trust after September 25, 1985.

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 relates to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, Trust is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

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 generation-skipping transfer tax under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, 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 § 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.

Section 26.2601-1(b)(4)(i)(D)(2) provides that 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. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If

the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. A modification that is administrative in nature that only indirectly increases the amount transferred (for example by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

In the present case, the Trust was created and became irrevocable on Date 1, and there have been no additions made to the Trust after September 25, 1985. Accordingly, the Trust is exempt from the GST tax under § 26.2601-1(b)(1).

The proposed modification to the Trust provides, among other things, that if a grandchild dies before attaining age thirty-five with one or more surviving children, the assets then constituting his or her trust shall be divided into a sufficient number of separate shares to provide one share for each of his or her surviving children. Each such share shall be allocated to a separate trust for the benefit of a child of the beneficiary grandchild so that a separate trust (Great-Grandchild's Trust) is created for each of them. In addition, if a beneficiary great-grandchild dies prior to complete distribution of his or her respective Great-Grandchild's Trust, the remaining trust estate shall, upon the death of the beneficiary great-grandchild, be distributed in the following manner: (i) the beneficiary great-grandchild shall have a testamentary general power of appointment to direct the distribution of his or her trust upon his or her death to any one or more persons or entities, including his or her estate; and (ii) if the beneficiary great-grandchild fails to effectively appoint some part or all of his or her trust, the unappointed part shall be distributed to the estate of the beneficiary great-grandchild. Accordingly, the assets of the Great-Grandchild's Trust will be included in the great-grandchild's gross estate for estate tax purposes under § 2041(a)(2). Further, the great-grandchild will be treated as the transferor of the trust corpus for GST tax purposes under § 2652(a)(1).

In addition, the proposed modification will not result in a shift of any beneficial interest in the Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification. Further, the modification of the Trust will not extend the time for vesting of any beneficial interest in the Trust beyond the period provided for in the original trust.

Under these circumstances and based on the facts submitted and the representations made, we conclude that the proposed modification complies with the provisions of § 26.2601-1(b)(4)(i)(D)(1) and will not cause the Trust, the Grandchildren's Trusts, and any resulting successor Great-Grandchildren's Trusts to be subject to the tax on generation-skipping transfers. In addition, the proposed reformation of the Trust will not constitute an addition to, or a change in the substance of the Trust.

### 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 § 1011 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, 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 §§ 1001 and 1002.

In the present case, Decedent's Will grants broad authority to the trustees to make unequal distributions that could in fact result in non-pro rata distributions. For instance, Article Seventh of Decedent's Will specifically acknowledges that the trustees "may pay to or apply for the benefit of each grandchild so much of the principal as the trustees in their sole and absolute discretion may determine is necessary to fully realize the purposes of the Trust." Article Seventh, paragraph F of Decedent's Will provides that the trustees, "in exercising their discretion as to whether to make distributions of income or principal, shall take into consideration the other income and resources available to the beneficiary, and may rely upon financial statements supplied by the beneficiary for information as to said income and resources." Such language implicitly recognizes that because the financial situation of one beneficiary may differ from that of the others, the trustees could make unequal distributions that would benefit a particular beneficiary more than the others.

Moreover, the language in Article Seventh, paragraph G of Decedent's Will governs the treatment of the grandchildren with respect to payments of income or principal by the Trust and directs the trustees to generally treat the beneficiaries "equally with respect to the distribution of income and principal, but the trustees may favor one beneficiary over the others if such action is deemed reasonably warranted by the trustees." This provision also recognizes the possibility of unequal and, possibly, non-pro rata distributions that may favor a particular beneficiary.

In addition, Article Twelfth of Decedent's Will grants very broad discretionary powers to the trustees, including all the powers granted by law and by the provisions of the Will, by the laws of State, and all the powers set forth in State Statute, and provides that the exercise of the powers shall be in the sole and absolute discretion of the trustees and without order or license of court. State Statute is very broad and permits the incorporation of certain powers of fiduciaries into any will or trust including the power: "To make distributions in cash or in kind or partly in each at valuations to be determined by the fiduciary, whose decision as to values shall be conclusive."

Accordingly, State Statute and the numerous provisions of Decedent's Will grant broad authority to the trustees with respect to the making of distributions. Such authority is what distinguishes the instant case from Rev. Rul. 69-486. Consequently, distributions pursuant to the settlement agreement should not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of the Trust.

Pursuant to the settlement agreement, the remaining balance of the assets of the Trust will apparently be divided pro rata and added to the four sub-accounts for distribution to each of the respective Grandchild's Trusts created out of each such sub-account. There would be no § 1001 consequences of such a pro rata division. See Rev. Rul. 56-437.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991). Properties exchanged are materially different if the properties embody legal entitlements "different in kind or extent" or if the properties confer "different rights and powers." Id. at 565. In Cottage Savings, 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. Id. at 566. 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. Id. at 564-65.

Because of the broad scope of the trustees' discretionary powers to make distributions of income and principal under Decedent's Will and the governing law, the exercise of such powers by the trustee pursuant to the settlement agreement does not result in the beneficiaries receiving legal entitlements with respect to distributions of

income and principal that are materially different in kind or extent from what the beneficiaries had prior to the settlement agreement.

Accordingly, we conclude that no gain or loss will be recognized under § 1001 upon the partition of the Trust as provided under the above facts and circumstances.

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. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect. 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.

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. In addition, no opinion is expressed or implied with respect to the income tax consequences of any transaction.

These rulings are directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,  
Katherine A. Mellody  
Senior Technician Reviewer, Branch 4  
Office of Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosures

Copy for section 6110 purposes  
Copy of this letter