

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200448040**

Release Date: 11/26/04

Index Number: 1001.00-00, 61.00.00-00,
643.06-00, 661.01-00,
1015.00-00, 1223.00-00,
2036.00-00, 2038.00-00,
2501.01-00, 2601.00-00

Person To Contact: _____, ID No.

Telephone Number: _____

Refer Reply To:
CC:PSI:B02 – PLR-154287-03

Date:
July 28, 2004

Trust =
1

Trust =
2

X =

Y =

Z =

A =

B =

C =

D1 =

D2 =

D3 =

Dear _____ :

This letter responds to your letter dated September 9, 2003, and subsequent correspondence, submitted by you on behalf of Trust 1 and Trust 2 (the Trusts) as the Trusts' authorized representative, seeking certain rulings under the Internal Revenue Code.

The information submitted states that X executed Trust 1, and Y, X's spouse, executed Trust 2. Both Trust 1 and Trust 2 became irrevocable at the death of their respective grantors and no contributions have been made to the Trusts after the deaths of their respective grantors. X died on D1 and Y died on D2 (both of which occurred before March 1, 1984).

Section 3.5 of Trust 1 provides that upon the death of Y, or at X's death, if Y predeceases X, the trustee shall divide the principal and accumulated income of the trust fund previously held for the benefit of Y or the remaining corpus of the trust as described in § 3.4, as the case may be, into shares, equal in value, one for each child of X who is then living, and one for the child, or children, then living of any child of X who has predeceased Y.

Section 3.5.1 of Trust 1 provides, in part, that the entire net income from one of said shares shall be paid to each of X's daughters, who is then living, during her lifetime, and upon her death the principal and accumulated income of said trust estate shall be distributed to such of the surviving descendants of said daughters as she shall, by the instrument admitted to probate as her last will, executed after the execution of Trust 1 and specifically referring thereto, have appointed to receive same; provided, however, that the aforesaid special power of appointment may also be exercised by creating a trust of, or by appointing to a pre-existing trust, all or a portion of the property to which it applies, for the use and benefit of any descendants of X's daughters for a term not to exceed the life of the last to die of X's descendants who are living at the time Trust 1 is executed, plus twenty-one years.

Section 3.5.3 of Trust 1 provides that should either of X's daughters survive X and die intestate or without exercising the power of appointment set forth in the preceding paragraph, the corpus of the trust therein established for such daughter shall continue during the lives of each child of such deceased daughter, and the net income shall be distributed to each such child of a deceased daughter on the terms and conditions thereafter set forth, in equal shares, and at the death of any such child of X's daughter (X's grandchild) the share of the corpus and accumulated income attributable to that grandchild shall be distributed to that grandchild's descendants, in fee, on a per stirpes basis; provided, however, that any portion which would be distributed to any such descendants under the age of twenty-one shall continue to be held in trust in accordance with the terms and conditions therein set forth until such descendant reaches that age of twenty-one.

Section 3.5.6 of Trust 1 provides that notwithstanding any other provisions of Trust 1, no trust therein established, or established by the exercise of any special power of appointment granted therein, shall continue for a period longer than twenty-one years after the death of the last to die of X's descendants living at the time of the execution of Trust 1. If any of the trusts therein established are terminated pursuant to the above provision, the corpus and accumulated income shall be distributed in fee to the then income beneficiaries in the same ratio that each of them is receiving a share of the income.

Section 5.5 of Trust 1 provides that the trustee may, upon application received from any one of the income beneficiaries hereunder, except Y, or on the trustee's own initiative, advance to or for the benefit of said beneficiary such portion of the trust estate then held for the use of such beneficiary, as may in the sole discretion of the trustee be necessary and proper by reason of some emergency, unusual hardship, or other unusual circumstances relative to the health, maintenance, support, or education of said beneficiary, or the beneficiary's spouse or children. It is not X's intention that this right to invade principal shall be exercised except in very unusual circumstances or in the case of real emergency; and, in any event, the trustee shall consider a beneficiary's other sources of income or funds in carrying out the provisions of this section. Any such advancement from principal shall be charged against the share of the trust corpus held for the benefit of the income beneficiary for whose benefit the advance was made. This section does not apply to Y.

Section 2.8 of Trust 2 provides that upon Y's death, the trustee shall continue to hold the corpus in three equal parts in trust during the lives of Y's three children and shall distribute the net income from said trust funds to said children in convenient installments but at least annually.

Section 2.9 of Trust 2 provides, in part, that upon the death of each of the children of Y, the corpus of the trust held for his or her benefit shall be distributed to such of the surviving descendants of said child as the child shall, by the instrument admitted to probate as that child's last will (executed after the execution of Trust 2 and specifically referring thereto) have appointed to receive same; provided, however, that the aforesaid special power of appointment may also be exercised by creating a trust of, or by appointing to a pre-existing trust, all or a portion of the property to which it applies for the use and benefit of any descendants of Y's children who are living at the time of the execution of Trust 2 for a term not to exceed said descendants' respective lives plus twenty-one years.

Section 2.10 of Trust 2 provides that should any of Y's children die intestate or without exercising the power of appointment set forth in the preceding paragraph, the corpus of the trust therein established for such child shall continue during the lives of each child of such deceased child, and the net income shall be distributed to each such child of a deceased child on the terms and conditions thereafter set forth, in equal shares; and at the death of any such child of Y's children (Y's grandchild) the share of

the corpus attributable to that grandchild shall be distributed to that grandchild's descendants, in fee, on a per stirpes basis; provided, however, that any portion which would otherwise be distributed to any such descendants under the age of twenty-one shall continue to be held in trust in accordance with the terms and conditions therein set forth until such descendant reaches the age of twenty-one.

Section 2.13 of Trust 2 provides that notwithstanding any other provisions of Trust 2, no trust therein established shall continue for a period longer than twenty-one years after the death of the last to die of Y's children and grandchildren living at the time of the execution of Trust 2. If any of the trusts therein established are terminated pursuant to the above provision, the corpus and accumulated income shall be distributed in fee to the then income beneficiaries in the same ratio that each of them is receiving a share of the income.

Section 4.4 of Trust 2 provides that the trustee may at any time in its sole discretion advance to any income beneficiary of a trust therein established from the principal of said beneficiary's portion an amount not exceeding ten per cent (10%) of the principal thereof in any one year, determined as of the first business day of the year, to be expended for educational purposes (including summer camp and travel of an education nature) or for unusually prolonged or expensive medical or dental treatment; provided, however, that the trustee shall give careful consideration to a beneficiary's source of income other than said trust estate before any such advancement from principal is made, and in the event an advancement is made, in determining the amount thereof.

Z, the daughter of X and Y, was the sole income beneficiary of the Trusts at the date of her death, D3. Z died without exercising the powers of appointment in § 3.5.1 of Trust 1 and § 2.9 of Trust 2. Z has three living children, A, B, and C.

The trustee of the Trusts believes it is in the best interests of the beneficiaries to divide Trust 1 into three separate trusts, one for each child of Z, and to divide Trust 2 into three separate trusts, one for each child of Z. Under the proposed division, the dispositive terms of each of the divided trusts would be identical to the dispositive terms of the original trusts, except that the discretionary distributions of principal of each divided trust would be limited to the child of Z for whom the divided trust was set aside, as well as such child's descendants. Each asset of Trust 1 would be divided into three equal parts and then allocated equally among the three separate trusts. Each asset of Trust 2 would be divided into three equal parts and then allocated equally among the three separate trusts.

RULINGS 1 AND 2

Section 2601 of the Internal Revenue Code 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 § 1433(a) of the Tax Reform Act of 1986 (the 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 § 1433(b)(2)(A) of the Act and § 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 § 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 of the governing instrument of an exempt trust 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. 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 § 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.

The proposed division of Trust 1 will result in three trusts, one for each of Z's children. Each asset of Trust 1 would be divided into three equal parts and then allocated equally among the three separate trusts. The proposed division of Trust 2 will result in three trusts, one for each of Z's children. Each asset of Trust 2 would be divided into three equal parts and then allocated equally among the three separate trusts. Because the terms of the divided trusts will be the same as the terms of the original trust, the proposed division of the original trust does not shift a beneficial interest 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. In

addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Based on the facts submitted and representations made, we conclude that the proposed division of Trust 1 into the three divided trusts will not cause Trust 1 to lose its GST tax exempt status as a grandfathered trust and will not cause the divided trusts to be subject to the GST tax, and will not cause any distribution from, or termination of any interests in, Trust 1 or any of the divided trusts to be subject to the GST tax. Additionally, we conclude that the proposed division of Trust 2 into the three divided trusts will not cause Trust 2 to lose its GST tax exempt status as a grandfathered trust and will not cause the divided trusts to be subject to the GST tax, and will not cause any distribution from, or termination of any interests in, Trust 2 or any of the divided trusts to be subject to the GST tax.

RULINGS 3 AND 4

Section 643(f) provides that, for purposes of subchapter J of chapter 1 of subtitle A, under regulations prescribed by the Secretary, 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 the tax imposed by chapter 1.

Section 1806(b) of the Act provides that § 643(f) shall apply to taxable years beginning after March 1, 1984; except that, in the case of a trust which was irrevocable on March 1, 1984, it shall apply only to that portion of the trust which is attributable to contributions to corpus after March 1, 1984.

Based solely on the facts and representations submitted, we conclude that as long as the three trusts created by the division of Trust 1 and the three trusts created by the division of Trust 2 are each separately managed and administered, they will be treated as separate trusts for federal income tax purposes.

RULINGS 5 AND 6

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year.

Section 1.662(a)-2(f) of the Income Tax Regulations provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as

defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

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 for determining gain, 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, the entire amount of the gain or loss on the sale or exchange of property is recognized.

Section 1.1001-1(a) provides, as a general rule, that except as otherwise provided in Subtitle A, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially in either kind or in extent, is treated as income or as 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 property interest. Such an exchange of property is a disposition under § 1001(a). See § 1.1001-1.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that 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 in order to extinguish their survivorship interests.

An exchange of property results in the realization of gain under § 1001 if the properties exchanged are materially different. 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.

Based on the information submitted, the representations made in the ruling request, and provided that the court renders judgment permitting the division, we conclude that the division of Trust 1 and Trust 2 into six separate trusts is not a distribution under § 661 or § 1.661(a)-2(f). Further, we conclude that the proposed division of Trust 1 and Trust 2 on a pro-rata basis into six separate trusts will not cause the interests of the trust beneficiaries to differ materially. The trust beneficiaries will hold essentially the same interests before and after the pro-rata division. Accordingly, the proposed division of the Trust 1 and Trust 2 assets among the six new trusts will not

cause the Trusts, the new trusts, or the beneficiaries to recognize any gain or loss from a sale or other disposition of property under §§ 61, 662, and 1001.

RULINGS 7 AND 8

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 by the amount of gain or decreased in the amount of loss 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 a taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person if under Chapter 1 of the Code such property has, for the purpose 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 solely on the facts and representations submitted, we conclude that because § 1001 does not apply to the division of the Trust 1 and Trust 2 assets, under § 1015, the tax basis of the assets of the six separate trusts received from Trust 1 and Trust 2 will be the same as the tax basis of Trust 1 and Trust 2 in such assets. Accordingly, under § 1223(2) the holding period of the six separate trusts in each asset received from Trust 1 and Trust 2 will include the holding period of Trust 1 and Trust 2 in such asset.

RULINGS 9 AND 10

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone

or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, revoke, or terminate or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

In order for §§ 2036-2038 to apply, the decedent must have made a transfer of property or any interest therein (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. In the present case, the proposed division of Trust 1 and the proposed division of Trust 2 do not constitute transfers within the meaning of §§ 2036-2038. The beneficiaries of the divided trusts will have the same interest after the division that they had as beneficiaries under the original trusts. We, therefore, conclude that the proposed division of Trust 1 into the three divided trusts and the proposed pro rata division of the assets of Trust 1 among the divided trusts will not cause any portion of the assets of Trust 1 or any of the divided trusts to be includible in the gross estate of any beneficiary of Trust 1 or any of the divided trusts. Additionally, we conclude that the proposed division of Trust 2 into the three divided trusts and the proposed pro rata division of the assets of Trust 2 among the divided trusts will not cause any portion of the assets of Trust 2 or any of the divided trusts to be includible in the gross estate of any beneficiary of Trust 2 or any of the divided trusts.

RULINGS 11 AND 12

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 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.

In this case, the beneficiaries of the divided trusts will have the same interest after the division that they had as beneficiaries under the original trusts. Because the beneficial interests of the beneficiaries are substantially the same, both before and after the proposed transaction, no transfer of property will be deemed to occur as a result of the division. Accordingly, we conclude that neither the proposed division of Trust 1 into the three divided trusts nor the proposed pro rata allocation of each existing asset of Trust 1 among the divided trusts will constitute a transfer by any beneficiary that will be subject to the gift tax under § 2501. Additionally, we conclude that neither the proposed division of Trust 2 into the three divided trusts nor the proposed pro rata allocation of each existing asset of Trust 2 among the divided trusts will constitute a transfer by any beneficiary that will be subject to the gift tax under § 2501.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code 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 the trustee of the Trusts.

Sincerely,

J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes