

generation-skipping transfer ("GST") tax consequences of a proposed division of a trust created under the last will and testament of Decedent.

The facts and representations are as follows: Decedent died on Date 1, a date prior to September 25, 1985, survived by Spouse, Daughter, Son, Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4.

Item Sixth of the Decedent's will provides that the residue of Decedent's estate will be divided into Trust A, a marital deduction trust, and Trust B, a non-marital trust. Only Trust B is at issue in the present case.

Item Sixth, paragraph II(a) provides that during the lifetime of Spouse, the trustee shall pay the net income of the trust to Spouse in quarterly or other convenient installments, but at least annually.

Item Sixth, paragraph II(b) provides that upon Spouse's death, the trustee shall distribute the net income of Trust B in equal shares to such of Decedent's children and the issue of Decedent's deceased children, with such issue to take per stirpes, as may be living at the time of the current quarterly distribution for the period of 21 years after the death of the survivor of Decedent, Spouse, Decedent's children, and those of Decedent's grandchildren who were living at the time of Decedent's death, but in no event beyond the period allowed under State's rule against perpetuities.

Item Sixth, paragraph II(c) provides that upon the expiration of the period of 21 years after the death of the survivor of Decedent, Spouse, Decedent's children, and those of Decedent's grandchildren who were living at the time of Decedent's death, or upon the expiration of the period allowed under State's rule against perpetuities, whichever shall occur first, the then remaining principal of the trust shall be distributed to Decedent's then living grandchildren, per stirpes, or if none, to Charity.

Item Seventh authorizes a corporate trustee to make distributions of principal to a child or grandchild if the share of income available to the beneficiary, when added to the beneficiary's other income and assets, is in the sole judgment of the corporate trustee insufficient to provide adequately for the beneficiary's health, education, support, and maintenance.

Spouse died on Date 2, survived by Daughter and Son. Daughter died on Date 3, leaving no issue. Son died on Date 4, survived by Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4, and their descendants. Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4, are the current trustees of Trust B. No corporate trustee is currently serving as a trustee of Trust B.

Currently, the sole asset of Trust B is stock in Company. The stock held by Trust B represents approximately $x\%$ of Company's outstanding shares. Decedent's family owns the majority of the remaining outstanding shares of Company. Disputes have arisen among the trustees of Trust B as to how Trust B's shares of Company stock

should be voted. To resolve these and other issues regarding the governance of Company and the voting of Trust B's Company stock, the shareholders of Company, including the trustees of Trust B, entered into a settlement agreement (the "Settlement Agreement") on Date 5. One aspect of the Settlement Agreement involved an agreement by all parties to cooperate in promptly seeking the division of Trust B into four separate trusts, one for the benefit of each of Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4, that would incorporate the dispositive scheme and administration provisions of Trust B.

In accordance with the terms of the Settlement Agreement, the trustees of Trust B filed a petition with State Court seeking authorization to divide Trust B into the Separate Trusts. On Date 6, State Court entered an order authorizing the division of Trust B into four equal, separate and distinct trusts, with one trust for the primary benefit of Grandchild 1, one trust for the primary benefit of Grandchild 2, one trust for the primary benefit of Grandchild 3, and one trust for the primary benefit of Grandchild 4 (referred to herein individually as a "Separate Trust" and collectively as the "Separate Trusts").

The order provides, generally, that the net income of each Separate Trust shall be paid to the grandchild for whose benefit it was created. After a grandchild's death, the net income shall be paid, per stirpes, to the grandchild's issue who are then living. Each Separate Trust will terminate at the termination date fixed in Item Sixth, paragraph II(c) of Decedent's will (the "Termination Date"), and the then remaining principal shall be distributed to the then living issue of the grandchild for whose benefit the Separate Trust had been created, per stirpes. If at any time prior to the Termination Date neither the grandchild for whom the Separate Trust was created nor any issue of that grandchild is living, the remaining principal of the Separate Trust for the benefit of that grandchild shall be divided equally among and added to the principal of the remaining Separate Trusts. If at the Termination Date no grandchild or issue of any grandchild of Decedent is living, the then remaining principal of the Separate Trust shall be distributed to Charity. Immediately upon the division of Trust B into the Separate Trusts, each grandchild shall be the sole trustee of his or her Separate Trust.

The order issued by State Court is subject to the receipt of a favorable private letter ruling from the Internal Revenue Service. Accordingly, the trustees of Trust B now request the following rulings:

1. The proposed division of Trust B into the Separate Trusts and the proposed pro rata allocation of the common stock of Company that constitutes the sole asset of Trust B among the Separate Trusts will not cause Trust B to lose its GST exempt status as a grandfathered trust, will not cause the Separate Trusts to be subject to the GST tax, and will not cause any distribution from, or termination of any interests in, Trust B or any of the Separate Trusts to be subject to the GST tax.

2. After the division of Trust B into the Separate Trusts and the proposed pro rata allocation of the common stock of Company that constitutes the sole assets of Trust B among the Separate Trusts, each of the Separate Trusts will be treated as a separate taxpayer under § 643(f).
3. The proposed division of Trust B into the Separate Trusts and the proposed pro rata allocation of the common stock of Company that constitutes the sole asset of Trust B among the Separate Trusts will not result in any amount having been paid, credited or distributed to any beneficiary under § 661 or § 1.661(a)-2(f)(1) of the Income Tax Regulations and will not result in the realization by any beneficiary of any income, gain or loss under § 1001.
4. The proposed division of Trust B into the Separate Trusts and the proposed pro rata allocation of the common stock of Company that constitutes the sole asset of Trust B among the Separate Trusts will not result in the realization by Trust B or any of the Separate Trusts of any income, gain or loss under § 61 or 1001, and will not result in the realization by any beneficiary of Trust B, or of any of the Separate Trusts, of any income, gain or loss under § 1001.
5. After the proposed division of Trust B into the Separate Trusts and the proposed pro rata allocation of the common stock of Company that constitutes the sole asset of Trust B among the Separate Trusts, (i) the assets of each Separate Trust received from Trust B will have the same basis under § 1015 as it had when held by Trust B at the time of the allocation, and (ii) the holding period for the assets allocated to each Separate Trust will include Trust B's holding period under § 1223.
6. The proposed division of Trust B into the Separate Trusts and the proposed pro rata allocation of the common stock of Company that constitutes the sole asset of Trust B among the Separate Trusts will not cause any portion of the asset of Trust B, or any of the Separate Trusts, to be includible in the gross estate of any beneficiary of Trust B or any of the Separate Trusts under §§ 2036 through 2038.
7. Neither the proposed division of Trust B into the Separate Trusts nor the proposed pro rata allocation of the common stock of Company that constitutes the sole asset of Trust B among the Separate Trusts will constitute a transfer by any beneficiary of Trust B or the Separate Trusts that will be subject to the gift tax under § 2501.

RULING 1

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

Section 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 provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii) (B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from the application of chapter 13 by § 1433(b)(2)(A) of the 1986 Act, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13.

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 generation-skipping transfer tax will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraphs (b)(4)(i)(A), (B), or (C) of this subsection) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, but only if -- (1) 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 (2) the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

In this case, Trust B was created and irrevocable before September 25, 1985. Also, it is represented that there have been no additions to Trust B after September 25, 1985. Consequently, Trust B is currently exempt from the GST tax.

The proposed division of Trust B into the Separate Trusts will not shift any beneficial interest in Trust B 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. In addition, the proposed transaction will not extend the time for vesting of any beneficial interest in the Separate Trusts beyond the period provided for in Trust B.

Accordingly, based on the facts submitted and the representations made, the proposed division of Trust B into the Separate Trusts and the proposed pro rata allocation of the Company stock held by Trust B among the Separate Trusts (i) will not cause Trust B to lose its GST exempt status as a grandfathered trust; (ii) will not cause the Separate Trusts to be subject to the GST tax; and (iii) will not cause any distribution from or termination of any interests in Trust B or any of the Separate Trusts to be subject to the GST tax.

RULING 2

Section 643(f) provides that, for purposes of subchapter J, 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.

As Son died on Date 4, each Separate trust will have a different beneficiary. Therefore, based solely on the facts and representations submitted, we conclude that the Separate Trusts created by the division of Trust B will be treated as separate taxpayers for federal income tax purposes.

RULINGS 3 and 4

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 1.661(a)-2(f) 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 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.

Based solely on the facts and representations submitted, we conclude that the division of Trust B into the Separate Trusts is not a distribution under § 661 or § 1.661(a)-2(f).

Section 61(a)(3) provides that gross income includes gains derived from dealings in property and, under § 61(a)(15), from an interest in a trust.

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 1001(b) states that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

A partition of jointly owned property is not a sale or other disposition of property if the co-owners of the joint property sever their joint interests but do not acquire a new or additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

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 a realization of gain or loss under § 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 of the United States in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different." In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that the 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. 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. Cottage Savings, 499 U.S. at 566.

In the present case, because State Court has approved the petition for partition, it is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the Separate Trusts will not differ materially from their interests in Trust B. In the proposed partition transaction, Trust B will be divided on a pro rata basis. Except for the changes described above, all other provisions of Trust B will remain unchanged. Accordingly, the proposed transaction will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries, and no gain or loss is recognized by the beneficiaries or Trust B or the Separate Trusts on the partition for purposes of § 1001(a).

RULING 5

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 the termination of the trust and distribution of the property, or thereafter.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included in the period for which such property was held by any other person, if the property has the same basis in the taxpayer's hands as it would have in the hands of that other person.

Based solely on the facts and representations submitted, we conclude that because § 1001 does not apply to the division of the assets of Trust B, under § 1015, the tax basis of the Separate Trusts in the property received from Trust B will be the same as the basis of Trust B in such property. In addition, because § 1001 does not apply to the partition of Trust B, pursuant to § 1223(2) the holding periods of the assets in the hands of the Separate Trusts will include the holding periods of the assets in the hands of Trust B.

RULING 6

Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

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 the 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 from the property.

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 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 beneficiaries of the Separate trusts will have the same interest that they had as beneficiaries under Trust B. Thus, the proposed division of Trust B into the Separate Trusts will not constitute a transfer within the meaning of § 2036-2038.

We therefore conclude that the proposed division of Trust B into the Separate Trusts and the proposed pro rata allocation of the common stock of Company among the Separate Trusts will not cause any portion of Trust B or any of the Separate Trusts to be includible in the gross estate of any beneficiary of Trust B or any of the Separate Trusts under §§ 2036 through 2038.

RULING 7

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

In this case, after the proposed division of Trust B into the Separate Trusts, each beneficiary will have the same beneficial interest as he or she held under Trust B. Accordingly, neither the proposed division of Trust B into the Separate Trusts nor the proposed pro rata allocation of Trust B's Company stock among the Separate Trusts will constitute a transfer by any beneficiary of Trust B or the Separate Trusts that will be subject to the gift tax under § 2501

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. Specifically, no opinion is expressed or implied concerning the tax consequences of any aspects of the Settlement Agreement other than those discussed 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 the taxpayer.

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,

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

Enclosures
Copy for 6110 purposes

cc: