



GC2 =  
GC3 =  
GC4 =  
Individual =  
Trustee =  
State =

Dear :

This is in response to your May 19, 2005 letter and other correspondence requesting a ruling concerning the income, gift, and generation-skipping transfer (GST) tax consequences of the proposed division of Trust 1.

You have requested the following rulings:

1. The division of Trust 1 into separate trusts in accordance with the terms of Order 2 will not affect the GST exempt status of Trust 1.
2. No taxable gift will be made by any party as a result of the implementation of Order 2 and such party's compliance therewith.
3. Neither Trust 1 nor any beneficiary thereof will realize gain or loss as a result of compliance with the terms of Order 2.
4. Each divided share of Trust 1 will be taxable as a separate trust.

The facts submitted are as follows:

Donor established Trust A, a revocable trust, on Date 1. Trust A was restated in its entirety on Date 2. It is represented that no additions were made to Trust A after September 25, 1985. Trustee was designated as trustee of Trust A.

Article First of Trust A provides, in part, that the Trustee is to pay over to Donor all income during her lifetime. Article First also provides that during Donor's life she shall act as the "Adviser" to the trustee. In that capacity, she shall have the power to direct the carrying into effect of the provisions of Trust A, and directions so given shall always be in writing and binding on the trustee. The trustee is exonerated from any liability for any act by the trustee made under the direction of the Adviser.

Article Third provides, in part, upon Donor's death after distribution of certain specific pecuniary amounts, the Trustee is to distribute income (up to \$3,000 per annum) for the support, maintenance, education, use or benefit of Donor's children until

such children reach the age of 30. Thereafter, the Trustee is to pay all the income of the trust to "such child or children" of Donor, "but in no event to exceed his or her proportionate share of income as long as other child or children of the Donor be living or shall have died leaving issue surviving." On the death of the last survivor of Donor's children, the Trustee is to distribute the residue of the trust estate equally to the use and for the benefit of the lawful issue of Donor's children, by representation.

Article Third, paragraph 9, provides that the Trustee with the consent and approval of the Adviser, is authorized from time to time during the term of the trust to expend such part of the income and of the principal of the share or shares of the trust estate to which any remote issue of the Donor shall for the time being be presumptively entitled, as the Trustee with the consent and approval of the Adviser deems proper for the support, maintenance, education, use and benefit of such presumptive beneficiary.

Article Nineteenth provides that unless sooner terminated the trust is to end immediately prior to the expiration of 21 years from and after the death of the last survivor of the Donor and her husband and issue, living on Date 2. On termination, the Trustee is to pay over the principal of the trust fund, free from trust, to the living issue of the Donor, per stirpes and not per capita. Article Twenty-first provides that Trust A is to be governed under the laws of State.

Donor died on Date 3 (before September 25, 1985) and Trust A became irrevocable upon her death. Donor was survived by Daughter 1 and Daughter 2. Daughter 2 died on Date 4 and Daughter 1 is still living. Daughter 1 currently has four children, GC1, GC2, GC3, and GC4.

It is represented that Trust A was the subject of protracted litigation in State Court. On Date 5, County Court issued Order 1 in settlement of this litigation, which divided Trust A into two trusts, Trust 1 for the benefit of Daughter 1 and her issue, and Trust 2 for the benefit of Daughter 2's issue.

Under paragraph 2 of Order 1, the income of Trust 1 is to be paid to Daughter 1 during her lifetime. Upon the death of Daughter 1, Trust 1 is to be distributed to the then living issue of Daughter 1, by right of representation.

Under paragraph 3, the income from Trust 2 is to be accumulated and added to the principal of Trust 2 during the life of Daughter 1. However, an amount, "the Distribution Amount," equal to one-half of the income of Trust 2 is to be distributed to Trust 1 and added to the principal of Trust 1. Upon the death of Daughter 1, Trust 2 is to be distributed to the then living issue of Daughter 2, by right of representation.

Under paragraph 4, to the extent the Distribution Amount provided under paragraph 3 is less than one percent of the fair market value of Trust 2 determined as of the last business day of the year preceding the year in which distribution of the

distribution amount occurs, then the Trustee is to also distribute from principal an additional amount such that the distribution equals one percent of the value of Trust 2.

Under paragraph 6, the Trustee's power to invade trust principal to or for the benefit of the remote issue of Donor during the lifetime of Daughter 1, is subject to the following conditions: (i) any discretionary distribution of principal to or for the benefit of the issue of Daughter 2 is to be made solely out of Trust 2; and (ii) any discretionary distribution of principal to or for the benefit of the issue of Daughter 1 is to be made solely out of Trust 1.

Under paragraph 7, except as may be otherwise provided in Order 1 or by further order of the court, Trust 1 and Trust 2 are to be held, administered, and distributed under the terms of Trust A.

Trustee petitioned State Court to divide Trust 1 into four separate trusts. On Date 6, State Court issued Order 2 authorizing Trustee to divide Trust 1 into four parts. Each part is to be held as a separate trust. Each separate trust will be held for the benefit of Daughter 1 and one of her respective children, GC1, GC2, GC3, and GC4, and their issue. Otherwise, the trusts will be subject to the same terms and conditions as described in Order 1. GC1 is appointed the Trust Adviser with respect to the trust established for his benefit and the benefit of GC4. Individual, an unrelated person, is appointed the Trust Adviser with respect to the trusts created for GC2 and GC3.

The taxpayer represents that Order 2 will be amended to provide that as adviser of the trust established for his benefit, GC1 shall not participate in any decision to distribute income or principal of said trust to GC1 pursuant to Article Third, paragraph 9 of Trust A.

## LAW AND ANALYSIS

### Ruling 1

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

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

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under section 26.2601-1(b) will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. A modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust.

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

In this case, the proposed division will not result in a shift of any beneficial interest in Trust 1 to any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed division will not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for in Trust. Accordingly, based on the facts submitted and representations made, we conclude that the division of Trust 1 into separate trusts in accordance with the terms of Order 2 will not affect the GST exempt status of Trust 1.

## Ruling 2

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year.

Section 2511(a) provides that the gift tax 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, upon the division of Trust 1 into four separate trusts, each beneficiary will have substantially the same beneficial interest as he or she had under Trust 1 prior to the division. Because the beneficial interests of the beneficiaries are substantially the same both before and after the proposed division, no transfer of property will be deemed to occur as a result of the division. Accordingly, based on the facts submitted and the representations made, we conclude that no taxable gift will be made by any party as a result of the implementation of Order 2 and such party's compliance therewith.

### Ruling 3

Section 61(a)(3) provides that gross income includes gains derived from dealings in property and, under section 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 section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in section 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 section 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under section 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides 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.

A partition of jointly owned property is not a sale or other disposition of property if the co-owner 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.

In Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), 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 issue presented was whether the exchange of mortgage loans constituted realization events for purposes of section 1001. The Court concluded that section 1.1001-1 reasonably interprets section 1001(a) and therefore, an exchange of property

gives rise to a realization event under section 1001(a) if the properties exchanged are “materially different.” In defining what constitutes a “material difference” for purposes of section 1001(a), the Court stated that properties are “different” in the sense that is “material” 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 instant case, the interests of the beneficiaries after the division will not differ materially from the interests in the original Trust. In accordance with the State Court approved order, the Trust will be divided on a pro rata basis. Except for the changes described above, all other provisions of Trust 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 the trusts on the division for purposes of section 1001(a).

#### Ruling 4

Section 643(f) provides that, under regulations to be 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 federal income tax.

Although the divided shares of the Trust have the same grantor, they have different beneficiaries. Therefore, based solely on the facts as presented in this ruling request, we conclude that as long as the four subtrusts are separately managed and administered, they will be treated as separate trusts for federal income tax purposes.

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

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. We are specifically not addressing any GST tax and gift tax consequences regarding Order 1.

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.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of provides that it may not be used or cited as precedent.

Sincerely yours,

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George Masnik  
Chief, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes