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Department of the Treasury

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P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-112978-00
Date: December 19, 2000

Re:

LEGEND:

Q =

R =

Decedent =

Spouse =

Date 1 =

Date 2 =

Date 3 =

Trust =

State =

Dear :

This is in response to your letter dated June 13, 2000 requesting rulings concerning the income, gift and estate tax consequences of a proposed severance of a trust ("Trust") under §§ 1001, 2033, 2036, 2037, 2038, 2501, and 2601 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: Decedent, a resident of State, executed his last will and testament on Date 1. On Date 2, Decedent died survived by his wife ("Spouse") and his two daughters, Q and R.

Decedent's will provides for various specific bequests. Thereafter, Item 14 of Decedent's will provides that the rest, residue and remainder of Decedent's estate is to be divided into equal parts, one for each child of Decedent that survives Decedent and

one share for each child who predeceases but leaves a child or children surviving. The shares of such descendants are to be disposed of as follows:

Each child's share set aside for a child of Decedent that survives Decedent is bequeathed to Spouse, Q, and R as trustees of Trust to hold, manage, control, invest and reinvest, and to pay the income therefrom as follows:

If both of Decedent's children survive Decedent and each child's share passes into Trust, the income therefrom is to be distributed equally between Decedent's children for life. Upon the death of a child income beneficiary, the corpus of the trust estate then on hand and allocable to that income beneficiary's share, shall pass, if the income beneficiary dying leaves descendants surviving her, to those descendants, per stirpes. Should the child income beneficiary dying leave no descendants of hers but other descendants of Decedent surviving, said corpus is to pass to such descendants of Decedent, per stirpes. If there are no descendants surviving the income beneficiary dying, then the corpus is to vest in those persons who, in accordance with the laws of descent and distribution of State, would be entitled to take Decedent's separate personal property had Decedent died immediately after the death of such income beneficiary.

Any share of Trust corpus that is to be allocated to a descendant (other than Q and R) who has not yet attained the age of 21 years at the date of the deceasing beneficiary's death is to be held in trust by the trustees of Trust for the minor descendant's benefit. The minor descendant is to receive income and/or corpus from his or her trust for maintenance, support and education. Upon the earlier to occur of (a) the death of the last to die of Q, R, and Spouse and (b) the minor descendant reaching age 21 the assets of the minor's trust are to be paid outright and free of trust to the minor beneficiary.

It is represented that Q and R are the only children of Decedent and both survived him. Accordingly, the income from Trust since Decedent's death has been and continues to be distributable equally between Q and R.

As a result of differences in investment policies, Q and R propose to partition Trust into two "Continuation Trusts", one for the benefit of Q and one for the benefit of R. Each Continuation Trust will be funded with a pro rata share of each asset of Trust, and those assets' respective bases, on the date of partition. To the extent that any assets of Trust cannot be distributed pro rata, the distribution to each Continuation Trust will be of equal value based upon the fair market value of the assets on the date of partition.

Q and R will each be named individually as the sole income beneficiary of her respective Continuation Trust and will receive distributions of income from her trust no less frequently than annually. Upon the death of each of Q and R, the assets of each's respective Continuation Trust will be paid over, per stirpes, to the income beneficiary's descendants, or held in further trust for the benefit of any minor descendant. In the

event that Q and/or R is not survived by a descendant, the assets of the beneficiary's Continuation Trust will be paid over to the Decedent's descendants (who in this case are limited to the surviving beneficiary), or if there are none, to Decedent's heirs at law.

Each of Q and R will serve as the sole trustee of her Continuation Trust. Each trustee of a Continuation Trust will be given the authority to appoint a successor trustee for himself or herself.

It is represented that there have been no additions to Trust after September 25, 1985.

The following rulings are requested:

1. The proposed partition will not cause Trust or the Continuation Trusts to lose their exempt status under § 2601 of the Internal Revenue Code.

2. The proposed partition will not cause the assets of either of Q's and R's Continuation Trusts to be includible in the respective beneficiary's gross estate under § 2033.

3. The proposed partition will not cause either of Q and R to be deemed to have made a transfer within the meaning of §§ 2036 through 2038 of the Code.

4. The proposed partition will not cause any beneficiary of Trust or the Continuation Trusts to have made a taxable gift under § 2501 of the Code.

5. The funding of the Continuation Trusts will not result in the recognition of gain or loss under § 1001 of the Code.

Ruling Request 1:

Section 2601 imposes a tax on every generation-skipping transfer, which is defined in § 2611(a) as (1) a taxable distribution, (2) a taxable termination, or (3) a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer 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) of the regulations, the tax does 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 that date (or out of income attributable to corpus so added).

A modification of a trust that is otherwise exempt from the generation-skipping transfer tax by reason of § 1433(b)(2)(A) of the Act will generally result in a loss of exempt status if the modification changes the quality, value, or timing of any powers, beneficial interests, rights, or expectancies originally provided for under the terms of the trust.

In the present case, Trust was irrevocable prior to September 25, 1985, and it is represented that no additions (actual or constructive) have been made to Trust after that date. Upon the proposed partition of Trust into two Continuation Trusts, each of the Continuation Trusts will continue to have the same terms as the terms of Trust created under Item 14 of Decedent's will. The interests of all the beneficiaries in Trust will remain the same, and the timing of the termination of the Continuation Trusts will remain the same. In addition, the value of the income and corpus interests of each beneficiary will not change as a result of the proposed division. Since its inception, Trust has been held as two shares, one for the benefit of Q and her descendants, and one for the benefit of R and her descendants.

Accordingly, based on the facts submitted and representations made, and provided that the Continuation Trusts are funded as described above and the assets transferred to each trust properly reflect the fair market value of the assets on the date of distribution and provided, further, that there are no future additions to either Continuation Trust, we conclude that any generation-skipping transfers from or with respect to the Continuation Trusts will remain exempt from the generation-skipping transfer tax under section 2601.

Ruling Request 2:

Section 2033 of the Code provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death. In the present case, both before and after the proposed division of Trust, the income interests of Q and R will terminate upon their respective deaths. At that time, Q and/or R's respective descendants will be entitled to the principal of said daughter's trust. Accordingly, we conclude that the proposed division of Trust will not cause the assets of Trust or of either Continuation Trust to be includible in Q and/or R's gross estate under section 2033.

Ruling Request 3:

Section 2036 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 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 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, or revoke, 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 through 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, Q and R, after the proposed division of Trust into two Continuation Trusts, will each have the right to the income from the property of her respective Continuation Trust, the same interest that each of Q and R had as an income beneficiary under Trust.

Accordingly, the proposed transaction will not cause either Q or R, as beneficiaries of Trust or as respective beneficiaries of the Continuation Trusts, to be considered to have made a transfer within the meaning of sections 2036 through 2038. In the absence of such a transfer, we conclude that the proposed transaction will not cause any portion of Trust or the Continuation Trusts to be includible in either Q's or R's gross estate under §§ 2036 through 2038.

Ruling Request 4:

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. Under § 2503(a) the term "taxable gifts" means the total amount of gifts made during the calendar year, less the deductions provided under § 2522 and other sections. 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. Upon division of Trust into two Continuation Trusts, each beneficiary will have the same right to income as the beneficiary had under Trust. Because the beneficial interests, rights, and expectancies of the beneficiaries of Trust 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 proposed division. Accordingly, we conclude that the proposed transaction will not cause Q or R, as

beneficiaries of Trust or as beneficiaries of a Continuation Trust, to have made a transfer subject to the gift tax under § 2501.

Ruling Request 5:

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

Section 1001 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 such section for determining loss over the amount realized.”

Section 1.1001-1(a) of the Income Tax Regulations provides that “[e]xcept 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 extent, is treated as income or as loss sustained.”

To the extent practicable, the trustees in the present case will either distribute to each Continuation Trust a pro rata share of each of the Trust assets and those assets’ respective bases.

In Cottage Savings Ass’n v. Commissioner, 499 U.S. 554 (1991), the Supreme Court addressed the issue of when a sale or exchange has taken place that results in realization of gain or loss under section 1001. Under the facts of that case, 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 institutions. The Supreme Court concluded that section 1.1001-1 of the regulations reasonably interprets section 1001(a) and stated that an exchange of property gives rise to a realization event under section 1001(a) if the properties exchanged are “materially different.” Id. at 560-561.

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” to the Code so long as their respective possessors enjoy legal entitlement that are different in kind or extent. Id. at 564-565. 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 the loans.

It is consistent with the Supreme Court’s opinion in Cottage Savings to find that the proposed distribution of Trust assets to the Continuation Trusts will not differ materially from each of Q’s and R’s respective share interest under the terms of Trust. Therefore, the interests of the beneficiaries in the Continuation Trusts will not differ

materially from their interests in Trust. Accordingly, the proposed distribution of assets does not give rise to a realization event under section 1001(a).

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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

Sincerely yours,
KATHERINE A. MELLODY
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy of letter for section 6110 purposes