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LEGEND

<u>Settlor</u>	=
<u>Date 1</u>	=
<u>Date 2</u>	=
<u>Trust</u>	=

<u>X</u>	=
<u>a</u>	=
<u>b</u>	=
<u>c</u>	=
<u>d</u>	=
<u>z</u>	=
<u>State</u>	=

Dear :

This letter responds to a letter dated January 20, 2006, submitted on behalf of Trust, requesting rulings on the income, estate, gift, and generation-skipping transfer (GST) tax consequences of the division of a trust.

FACTS

On Date 1, Settlor executed Trust, an irrevocable trust under the laws of State, for the primary benefit of X, one of Settlor's children. Settlor died on Date 2. Trust was not included in Settlor's estate. X is living and has four children, all of whom are living. X and all of X's children have attained age z. There have been no additions to Trust since Settlor's initial contribution of property to Trust.

Article FIRST of Trust provides that the income of Trust is to be distributed to X during X's life. Upon the death of X, the principal of Trust and any net income on hand or accrued shall be distributed to the descendants of X who shall survive X, in equal shares per stirpes, or in default of any such descendant, in equal shares per stirpes to the descendants of Settlor who shall survive X.

Article SECOND (B) of Trust provides that whenever the trustees are authorized or required to pay or distribute any amount, whether income or principal, to a descendant of Settlor (other than a child of Settlor) who will not have attained the age of z years, the trustee is authorized, in its absolute discretion, to retain all or any part of such amount as the principal of a separate trust for the benefit of such descendent (Holdback Beneficiary) or to add it to the principal of any separate trust which shall previously have been established for the benefit of the Holdback Beneficiary. In respect of each such separate trust (Holdback Trust), the trustee is directed to pay the net income of the Holdback Trust to the Holdback Beneficiary until that person attains age z or sooner dies (Holdback Distribution Date). On the Holdback Distribution Date, the trustee shall distribute the then principal of the Holdback Trust and any income on hand or accrued to the Holdback Beneficiary if that person is then living, otherwise in equal shares to the Holdback Beneficiary's then living children or, in default of any such child, in equal shares per stirpes to the then living descendants of the most immediate ancestor of the Holdback Beneficiary who shall have been Settlor or one of his descendants and who shall theretofore have died leaving descendants then living.

Article THIRD (B)(2) of Trust authorizes the trustee to withhold from any Beneficiary all or any part of the income which could be properly paid to the Beneficiary, and instead pay the amount so withheld to any descendent of the Beneficiary or, to the extent permitted by law, to accumulate the withheld income and add it to the principal of the trust, as the trustee deems to be in the best interest of the Beneficiary and the descendants of the Beneficiary as a group.

Article THIRD (B)(1) of Trust also authorizes the trustee, in its absolute discretion, to pay to the Beneficiary or to any of the Beneficiary's descendants, so much of the principal of such trust as the trustee shall deem necessary or advisable (a) for the maintenance and welfare of the Beneficiary of any descendant of his, or (b) to enable

the Beneficiary or any descendent of his to pay any debts or to enter into any financial transaction or transactions which the trustee shall deem to be in his best interests.

To date, all distributions from Trust have been made directly either to X or to X's children. No Holdback Trust has ever been established.

Section a of State statute permits a trustee, after notice to the "qualified beneficiaries," to divide a trust into two or more separate trusts, if the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trust. A proceeding to divide a trust may be commenced by the trustee pursuant to section b of State statute.

In addition, section c of State statute provides that a judicial proceeding involving a trust may relate to any matter involving the trust's administration, including but not limited to a proceeding to combine trusts or divide a trust. Section d of State Statute permits a court, with the consent of all adult beneficiaries who are not disabled and on a finding that the action will benefit the disabled, minor, unborn, and unascertained beneficiaries, to vary the terms of a trust.

For various reasons, Trust, through its trustee, proposes to divide Trust's property into four separate trusts of equal value, where each new trust will benefit X and one of X's four children and the descendants of such child. The trustee proposes to effect this division pursuant to authority granted to it under State law and only after approval of its action by a court of competent jurisdiction in State. The trustee will allocate a pro-rata portion of each of the assets of Trust to each of the four separate trusts insofar as possible. The provisions of each separate trust will continue to be governed by the terms of Trust, except that so long as there is any living descendant within a particular family line, distributions of income and principal will be limited to X and the descendants of that particular family line. In all other respects, the four separate trusts will be identical to Trust.

RULINGS REQUESTED

1. The division of Trust into four separate trusts will not cause Trust or any of the four separate trusts to become subject to the GST tax.
2. The four separate trusts into which Trust is divided will be treated as separate trusts for federal income tax purposes.
3. The division of Trust into four separate trusts will not cause Trust or any of the four separate trusts, or their beneficiaries, to recognize any gain or loss from a sale or other disposition of property under §§ 61, 662, or 1001.

4. The tax basis of each of the assets of the four separate trusts received from Trust will be the same as the tax basis of Trust in such asset. The holding period of the four separate trusts in each asset received from Trust will include the holding period of Trust in that asset.
5. A pro-rata division of the assets of Trust among the four separate trusts will not cause any portion of the assets of Trust or of the four separate trusts to be includible in the gross estate of any beneficiary of Trust or of the four separate trusts.
6. Neither the division of Trust into four separate trusts nor the proposed pro-rata allocation of the existing assets of Trust among the four separate trusts will constitute a transfer by any beneficiary that will be subject to the federal gift tax under § 2501.

LAW AND ANALYSIS

Ruling Request # 1

Section 2601 imposes a tax on every GST made after October 26, 1986. A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term taxable termination means a termination (by death, lapse of time, release of a power or otherwise) of an interest in property held in trust where the property passes to a skip person with respect to the transferor of the property. Section 2612(b) provides that the term taxable distribution means any distribution from a trust to a skip person other than a taxable termination or a direct skip. Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person.

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 GST 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, but only to the extent that the 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, is considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C) (relating to property includible in a grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(4)(i) provides that, in general, unless specifically provided otherwise, 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 GST tax purposes. Thus (unless specifically noted), 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 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 paragraph (b)(4)(i)(A), (B), or (C) of this section) 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, 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 for purposes of this section, 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. 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 addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of § 1.643(b)-1.

Section 26.2601-1(b)(4)(i)(E), Example 5 provides as follows: In 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate.

On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The division of the 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. In addition, 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. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In the present case, Trust was irrevocable on September 25, 1985. It has been represented that no additions have been made to Trust after that date. The proposed modification of Trust is similar to the modification described in § 26.2601-1(b)(4)(i)(E), Example 5. Therefore, based on the facts submitted and the representations made, we conclude that the proposed division will not shift a beneficial interest in any trust operating under Trust to a beneficiary who occupies a lower generation than the persons who held beneficial interests prior to the division. In addition, the division will not extend the time for vesting of any beneficial interest in the trusts operating under Trust beyond the period provided in Trust. Accordingly, the proposed division will not affect the status of any of the trusts operating under Trust as exempt from the GST tax under § 2601.

Ruling Request # 2

Section 643(f) provides that, for purposes of subchapter J of chapter 1 of subtitle A of the Code, 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 Tax Reform Act of 1986 provides § 643(f) shall apply to taxable years beginning after March 1, 1984; except that, in the case of a trust that was irrevocable on March 1, 1984, it shall apply only to that portion of the trust that is attributable to contributions to corpus after March 1, 1984.

The trustee of Trust has represented that no portion of the corpus of Trust was contributed to Trust after March 1, 1984. Based on the facts submitted and representations made, we conclude that as long as the new separate trusts are separately managed and administered, they will be treated as separate trusts for federal income tax purposes.

Ruling Request # 3

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

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, but such deduction shall not exceed the distributable net income (DNI) of the estate or trust.

Section 1.661(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. If the sum of (A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and (B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries exceeds the DNI of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to DNI (reduced by the amounts specified in (A)) as the other amounts properly paid, credited, or required to be distributed to the beneficiary bear to the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

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.

Section 1.1001-1(a) 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 as loss sustained.

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 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 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.

It is consistent with Cottage Savings to find that the interests of the beneficiaries after the division of Trust will not differ materially from their interests prior to the proposed division. Because State statute grants the trustees the power to administer the four separate trusts in the same manner as proposed in the division, the division of Trust is not treated as an exchange of interests by the beneficiaries or the trusts. Except for the changes described above, all other provisions of the trusts will remain unchanged.

Based on the facts submitted and the representations made, we conclude that the proposed division of Trust will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries. We further conclude that the division of Trust into four separate trusts is not a distribution under § 661 or § 1.661(a)-2(f). Accordingly, the proposed division of Trust's assets among the four new trusts will not cause Trust, the four new trusts, or the beneficiaries to recognize any income, gain, or loss under §§ 61, 662, and 1001.

Ruling Request # 4

Section 1015(b) provides that if property is acquired after December 31, 1920, 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 in 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 the 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 Subtitle A 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. See also § 1.1223-1(b).

Based on the facts submitted and representations made, we conclude that because § 1001 does not apply to the division of Trust, under § 1015 the basis of the assets received by the four separate trusts from Trust will be the same after the division as the basis of those assets in the hands of Trust before the division. Pursuant to § 1223(2), the holding period of each asset in the hands of one of the four separate trusts will include the holding period of Trust in that asset.

Ruling Request # 5

Section 2033 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.

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 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 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 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 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 (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period on the date of the decedent's death.

Section 2041(a)(2) provides that to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

In this case, the interests of the beneficiaries in Trust are the same before the proposed division as they are after the division. Therefore, based on the facts submitted and the representations made, we conclude that the proposed division of Trust will not cause any of the property of Trust or the four separate trusts to be included in the gross estate of any of the beneficiaries of Trust or the four separate trusts, except to the extent of property that is distributed to such person and remains in his or her estate at the date of death.

Ruling Request # 6

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 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 25.2511-2(b) of the Gift Tax Regulations provides that as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and

control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.

In this case, upon division of Trust into separate trusts, each beneficiary will have substantially the same beneficial interest as he or she had under Trust 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 the proposed division will not cause any beneficiary to be considered as having made a taxable gift under § 2501.

CONCLUSIONS

1. The proposed division of Trust will not affect the status of any of the trusts operating under Trust as exempt from the GST tax under § 2601.
2. As long as the new trusts are separately managed and administered, they will be treated as separate trusts for federal income tax purposes.
3. The proposed division of Trust into four separate trusts will not cause Trust or any of the four separate trusts or their beneficiaries to recognize any gain or loss under §§ 61, 662, or 1001.
4. Because § 1001 does not apply to the division of Trust, under § 1015 the basis of the assets received by the four separate trusts from Trust will be the same after the division as the basis of those assets in the hands of Trust before the division. Pursuant to § 1223(2), the holding period of the four separate trusts in each asset received from Trust will include the holding period of Trust in that asset.
5. The proposed division of Trust will not cause any of the property of Trust or the four successor trusts to be included in the gross estate of any of the beneficiaries of Trust or the four successor trusts, except to the extent of property that is distributed to such person and remains in his or her estate at the date of death.
6. The proposed division of Trust will not cause any beneficiary to be considered as having made a taxable gift 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.

This ruling is 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Trust's authorized representative.

Sincerely,

Audrey Ellis
Senior Counsel, Branch 1
(Passthroughs & Special Industries)

Enclosure (1)
Copy of letter for § 6110 purposes