

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-136842-13

Date:

December 30, 2013

### Legend

Decedent

Trust 1

Trust 2

Trust 3

Trust 1a

Trust 2a

Trust 3a

Child 1

Child 2

Child 3

Date 1

Date 2

State

State

Statute

X

Dear \_\_\_\_\_ :

This letter responds to your authorized representative's letter dated May 8, 2013, requesting income, estate, gift, and generation-skipping transfer (GST) tax rulings with respect to the proposed division of Trust.

The facts and representations submitted are summarized as follows:

Decedent died on Date 1, a date prior to September 25, 1985. Article Fourth of Decedent's will, provides, in relevant part, that the residue of Decedent's estate is to be

held in trust. For X years from the date of Decedent's death, the trustees are to pay the entire net income of the trust annually to charitable organizations that the trustees select. Upon the expiration of X years from the date of Decedent's death, the trust is to be divided into as many equal shares as there shall be children then living and the issue, collectively, of each child not then living, one equal share for the benefit of each surviving child and one equal share for the issue, collectively, of each deceased child, and to distribute the share for the issue, collectively, of a deceased child to such issue in equal shares, *per stripes*, outright. The trustee is to retain the remaining share in a separate trust, one trust for each child. Pursuant to Decedent's will, on Date 2, the trust was divided into three trusts: Trust 1 for the benefit of Child 1 and Child 1's family, Trust 2 for the benefit of Child 2 and Child 2's family, and Trust 3 for the benefit of Child 3 and Child 3's family.

The trustees have the discretion to pay the income and principal of each trust to the beneficiary child, the child's spouse, or the child's issue in any amount that the trustee may deem to be for his, her, or their best interests. Upon the death of the child, the trustee is to pay over the then remaining principal amount of the trust to the surviving spouse, or issue of the child in such amounts as may be directed in child's will. The child is expressly excluded from directing that any portion of the trust be distributed to that child's estate, the child's creditors, or the creditors of the child's estate.

The current trustees of Trust 1, Trust 2, and Trust 3 wish to resign. The trustees intend to seek judicial approval of their resignation and appointment of successor trustees.

Each trust owns an interest in a limited liability company (LLC). After the current trustees resign, the new trustees propose to partition each trust in a non-pro rata division. Trust 1's interest in the LLC will continue to be held by Trust 1, and the other assets of Trust 1 will be distributed to a new trust known as Trust 1a. Trust 2's interest in the LLC will continue to be held by Trust 2, and the other assets of Trust 2 will be distributed to a new trust known as Trust 2a. Trust 3's interest in the LLC will continue to be held by Trust 3, and the other assets of Trust 3 will be distributed to a new trust known as Trust 3a.

In each case after the proposed partitions, each successor trust will be subject to the same terms and conditions to which the original trust was subject immediately prior to the partition. Thus, each of the beneficiaries of the original trusts will have the same beneficial interests in the successor trusts.

State Statute provides that in the absence of contrary or limiting provisions in the judgment or order appointing a fiduciary, in the will, deed, or other instrument or in a subsequent court judgment or order, every fiduciary shall, in the exercise of good faith and reasonable discretion, have the power, in the case of a trustee, to divide a trust, before or after its initial funding, into two or more separate trusts, provided that such

division will not materially impair the accomplishment of the trust purposes or the interests of any beneficiary. Distributions provided for by the governing instrument may be made from one or more of the separate trusts.

You have requested the following rulings:

1. Trust 1, Trust 2, and Trust 3 will continue to be exempt from the application of the GST tax after the proposed partitions.
2. Trust 1a, Trust 2a, and Trust 3a will be exempt from the application of the GST tax after the proposed partitions.
3. None of the beneficiaries of Trust 1, Trust 2, and Trust 3 will be treated as making a gift for gift tax purposes as a result of the proposed partitions of Trust 1, Trust 2, and Trust 3.
4. As a result of the proposed partitions, none of Trust 1, Trust 2, Trust 3, Trust 1a, Trust 2a, and Trust 3a, and none of the beneficiaries of the trusts will realize gross income for income tax purposes.

## LAW AND ANALYSIS

### 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 § 2611 as a taxable distribution, a taxable termination, and 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 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. In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer 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. 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 capital gain for purposes of § 1001.

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 § 26.2601-1(b)(4)(i)(A), (B), or (C)), 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. 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 GST transfer or the creation of a new GST transfer.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's 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 in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In this case, Trust 1 will be partitioned into Trust 1 and Trust 1a, Trust 2 will be partitioned into Trust 2 and Trust 2a, and Trust 3 will be partitioned into Trust 3 and Trust 3a. The proposed partitions will not result in a shift of any beneficial interest in the

trusts to any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed partitions will not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for in the original trusts. Accordingly, based on the facts submitted and the representations made, we conclude that Trust 1, Trust 2, and Trust 3 will continue to be exempt from the application of the GST tax after the proposed partition. Further, we also conclude that Trust 1a, Trust 2a, and Trust 3a will be exempt from the application of the GST tax after the proposed partition.

### Ruling 3

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

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 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 Trust 1, Trust 1a, Trust 2, Trust 2a, Trust 3, and Trust 3a will have the same interests after the partitions that they had before the partitions. Because the beneficial interests of the beneficiaries are substantially the same, both before and after the proposed partitions, no transfer of property will be deemed to occur as a result of the partitions. Accordingly, based on the facts submitted and the representations made, we conclude that none of the beneficiaries of Trust 1, Trust 2, and Trust 3 will be treated as making a gift for gift tax purposes as a result of the proposed partitions.

### Ruling 4

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

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss realized is the excess of the adjusted basis provided

in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss realized must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for cash or for other property differing materially either in kind or in extent is treated as income or loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that a conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature, and the partition of a joint tenancy in stock, are not sales or exchanges and, therefore, do not result in the realization of gain or loss.

In this case, Trust 1a, Trust 2a, and Trust 3a will contain the same terms as Trust 1, Trust 2, and Trust 3. After the proposed partitions, the beneficiaries will have the same beneficial interest in the assets of Trust 1a, Trust 2a, and Trust 3a that they had in the assets when those assets were held by Trust 1, Trust 2, and Trust 3. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed transfer of a portion of the assets currently in Trust 1, Trust 2, and Trust 3 to Trust 1a, Trust 2a, and Trust 3a is not a sale or exchange and, therefore, will not result in the realization of gain or loss under § 1001 to Trust 1, Trust 2, Trust 3, Trust 1a, Trust 2a, Trust 3a, or any of the trust beneficiaries.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

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Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures

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Copy of this letter

cc: