

Internal Revenue Service

Department of the Treasury

Number: **200221032**

Washington, DC 20224

Release Date: 5/24/2002

Index Nos: 61.00-00; 1001.00-00; 1015.00-00;
1223.00-00; 2501.00-00; 2601.00-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:1 / PLR-113923-01

Date:

February 21, 2002

Legend:

Trust

Decedent

Spouse

A

B

C

D

E

F

G

H

J

Trust Company 1

Trust Company 2

Date 1

Date 2

Date 3

Date 4

Court

PLR-113923-01

a

Dear

This letter responds to the letter dated November 6, 2001 and prior correspondence, submitted on behalf of Trust, requesting a ruling under §§ 61, 1001, 1015, 1223, 2501, and 2601 of the Internal Revenue Code.

Decedent died testate on Date 1, survived by Spouse and Decedent's two children, A and B. Spouse died on Date 2. A died on Date 3, survived by A's four children, C, D, E, and F. B and B's two children, G and H, are living. At Decedent's death, Decedent's six grandchildren, C, D, E, F, G, and H, were living.

In Article Fourth, Paragraph A(2)(a), of Decedent's will, Decedent created Trust for the benefit of his sister J, his son A and A's issue, his daughter B and B's issue, and Spouse. The trustees of Trust are to pay J for her lifetime the sum of \$a per annum, payable monthly from the net income of the trust estate and to pay Spouse for her lifetime all of the rest of the net income of Trust. The trustees have discretion to distribute portions of the principal as the trustees deem necessary for Spouse's proper support, maintenance or comfort, with or without consideration of her other resources. After the death of Spouse, the trustees are to divide the trust estate into two equal shares and continue to hold one such share for the benefit of A and A's issue and the other such share for the benefit of B and B's issue. From each such share, the trustees are to pay Decedent's child for whom such share is held and such child's issue all or any such portion of the net income as the trustees deem advisable and also portions of the principal as the trustees deem necessary for such beneficiaries' needs. The trustees are not required to take into account such beneficiaries's other resources and to keep the payments of income or principal equal or proportionate.

Under Article Fourth, Paragraph B, of Decedent's will, Trust is to terminate twenty years after the death of the last survivor of Spouse and Decedent's issue living on the date of Decedent's death. Upon termination, the trustees are to transfer each share of Trust to the respective surviving issue, per stirpes, by right of representation in each generation and not per capita.

Article Eighth, Paragraph B, of Decedent's will provides that Trust is to be administered by five trustees, consisting of four individual trustees and a corporate trustee. Two of the individual trustees must be appointed by the adult beneficiaries of Trust from the group consisting of A and A's issue, and two of the individual trustees must be appointed by the adult beneficiaries of Trust from the group consisting of B and B's issue. The corporate trustee shall be Trust Company 1.

The trustees represent that A's surviving children have different financial needs and investment objectives that cannot be satisfied by a single investment program. Therefore, the trustees and the beneficiaries of A's share have unanimously decided

PLR-113923-01

they would like A's share of Trust divided into four separate trusts so that different investment programs may be implemented based on the individual needs of A's children and their issue.

The trustees petitioned Court to reform the terms of Trust. On Date 4, Court issued an order approving the proposed modification of the terms of Trust. Under the new terms of Trust, A's share of Trust will be partitioned into four separate trusts, which will be referred as "Grandchildren's Trusts," and the assets of A's share of Trust will be divided among the partitioned trusts, pro-rata. The terms of the partitioned trusts will be identical to those of Trust.

A's share of Trust will be partitioned into four separate trusts under the new Paragraph A(2)(b), which will be added to Article Fourth of Decedent's will. The new Paragraph A(2)(b) will read as follows:

As soon as practicable after the death of [A], the share provided for the benefit of [A] and his issue shall be divided into such number of equal shares as shall provide one (1) share for each then living child of [A] and one (1) share for the issue, collectively, of each child of [A] then deceased with issue then surviving (each share so provided hereinafter referred to as a "Grandchild's Trust"). The assets of the share for the benefit of [A] and his issue shall be partitioned on a pro rata basis among the Grandchildren's Trusts so provided. Each Grandchild's Trust shall be held, administered and distributed as follows:

(i) The Trustees shall, until the termination of any of the four Grandchildren's Trusts, pay to or for the benefit of an income beneficiary who shall be surviving from time to time of the child of mine for whom such share is held and such child's issue all of the net income of the four Grandchildren's Trusts or any portion of such net income as the Trustees shall deem advisable (subject to a charge against net income of one-half (½) the payment provided for my said sister in Paragraph A (1) above divided by the number of Grandchildren's Trusts in existence at the time of the payment to my sister is required). Any distribution of net income from a Grandchild's Trust to a current income beneficiary of a Grandchild's Trust will be made at the discretion of the Trustees of the four Grandchildren's Trusts and will be charged equally to each Grandchild's Trust. To the extent any Grandchild's Trust is exhausted, any such distribution of net income to a current income beneficiary of a Grandchild's Trust (including to a current income beneficiary whose Grandchild's Trust has been exhausted) will be charged equally to the remaining Grandchildren's Trusts.

(ii) The Trustees shall make a distribution of a portion of the principal of a Grandchild's Trust to a current income beneficiary of a Grandchild's Trust, in such amounts and at such times as the Trustees

PLR-113923-01

shall in their discretion deem necessary or advisable, in accordance with the income beneficiary's needs as determined by the Trustees in their discretion with or without consideration of such current income beneficiary's other resources. Any distribution of principal to a current income beneficiary of a Grandchild's Trust will be charged equally to the four Grandchildren's Trusts (or those trusts in existence at the time of distribution). To the extent any Grandchild's Trust is exhausted, any distribution of principal to a current income beneficiary of a Grandchild's Trust (including to a current income beneficiary whose Grandchild's Trust has been exhausted) will be charged equally to the remaining Grandchildren's Trusts.

(iii) The Trustees of the four Grandchildren's Trusts have no obligation to keep the payments of income or principal to the current income beneficiaries of the four Grandchildren's Trust, equal or proportionate, and shall accumulate all surplus net income and may add the same to the principal of the Grandchild's Trust that earned the net income.

(iv) In the event the last surviving beneficiary of any Grandchild's Trust dies prior to the termination of the trust (as provided in Paragraph B) the remaining assets of such Grandchild's Trust shall be distributed on a pro-rata basis to and held as part of the remaining Grandchildren's Trusts which then have surviving beneficiaries.

Paragraph B of Article Fourth will be modified to read as follows:

Each trust created hereunder shall terminate twenty (20) years after the death of the last survivor of my wife and my issue living on the date of my death. Upon such termination the Trustees shall transfer, convey and deliver absolutely and free from any trust, the principal of such trust estate and any undistributed income then on hand to the then current income beneficiaries thereof.

Under the modified terms of Trust, each Grandchild's Trust, created for the benefit of C, D, E, F, and their issue, will have two trustees, one individual trustee and one corporate trustee. The corporate trustee will be Trust Company 2. C will be the initial individual trustee for the Grandchild's Trust for the benefit of C and C's issue, D will be the initial individual trustee for the Grandchild's Trust for the benefit of D and D's issue, E will be the initial individual trustee for the Grandchild's Trust for the benefit of E and E's issue, and F will be the initial individual trustee for the Grandchild's Trust for the benefit of F and F's issue. If the initial individual trustee fails to serve, because of death, disability, resignation or otherwise, the successor individual trustee will be chosen by a majority of the adult income beneficiaries of each Grandchild's Trust. If there are none, no individual trustee will be chosen until there is an eligible individual trustee.

PLR-113923-01

The trustees represent that no additions, actual or constructive, have been made to Trust after September 25, 1985.

The trustees requested the following rulings:

(1) The proposed partition of the share of Trust for the benefit of A and his issue into four equal separate trusts will not cause the original remaining trust share and resulting four separate trusts to lose their exempt status for generation-skipping transfer (GST) tax purposes and will not subject the original remaining trust share, the four separate trusts, or distributions from any of these trusts to the generation-skipping transfer tax under § 2601.

(2) The proposed pro-rata distribution of the original trust assets among the successor trusts will not cause any beneficiary, the original trust, or the successor trusts to recognize any gain or loss from a sale or other disposition of the property under §§ 61 and 1001.

(3) The proposed partition and pro-rata distribution will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries.

(4) The basis of each successor trust in each asset received from the original trust will be the same as the original trust's basis in that asset pursuant to § 1015.

(5) The holding period of each successor trust for each asset received from the original trust will include the original trust's holding period for that asset according to § 1223(2).

Ruling Request 1

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

Section 2611(a) provides that, for purposes of the GST tax, the term "generation-skipping transfer" means (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 26.2601-1(b)(1)(i) of the GST Tax Regulations provides in part that the GST tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust (as defined in § 2652(b)) in existence on September 25, 1985, is considered an irrevocable trust.

PLR-113923-01

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 § 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.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of § 26.2601-1(b)(4)(i)(D)(2), 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. 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.

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 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, 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 partition of A's share of Trust into four separate trusts will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the persons who held the beneficial interest prior to the partition. Further, the proposed partition will not extend the time for vesting of any beneficial interest in the partitioned trusts beyond the period provided for in the original Trust.

Accordingly, based on the information submitted and representations made, we conclude that the proposed pro-rata partition of A's share of Trust into four separate trusts will not cause the original remaining trust share, i.e., the share of Trust for the benefit of B and B's issue, and the resulting four separate trusts to lose their exempt

PLR-113923-01

status for generation-skipping transfer tax purposes. We also conclude that, if Trust is partitioned as proposed, this modification will not cause distributions from the share for B and B's issue or the separate trusts for A's issue to be subject to the GST tax.

Ruling Request 2

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 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 such section for determining loss over the amount realized.

Section 1001(b) provides 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 received.

Section 1001(c) provides that, except as otherwise provided in subtitle A, the entire amount of the gain or loss determined under § 1001 on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A of the Code, the gain or loss realized from an exchange of property for other property differing materially either in kind or in extent is treated as income or loss sustained. Properties are viewed as "different" in a sense that is "material" to the Code when their possessors enjoy legal entitlements, different in kind or extent from the properties given up. Cottage Savings Ass'n v. Commissioner, 499 U.S. 554, at 564-565 (1991).

The conversion, for the purpose of eliminating a survivorship feature, of a joint tenancy into a tenancy in common is a nontaxable transaction. Likewise, the severance of a joint tenancy under a partition action pursuant to state law is a nontaxable transaction. Rev. Rul. 56-437, 1956-2 C. B. 507. Rev. Rul. 69-486, 1969-2 C. B. 159 (non-pro-rata, in-kind distribution from trust pursuant to agreement of beneficiaries is an exchange between the beneficiaries because the trustee was not authorized by the trust instrument or local law to make non-pro-rata distribution), distinguished by Rev. Rul. 83-61, 1963-1 C. B. 78.

Accordingly, the proposed partition on a pro-rata basis into four separate trusts will not constitute an exchange or other disposition of property as no material difference will exist between the property received and given by the beneficiaries. Consequently, the partition of A's share of Trust on a pro-rata basis will not give rise to a realization of income under §§ 61 and 1001.

PLR-113923-01

Ruling Request 3

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, upon the partition of A's share of Trust into the four separate trusts, each beneficiary of a partitioned trust will have the same beneficial interest as he or she had under Trust. Because the beneficial interests of the beneficiaries 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 partition. Accordingly, we conclude that the proposed partition of A's share of Trust and the pro-rata distribution of the assets of A's share of Trust among the partitioned trusts will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries.

Ruling Request 4 and 5

Section 1015(b) provides that, if the property was acquired by a transfer in trust (other than by 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 the transfer.

Section 1.1015-2(a) provides that, in the case of property acquired by transfer in trust (other than by a transfer in trust by a 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 upon such transfer under the law applicable to the year in which the transfer was made. In addition, the principles in § 1.1015-2(b) concerning the uniform basis are applicable in determining the basis of property where more than one person acquires an interest in property by transfer in trust. Section 1.1015-2(b) provides that property acquired by gift has a single or uniform basis although more than one person may acquire an interest in the property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017.

Because § 1001 will not apply to the proposed partition of A's share of Trust, the basis of the assets in the partitioned trusts will be the same as the basis of the assets currently held in Trust.

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 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 taxpayers hands as it would have in the hands of such

PLR-113923-01

other person.

Accordingly, based on facts submitted and the representations made, we conclude that, after the partition of Trust into four separate trusts, the basis and holding periods of the assets held in the four separate trusts will be the same as the basis and holding periods of the assets held in Trust.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

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

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.

Sincerely,
James F. Hogan
Senior Technician Reviewer, Branch 9
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: Copy for § 6110 purposes