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In Re:

Refer Reply To:

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Date: MARCH 22, 2004

Legend

Trust =

H =

W =

Daughter 1 =

Daughter 2 =

Son 1 =

Son 2 =

Date 1 =

Year 1 =

Year 2 =

Court =

State =

State Statute =

Dear :

This is in response to the August 13, 2003 letter and subsequent correspondence, concerning the generation-skipping transfer (GST) tax and income tax consequences of the proposed division of Trust.

The facts and representations submitted are summarized as follows: H and W are the trustors of an irrevocable trust, Trust, dated Date 1, prior to September 25, 1985. Trust was created for the lifetime benefit of their daughters, Daughter 1 and Daughter 2. The trustees of Trust are Daughter 1 and Daughter 2.

Article II of Trust provides, in part, that the trustee shall distribute the net income, annually or at more frequent intervals, in equal shares to Daughter 1 and Daughter 2 while both are living. Upon the death of either Daughter 1 or Daughter 2, leaving surviving children, the share of income otherwise distributable to such deceased daughter shall accrue to the benefit of such surviving children, share and share alike, and the descendants, per stirpes, of any child then deceased. If there be no surviving children or other descendants of such deceased daughter, then her share of income shall be distributed to the other living children of trustors (including their sons, Son 1 and Son 2), share and share alike, and or to the living descendants, per stirpes, of any such other child of trustors then deceased.

Article III provides, in part, that the trust estate shall finally terminate upon whichever of the following events shall last occur: (a) the death of the survivor of Daughter 1 or Daughter 2; or (b) upon the youngest child of Daughter 1 or Daughter 2 attaining age 21. Upon such final termination, the corpus of the trust estate as then constituted shall be allocated and distributed free of trust to the persons to whom and in the proportions in which the income of the trust shall then be distributable.

Trustees propose to file a petition in State Court to request the following relief: (1) the division of Trust, at the death of the first of Daughter 1 or Daughter 2 to die, into two separate trusts, with a pro rata division of the assets of Trust between the separate trusts, and (2) the modification of Trust so that (a) if the first of Daughter 1 or Daughter 2 to die has descendants then living, the separate trust allocable with respect to the deceased daughter would be distributed as provided in Trust, or (b) if the first of Daughter 1 or Daughter 2 to die has no descendants then living, the separate trust allocable with respect to the deceased daughter would be allocated among the then living descendants of the trustors and held in separate trusts for such descendants until the death of the other daughter, with a pro rata division of assets among such separate trusts.

State Statute provides that upon petition by a trustee, beneficiary or any party in interest, for good cause shown, a court having jurisdiction over a trust, after a hearing on notice to all parties in interest, in such manner as the court may direct, may divide a trust into two or more single trusts upon such terms and conditions as it deems appropriate, if the consolidation or division: (1) is not inconsistent with the intent of the trustor with regard to any trust to be divided; (2) would facilitate administration of the trust or trusts; and (3) would be in the best interest of all beneficiaries and not materially impair their respective interests.

Daughter 1 has 4 children and 4 grandchildren currently living. One child of Daughter 1 died in Year 1, leaving no issue. All of Daughter 1's living children are over age 21. Daughter 2 has no issue. Son 1 has 3 children and 2 grandchildren currently living. Son 2 died in Year 2, survived by 2 children and 4 grandchildren. It is represented that all living beneficiaries of Trust, either personally or, in the case of minor beneficiaries, by means of virtual representation, will consent to the jurisdiction of the court with respect to the division and modification.

Trust was irrevocable on September 25, 1985. It is represented that no actual or constructive additions have been made to Trust after that date.

You have requested the following rulings: 1) the proposed modification to Trust will not cause Trust or the separate trusts to lose their exempt status under section 2601 of the Code; and 2) the proposed modification to Trust will not cause Trust or the separate trusts to recognize gain or loss under section 61 or 1001.

#### Issue 1

Section 2601 imposes a tax on each generation-skipping transfer (GST) which includes under section 2611 a taxable distribution, a taxable termination, and a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (Act), 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) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. See section 26.2601-1(b)(1)(v) regarding constructive addition.

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 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, involves a trust that is irrevocable on or before September 25, 1985. 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 terms are identical except for the beneficiaries. 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 section 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 this case, Trust was irrevocable on September 25, 1985, and no additions, constructive or actual, have been made to Trust since that date. The parties propose to divide Trust at the death of the first of Daughter 1 or Daughter 2 to die, into two separate trusts, with a pro rata division of the assets of Trust between the separate trusts. If the first of Daughter 1 or Daughter 2 to die has living descendants then living, the separate trust allocable with respect to the deceased daughter would be distributed as provided in Trust. If the first of Daughter 1 or Daughter 2 to die has no descendants then living, the separate trust allocable with respect to the deceased daughter would be allocated among the then living descendants of trustors and held in separate trusts for such descendants until the death of the other daughter.

Accordingly, based on the submitted information, the modification to divide Trust into the separate trusts will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division. Further, the proposed division will not extend the time for vesting of any beneficial interest in the separate trusts beyond the period provided for in the original trust. We conclude that the proposed modification to divide Trust into separate trusts upon the death of the first of Daughter 1 or Daughter 2 to die will not cause the separate trusts to lose exempt status for GST tax purposes under section 2601.

## Issue 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 is the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss is the excess of the adjusted basis provided in section 1011 over the amount realized. Section 1001(c) provides that,

except as otherwise provided, the entire amount of the gain or loss on the sale or exchange of property is recognized.

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

For purposes of section 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional property interest. Such an exchange of property is a disposition under section 1001(a). See section 1.1001-1.

Rev. Rul. 56-437, 1956 C.B. 507, holds that a partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests in order to extinguish their survivorship interests.

An exchange of property results in the realization of gain under section 1001 if the properties exchanged are materially different. Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." Id. at 565.

Based on the information submitted and the representations made in the ruling request, the proposed division of Trust on a pro-rata basis into two separate trusts will not cause the interests of Daughter 1 or Daughter 2 to differ materially. Daughter 1 and Daughter 2 will hold essentially the same interests before and after the pro-rata division. Also, the proposed modification of Trust to provide for the distribution of the separate trusts based on the status of the first of Daughter 1 or Daughter 2 to die will not cause the interests of any beneficiary to differ materially. Accordingly, the proposed division and modification of Trust will not cause the trusts nor the beneficiaries to recognize any gain or loss from a sale or other disposition of property under sections 61 or 1001.

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

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Lorraine E. Gardner  
Senior Counsel, Branch 4  
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes  
Copy of this letter

cc:

cc:

cc: