

## Internal Revenue Service

Department of the Treasury  
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Date of Communication: Not Applicable

Person To Contact:

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Refer Reply To:

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Date: OCTOBER 21, 2011

RE:

### Legend

|                   |   |
|-------------------|---|
| Settlor           | = |
| Trust             | = |
| Trustee           | = |
| Date 1            | = |
| Date 2            | = |
| State 1           | = |
| State 2           | = |
| State 1 Statute 1 | = |
| State 1 Statute 2 | = |
| Court             | = |

Dear :

This letter responds to your authorized representative's letter dated April 25, 2011, 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:

Trust was created by Settlor under an agreement effective Date 1 (prior to September 25, 1985), for the benefit of Settlor's children and the issue of his children. Settlor's wife is also a beneficiary upon Settlor's death. Trustee is the current trustee of

Trust. Trust income and principal may be distributed to any one or more trust beneficiaries in Trustee's sole discretion, for the support, maintenance, welfare, happiness, medical needs, costs of last illness, funeral costs, emergency needs and for entering any business of such beneficiaries.

Upon the later of the death of Settlor, Settlor's wife, and Settlor's youngest child living on Date 1, the trust will be divided into shares for Settlor's issue *per stripes* to be held in further trust for each such beneficiary until the age of 40 years (or 21 years for each descendant of a child not living on Date 1). Each descendant has a general testamentary power of appointment to appoint his or her trust upon that descendant's death.

The current beneficiaries of the trust are Settlor's daughter and her two daughters. Trust owns interests in State 1 partnerships, which own real estate interests in State 1. Trust also owns marketable securities.

Trust provides that the situs of Trust is State 1, but permits Trustee to change the situs. Trust does not expressly authorize or prohibit severance of the trust. Under State 1 Statute 1, a trustee may direct the establishment of separate trusts unless directly contrary to the primary purpose of the trust. State 1 Statute 2 allows for a non-pro rata distribution of trust property to separate trusts upon direction of the court.

Trustee and Settlor propose to divide Trust into two separate trusts, New Trusts, one to hold the State 1 partnership interests and the other to hold the marketable securities. The Trustee and Settlor also propose to move the situs of the New Trusts to State 2. Trustee and Settlor brought a proceeding in Court seeking the division of Trust into New Trusts and transfer of the situs of New Trusts to State 2 where Trustee resides and conducts operation of the trust. On Date 2, Court issued a decree granting permission to the Trustee to sever Trust, allocate assets to the New Trusts on a non-pro rata basis, and change the situs of the New Trusts, subject to a favorable ruling from the Internal Revenue Service. The decree also states that the terms of Trust will govern both of the New Trusts.

The Trustee represents that Trust has been irrevocable since its creation and that no property has been added to Trust after September 25, 1985. The Trustee further represents that he has not made an election pursuant to § 643(a)(3) of the Internal Revenue Code (Code).

You have requested the following rulings:

1. The proposed division will not cause Trust, the New Trusts, or any beneficiaries to recognize any gain or loss from the sale or other disposition of property under § 61 or 1001.

2. Because § 1001 does not apply to the proposed division of Trust, pursuant to § 1015, the basis that the New Trusts have in the assets of the New Trusts immediately after the division will be the same as the basis of Trust in such assets immediately before such division.
3. Because § 1001 does not apply to the proposed division of Trust, pursuant to § 1223(2), each asset transferred by Trust to the New Trusts will have the same holding period in the hands of the New Trusts immediately after the division that it had in Trust immediately before the division.
4. The proposed division will not cause the interest of any beneficiary to be includible in the beneficiary's estate under §§ 2033, 2036, 2037, or 2038.
5. The proposed division will not cause any beneficiary to have made a taxable gift.
6. After the proposed division, the New Trusts will each be exempt from GST tax.
7. Transfers from Trust to the New Trusts and distributions from the New Trusts (and any successor trusts) to their beneficiaries will not be subject to GST tax.

## LAW AND ANALYSIS

### Ruling 1

Section 61(a) defines gross income as "all income from whatever source derived." Under § 61(a)(3), gross income includes "[g]ains derived from dealings in property." Under § 61(a)(15), income from an interest in a trust is included in gross income.

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 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 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 other property differing materially either in kind or in extent is treated as income or as loss sustained.

A partition of jointly owned property is not a sale or other disposition of property if the co-owners of the joint property sever their joint interests but do not acquire a new or

additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), a financial institution exchanged its interest in one group of residential mortgage loans for another lender's interest 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 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." Id. at 560-61. 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" so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 565. The Court held that mortgage loans made to different obligors and secured by different homes embodied distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Id. at 566.

In this case, the beneficiaries will have the same beneficial interest in the assets of the New Trusts that they had in the assets of Trust. The New Trusts will contain the same terms as Trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division of Trust into New Trusts and non-pro rata allocation of the assets to the New Trusts will not result in the realization or recognition of any gain or loss under § 61 or 1001 to Trust, the New Trusts, or any of the trust beneficiaries.

### Rulings 2 and 3

Section 1015(b) provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss recognized.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by a transfer in trust (other than a 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 by 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.

Section 1.1015-2(a)(2) applies the uniform basis principles in § 1.1015-1(b) for determining the basis of property where more than one person acquires an interest in property by transfer in trust.

Under § 1.1015-1(b), 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.

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 taxpayer's hands as it would have in the hands of such other person.

In this case, § 1001 does not apply to the proposed transaction. Thus, after the division of Trust and transfer of the assets into the New Trusts, the basis in each asset will be the same in the New Trusts as it was in Trust under § 1015. Furthermore, we conclude that, under § 1223(2), the holding period for each asset received by the New Trusts will include the period that the asset was held by Trust.

#### Ruling 4

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of 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 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 therefrom.

Section 2037(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 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(a)(1) 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, 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, revoke, or terminate, 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, the proposed division of Trust does not constitute a transfer within the meaning of §§ 2036 through 2038. The beneficiaries of the New Trust will have the same interests after the division that they had as beneficiaries under Trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division will not cause the interest of any beneficiary to be includible in the beneficiary's estate under §§ 2033, 2036, 2037, or 2038.

#### Ruling 5

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift 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 the New Trusts will have the same interests after the division that they had as beneficiaries under Trust. 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 have made a taxable gift.

Rulings 6 and 7

Section 2601 imposes a tax on every generation-skipping transfer. The term generation-skipping transfer is defined in § 2611 as a taxable distribution, a taxable termination, or 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.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust, by judicial reformation or nonjudicial reformation that is valid under applicable state law, 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 § 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. 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, 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 a 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 GST tax.

In this case, Trust will be divided into two New Trusts. The proposed division 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 division will not extend the time for vesting of any beneficial interest in the New Trusts beyond the period provided for in Trust. Accordingly, based on the facts submitted and the representations made, we conclude that after the proposed division, the New Trusts will each be exempt from GST tax. Further, we also conclude that transfers from Trust to the New Trusts and distributions from the New Trusts (and any successor trusts subject to the terms of Trust) to their beneficiaries will not be subject to GST tax.

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

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.

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.

The rulings in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

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

Copy for § 6110 purposes  
Copy of this letter