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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-137127-01

Date:

JUNE 24, 2002

Re:

Legend:

Grantor	=
Spouse	=
Son	=
Trust 1	=
Trust 2	=
Trust 3	=
Trust 4	=
Date	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
University	=
State	=
State District Court	=

Dear :

This is in response to your letter of March 22, 2002, and prior correspondence, in which you request a ruling on the application of the income, gift, estate and generation-skipping transfer (GST) tax provisions of the Internal Revenue Code to the proposed modification to Trust.

Grantor and Spouse created an irrevocable inter vivos trust, Trust 1, for the benefit of the then living children of Son, Grandchild 1 and Grandchild 2, and any children of Son born after creation of Trust 1.

Article III (a) of Trust 1 provides that the trust will terminate 21 years after the last to die of Grandchild 1 and Grandchild 2.

Article III (b) of Trust 1 provides as follows:

(b) During the continuance of this trust, the trustees shall have the power to pay out of the income or corpus of this trust estate, such amount or amounts to or for the benefit of [Grandchild 1, or Grandchild 2] or any child or children of [Son] as may hereafter be born, or either of them, as to

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said trustees may be found necessary for the care, support, education and maintenance of said named parties. In this connection, the amount and number of said payments are vested in the sole discretion of said trustees and their authority in this connection shall not be subject to question by any beneficiary or any other party.

Article III (c) provides:

(c) Upon the expiration of the term as hereafter provided, the trustees shall make a final accounting of the estate in their hands and shall deliver said trust estate, in fee simple,

(1) To any child or children as may hereafter be born to [Son], if any then survive or if deceased, to their respective issue, if any; and

(2) To any child or children as may hereafter be born to Grandchild 1, if any then survive or if deceased, to their respective issue, if any; and

(3) To any child or children as may hereafter be born to [Grandchild 2], if any then survive or if deceased, to their respective issue; if any,

per stirpes, in accordance with their respective relationship to the Grantors herein.

If there is no beneficiary living then the trustee will deliver all of the trust estate in fee simple to Son, if living. If Son is not living then the trustees will deliver the trust estate in fee simple to University.

If any beneficiary of Trust 1, has not attained the age of 21 at the time of vesting of the trust estate, then trustees will act as Guardian of the trust estate.

Since creation of Trust 1, Son had an additional child, Grandchild 3. Son is currently living. The current beneficiaries of Trust 1 are Grandchild 1, Grandchild 2, and Grandchild 3.

You propose to divide Trust 1 into three subtrusts, one each for Grandchildren 1 (Trust 2), Grandchild 2 (Trust 3) and Grandchild 3 (Trust 4), with each of the new trusts receiving an undivided one-third of the assets of Trust 1. Trust 1 will be divided pursuant to an appropriate judicial proceeding brought in State District Court of proper jurisdiction. Each of the three trusts will have terms identical to Trust 1, except that Article III, paragraphs (a), (b) and (c) will be revised. Trust 2 will be revised to read as follows:

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(a) This trust shall terminate twenty-one (21) years after the death of both [Grandchild 1 and Grandchild 2].

(b) During the continuance of this trust, the trustees shall have the power to pay out of the income or corpus of this trust estate, such amount or amounts to or for the benefit of [Grandchild 1] and/or any child (other than [Grandchild 2] and [Grandchild 3]) of [Son], as to said trustees may be found necessary for their care, support, education and maintenance. After the death of [Grandchild 1], the trustees shall have the power to pay out of the income or corpus of the trust estate, such amount or amounts to or for the benefit of [Grandchild 1's] children and/ or any child (other than [Grandchild 2] and [Grandchild 3]) of [Son] as to said trustees may be found necessary for their care, support, education and maintenance. In this connection, the amount and number of said payments are vested in the sole discretion of said trustees and their authority in this connection shall not be subject to question by any beneficiary or any other party.

(c) Upon the expiration of twenty-one (21) years after the last to die of [Grandchild 1 and Grandchild 2], the trustees shall make a final accounting of the estate in their hands and will deliver the trust estate as follows:

(i) if any child (other than [Grandchild 1, Grandchild 2, or Grandchild 3]) is born to [Son], a portion thereof equal to a fraction, (A) the numerator of which is one (1) and (B) the denominator of which is equal to the total number of [Son's] children who are living or deceased leaving issue then living, shall pass to such child if such child is then living; otherwise to such child's then living issue per stirpes. Example: If [Son] has a fourth (4th) child, then one-fourth (1/4th) of the trust would pass to such child.

(ii) Any portion of said trust estate not disposed of under subparagraph (i) above shall pass as follows:

(A) If any issue of [Grandchild 1] are then living, then to [Grandchild's] then living issue, per stirpes;

(B) If no issue of [Grandchild 1] are then living, then to Grantors' then living issue, per stirpes

(C) If no person described in subparagraph (A) or (B) above is then living, then to [Son], if he is then living; or

(D) If no person described in subparagraph (A), (B) or (C) is then living, then to [University]... .

Trust 3 will be revised to read as follows:

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(a) This trust shall terminate twenty-one (21) years after the death of both [Grandchild 1 and Grandchild 2].

(b) During the continuance of this trust, the trustees shall have the power to pay out of the income or corpus of this trust estate, such amount or amounts to or for the benefit of [Grandchild 2] and/or any child (other than [Grandchild 1] and [Grandchild 3]) of [Son], as to said trustees may be found necessary for their care, support, education and maintenance. After the death of [Grandchild 2], the trustees shall have the power to pay out of the income or corpus of the trust estate, such amount or amounts to or for the benefit of [Grandchild 2's] children and/ or any child (other than [Grandchild 1] and [Grandchild 3]) of [Son] as to said trustees may be found necessary for their care, support, education and maintenance. In this connection, the amount and number of said payments are vested in the sole discretion of said trustees and their authority in this connection shall not be subject to question by any beneficiary or any other party.

(c) Upon the expiration of twenty-one (21) years after the last to die of [Grandchild 1 and Grandchild 2], the trustees shall make a final accounting of the estate in their hands and will deliver the trust estate as follows:

(i) if any child (other than [Grandchild 1, Grandchild 2, or Grandchild 3]) is born to [Son], a portion thereof equal to a fraction, (A) the numerator of which is one (1) and (B) the denominator of which is equal to the total number of [Son's] children who are living or deceased leaving issue then living, shall pass to such child if such child is then living; otherwise to such child's then living issue per stirpes. Example: If [Son] has a fourth (4th) child, then one-fourth (1/4th) of the trust would pass to such child.

(ii) Any portion of said trust estate not disposed of under subparagraph (i) above shall pass as follows:

(A) If any issue of [Grandchild 2] are then living, then to [Grandchild's] then living issue, per stirpes;

(B) If no issue of [Grandchild 2] are then living, then to Grantors' then living issue, per stirpes Paragraphs,

(C) If no person described in subparagraph (A) or (B) above is then living, then to [Son], if he is then living; or

(D) If no person described in subparagraph (A), (B) or (C) is then living, then to [University]... .

Trust 4 will be revised to read as follows:

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(a) This trust shall terminate twenty-one (21) years after the death of both [Grandchild 1 and Grandchild 2].

(b) During the continuance of this trust, the trustees shall have the power to pay out of the income or corpus of this trust estate, such amount or amounts to or for the benefit of [Grandchild 3] and/or any child (other than [Grandchild 1] and [Grandchild 2] of [Son], as to said trustees may be found necessary for their care, support, education and maintenance. After the death of [Grandchild 3], the trustees shall have the power to pay out of the income or corpus of the trust estate, such amount or amounts to or for the benefit of [Grandchild 3's] children and/ or any child [other than Grandchild 1 or Grandchild 2] of son as to said trustees may be found necessary for their care, support, education and maintenance. In this connection, the amount and number of said payments are vested in the sole discretion of said trustees and their authority in this connection shall not be subject to question by any beneficiary or any other party.

(c) Upon the expiration of twenty-one (21) years after the last to die of [Grandchild 1 and Grandchild 2], the trustees shall make a final accounting of the estate in their hands and will deliver the trust estate as follows:

(i) if any child (other than [Grandchild 1, Grandchild 2, or Grandchild 3]) is born to [Son], a portion thereof equal to a fraction, (A) the numerator of which is one (1) and (B) the denominator of which is equal to the total number of [Son's] children who are living or deceased leaving issue then living, shall pass to such child if such child is then living; otherwise to such child's then living issue per stirpes. Example: If [Son] has a fourth (4th) child, then one-fourth (1/4th) of the trust would pass to such child.

(ii) Any portion of said trust estate not disposed of under subparagraph (i) above shall pass as follows:

(A) If any issue of [Grandchild 3] are then living, then to [Grandchild's] then living issue, per stirpes;

(B) If no issue of [Grandchild 3] are then living, then to Grantors' then living issue, per stirpes Paragraphs

(C) If no person described in subparagraph (A) or (B) above is then living, then to [Son], if he is then living; or

(D) If no person described in subparagraph (A), (B) or (C) is then living, then to [University]... .

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You represent that Trust 1 was created before September 25, 1985, and that there have been no additions to Trust after that date.

You have requested the following rulings:

1. That the proposed transaction will not cause the interest of Grandchild 1, Grandchild 2 or Grandchild 3, with respect to Trust 1 or any of Trust 2, Trust 3 or Trust 4 to be includible in such beneficiary's gross estate under § 2033.

2. That the proposed transactions will not cause the interest of Grandchild 1, Grandchild 2 or Grandchild 3, with respect to Trust 2, Trust 3, or Trust 4 to be includible in such beneficiary's gross estate under §§ 2036 through 2038.

3. That the proposed transactions will not cause Grandchild 1, Grandchild 2 or Grandchild 3, or Trust 1, Trust 2, Trust 3, or Trust 4 to have made a gift under Chapter 12 of the Code.

4. Each of Trust 1, Trust 2, Trust 3, and Trust 4 will be treated as a trust that was irrevocable on September 25, 1985 for purposes of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and will remain exempt from generation-skipping transfer tax and no constructive or actual addition to any of Trusts 1, 2, 3, or 4 will result from the proposed transactions.

5. Transfers to Trusts 2, 3, and 4 pursuant to the proposed transactions will not be generation-skipping transfers and will not be subject to tax under § 2601.

6. The proposed transactions will not cause Trusts 1, 2, 3 or 4 or any beneficiary, to recognize gain or loss from the sale or other disposition of property under § 61 or § 1001.

7. Pursuant to § 1223(2), the holding period for each of Trusts 2, 3 and 4 in each asset received from Trust 1 will include Trust 1's holding period for each asset.

8. Pursuant to § 1015, the basis for each of Trusts 2, 3, and 4 in each asset received from Trust 1 will include Trust 1's basis for each such asset.

Estate Tax Rulings - 1 and 2

Section 2001 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 shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

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In this case, Trust 1 is an inter vivos trust created by Grantor and Spouse for the benefit of their grandchildren. After the proposed division of Trust 1, into Trusts 2, 3, and 4 the same beneficiaries will have the same rights with respect to the particular trust that is partitioned for their benefit.

Accordingly, we conclude that if Trust 1 is divided pursuant to the proposed court order, the proposed division of Trust 1, into Trusts 2, 3, and 4 will not cause the interest of Grandchild 1, Grandchild 2, or Grandchild 3 with respect to Trust 1, or Trusts 2, 3, or 4, to be includible in such beneficiary's gross estate under § 2033.

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 the 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 from the property.

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 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, or revoke, 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 §§ 2036-2038 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 beneficiaries of Trust 1, after the proposed division of Trust 1 into Trusts 2, 3, and 4 will have the same interest that each beneficiary had as a beneficiary under Trust 1.

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Accordingly, the proposed division of Trust 1 into Trusts 2, 3, and 4 will not constitute a transfer by Grandchild 1, Grandchild 2, or Grandchild 3 within the meaning of §§ 2036-2038. We conclude that the proposed transaction will not cause the interest of Grandchild 1, Grandchild 2, or Grandchild 3 with respect to Trust 1 or Trusts 2, 3 or 4 to be includible in their respective gross estate under §§ 2036-2038.

Gift Tax Ruling - 3

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 2512(a) provides that, if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

In this case, the interest of Grandchild 1, Grandchild 2, and Grandchild 3 will remain the same after the proposed division. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed transaction will not cause Grandchild 1, Grandchild 2, or Grandchild 3 to have made a taxable gift for purposes of the Federal gift tax under chapter 12 of the Code.

GST Rulings - 4 and 5

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

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 generation-skipping transfer tax does not apply to any generation-skipping 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)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(1)(ii) (B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from the application of chapter 13 by § 1433(b)(2)(A) of the 1986 Act, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13.

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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 generation-skipping transfer tax will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes.

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 paragraphs (b)(4)(i)(A), (B), or (C) of this subsection) 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, but only if –

(1) 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

(2) 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.

In this case, Trust 1 was created and irrevocable before September 25, 1985. Also, it is represented that no additions have been made to Trust 1 since September 25, 1985. Consequently, Trust 1 is currently exempt from GST tax.

The proposed partition of Trust 1 into Trusts 2, 3 and 4 will not shift any beneficial interest in Trust 1 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 proposed partition of Trust 1 will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trust. Further, the modification will not result in an actual or constructive addition to Trusts 2, 3, or 4. See, §26.2601-1(b)(4), Example 5. Accordingly, based on the facts submitted and the representations made, if State District Court issues an order approving the modification of Trust 1, the three trusts resulting from the partition of Trust 1 will be treated as Trust 1 for GST tax purposes and distributions from Trusts 2, 3 or 4 to the beneficiaries will not be subject to the provisions of chapter 13.

Income Tax Rulings - 6, 7 and 8

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

Section 1001(a) of the Code 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 section 1011 for determining gain, and the loss shall be the

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excess of the adjusted basis provided in such section for determining loss over the amount realized.

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 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 where the co-owners of the joint property sever their joint interests, but do not acquire a new or additional interest as a result thereof. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Rev. Rul. 69-486, 1969-2 C.B. 159, distinguished by, Rev. Rul. 83-61, 1983-1 C.B. 78, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries and was subject to the provisions of sections 1001 and 1002 of the Code.

The present case is distinguishable from Rev. Rul. 69-486 because the assets of Trust 1 will be allocated pro rata among the Trusts 2, 3 and 4. Thus, these trusts will not receive property with a different quality and value than the property held in Trust 1. Therefore, although each beneficiary will be entitled to receive income and/or principal from only one of the subtrusts, the amount of such distributions will be the same as the fractional amount that he or she would have been entitled to receive under Trust 1.

Accordingly, the proposed transaction with respect to the division of Trust 1 will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries.

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 section 1001 of the Code. 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 in Cottage Savings, 499 U.S. at 560-61, concluded that section 1.1001-1 of the regulations reasonably interprets section 1001(a) and stated that an exchange of property gives rise to a realization event under section 1001(a) if the properties exchanged are "materially different."

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In defining what constitutes a "material difference" for purposes of section 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 Supreme 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.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of Trusts 2, 3, and 4 will not differ materially from their interests in Trust 1. The proposed transactions will not change the interests of the beneficiaries. Instead, the beneficiaries will be entitled to the same benefits after the proposed transactions as before. The proposed transactions are similar to the kinds of transactions discussed in Rev. Rul. 56-437, since the existing trust is to be partitioned and divided, but all other provisions of such trusts will remain substantially unchanged, other than changes described above which are necessary to ensure that the beneficiaries will be entitled to the same benefits under the Trusts 2, 3, and 4 as before. Thus, the proposed transactions will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

Therefore, if State District Court issues the proposed court order, the partition and division of Trust 1 into Trusts 2, 3 and 4 and the pro rata allocation of each existing asset among Trusts 2, 3, and 4 will not result in the recognition by Trust 1, by any of Trusts 2, 3 or 4, or by any beneficiary, of any gain or loss from the sale or other disposition of property under § 61(a)(3) or § 1001.

Because ruling that there is no income under § 61 would be too broad, we have limited our holdings only to § 61(a)(3), gains derived from dealings in property.

Section 1015 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 transfer in trust, (other than by 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 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 is made. In addition, the principles in § 1.1015-1(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 1.1015-1(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.

In this case because § 1001 does not apply to the proposed division of Trust 1.

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The basis of the assets in Trusts 2, 3, and 4, will be the same as the basis of the assets in Trust 1.

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 the property was held by any other person, if under chapter 1 of the Code the property has, for the purposes 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 the other person. If a successor trust's basis in an asset transferred to it by the trust equals the trust's basis in that asset at the time of transfer, then under § 1223(2) the successor trust obtains the trust's holding period of the same assets in trust.

As noted above, the basis of the assets held by Trusts 2, 3, 4, will be the same as the assets currently held by Trust 1. Accordingly, under § 1223(2), the holding period of the assets in Trusts 2, 3, and 4 will include the holding period of the same assets in Trust 1.

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

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to the taxpayers.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

George L. Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for 6110 purposes

cc: