

Decedent =
Trust =

Daughter	=
Child 1	=
Child 2	=
State	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
State Court	=
Date 1	=
Date 2	=
Date 3	=
Year 1	=

Dear :

This responds to a letter dated April 15, 2004 requesting rulings regarding the income, gift, and generation-skipping transfer (GST) tax consequences of the proposed division of a trust.

The facts submitted and representations made are as follows. Decedent died on Date 1. Date 1 was prior to September 25, 1985. Under Decedent's will a testamentary trust was established for the benefit of his daughter (Daughter) and her heirs. The terms of the trust were established in a court order dated Date 2 (Trust).

Article VII, (c) of Trust provides that after Daughter dies, the trustees are to pay the Trust's net income to Child 1 and Child 2, Daughter's two children. In the event Child 1 or Child 2 dies leaving surviving issue, the share of the net income being paid to the deceased child is to be paid to her issue, per stirpes, and to the lineal descendants of any deceased issue of hers, by right of representation.

Article VII, (d) provides that in the event Child 1 or Child 2 dies without surviving issue or lineal descendants of issue, the deceased child's the share of the net income is to be paid equally to the surviving child, the surviving issue of any deceased child of Child 1 or Child 2, and surviving lineal descendants of any deceased issue of Child 1 and Child 2, per stirpes.

Article VII, (e) provides that upon the death of the survivor of Child 1 or Child 2, the Trust will terminate and be distributed to the surviving issue, per stirpes, of Daughter and the surviving lineal descendants of any deceased issue of Daughter, by right of representation. In the event at the time of termination there are no issue of Daughter or lineal descendants of any deceased issue surviving, the trust estate is to be distributed to the then living blood heirs of Daughter as determined under State law.

Article XIII generally provides that if the trustees determine that the income is insufficient to provide a beneficiary with suitable support, maintenance, and education, then the trustee may distribute principal to the beneficiary. Principal distributed is not to exceed the beneficiary's proportionate share of trust income.

Daughter died in Year 1. Child 2 predeceased Daughter survived by three children, Grandchild 1, Grandchild 2, and Grandchild 3. The Trust's current income beneficiaries are Child 1, Grandchild 1, Grandchild 2, and Grandchild 3.

On Date 3, State Court issued an order to divide the Trust into four trusts. Under the order, one-half of the Trust's assets will be allocated to a trust for the benefit of Child 1. The other half of the Trust's assets will be equally divided among three trusts, one each for the benefit of Grandchild 1, Grandchild 2, and Grandchild 3. The Trust's assets will be divided proportionately into each of the successor trusts. In the event that any asset is not divisible, the asset will be sold and the cash from the sale (net of cost of sale and any tax owned as a result of sale) will be distributed among the successor trusts.

The terms of the successor trusts will be identical to Trust except for the following changes. Article VII, (c) of Trust, will be modified to provide that the entire net income from each successor trust will be paid to the primary beneficiary of such successor trust. If the primary beneficiary is a descendant of Child 2 who predeceases Child 1, then the net income is to be distributed to the issue of the primary beneficiary, per stirpes, and to the lineal descendants of any deceased issue, by right of representation. If any primary beneficiary predeceases Child 1 without issue, the income of his or her trust is to be distributed to the surviving issue, per stirpes, of Daughter, and the surviving lineal descendants of any deceased issue of Daughter, by right of representation.

Article VII, (e) will be modified to provide that upon the death of Child 1, each of the successor trusts will terminate. For the successor trust established for Child 1, upon termination, the trust estate is to be distributed to the surviving issue, per stirpes, of Child 1, and the surviving lineal descendants of any deceased issue of Child 1, by right of representation. If at the time of termination there are no surviving issue of Child 1 or surviving lineal descendants of a deceased issue of Child 1, the trust estate is to be distributed to the living blood heirs of Daughter as determined under the laws of succession of State.

For the three successor trusts established for Grandchild 1, Grandchild 2, and Grandchild 3, upon termination, the trust estate is to be distributed to the trust's primary beneficiary. If the primary beneficiary predeceased Child 1, the trust estate is to be distributed to the surviving issue of the primary beneficiary and the surviving lineal descendants of any deceased issue of the primary beneficiary, by right of representation. If upon termination the primary beneficiary is not survived by issue or lineal descendants of any deceased issue, the trust estate is to be distributed to the then living issue, per stirpes, of Child 2, and the lineal descendants of any deceased

issue of Child 2, by right of representation. If upon termination there are no surviving issue of Child 2 or lineal descendants of any deceased issue of Child 2, the trust estate is to be distributed to the living blood heirs of Daughter as determined under the laws of succession of State.

It has been represented that the Trust has not yet been divided. The following rulings have been requested.

1. The proposed partition of the Trust into four successor trusts will not constitute an addition to any of the successor trusts, will not cause the Trust or any of the successor trusts to lose their exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986, and will not subject distributions from any of the successor trusts to the GST tax, so long as there are no additions to these trusts.
2. The proposed partition and pro rata in kind distribution will not result in a transfer subject to gift tax under Internal Revenue Code (Code) § 2501 by any of the beneficiaries.
3. The proposed pro rata in kind distribution of the Trust's assets among the successor trusts will not cause any beneficiary, the Trust or any of the successor trusts to recognize any gain or loss from a sale or other disposition of the property under § 61 or § 1001.
4. The basis of each successor trust in each asset received from the Trust will be the same as the Trust's basis in that asset pursuant to § 1015.
5. The holding period of each successor trust for each asset received from the Trust will include the Trust's holding period for that asset according to § 1223(2).

Law and Analysis:

Ruling 1:

Section 2601 imposes a tax on every GST (within the meaning of Subchapter B).

Under § 1433(a) of the Tax Reform Act of 1986, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) and § 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. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would cause the trust to be included in his or her gross estate under §§ 2038 or 2042, if the settlor had died on September 25, 1985.

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 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, provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of his 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 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 the present case, the Trust was irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, have been made to the Trust after that date. The Trust will be divided on a pro-rata basis into four successor trusts, and, except for the changes to Article VII, (c) and (e) the successor trusts will have the same terms as the Trust. The changes to Article VII, (c) and (e) are similar to the changes described in § 26.2601-1(b)(4)(i)(E), Example 5. Therefore, the proposed division of Trust 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 proposed

division and the proposed division will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in Trust.

Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division of Trust into four successor trusts will not constitute an addition to the successor trusts, will not cause the Trust or the successor trusts to lose their exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986, and will not subject any distributions from any of the successor trusts to the GST tax imposed under § 2601, provided there are no additions, actual or constructive, to the successor trusts after September 25, 1985.

Ruling 2:

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 each beneficiary will remain the same after the proposed division as it was prior to the division. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division will not cause any beneficiary to be considered as having made a taxable gift under § 2501.

Rulings 3:

Section 61(a)(3) provides that gross income includes gains derived from dealing in property. Under § 1001(a) the gain from the sale or other disposition of property is the excess of the amount realized therefrom over the adjusted basis (provided in § 1011), and the loss is the excess of the adjusted basis over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations treats as income or as loss sustained the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent.

In Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991), the Supreme Court of the United States examined the issue of what constitutes a material difference in exchanged properties or a disposition of property for purposes of the realization requirement implicit in § 1001(a). In Cottage Savings, a savings and loan association sold 90-percent participation interests in 252 mortgage loans to four other lenders. Simultaneously, the association purchased 90-percent participation interests in 305 mortgage loans held by these lenders. The exchanged properties were derived from

loans made to different obligors, secured by different homes, and thus embodied legally distinct entitlements. The association claimed a deduction under § 165(a) for the adjusted difference between the face value of the participation interests the association had traded and the fair market value of the participation interests it had received.

The Supreme Court set forth a test for determining whether exchanged properties are materially different for purposes of § 1001; their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 565. Because the mortgages had different mortgagors and were secured by different properties, the loans were materially different. The Court therefore held that the taxpayer actually sustained a loss for purposes of § 165(a).

In Rev. Rul. 69-486, 1969-2 C.B. 159, a trust instrument required the trustee to distribute the corpus of a trust, consisting of promissory notes and common stock, one-half to an individual and one-half to a tax-exempt charitable organization. The beneficiaries, however, agreed that the individual should receive all of the notes and the charitable organization should receive all of the stock. Although the trustee complied with their request, neither the trust instrument nor local law allowed the trustee to make an allocation of specific property in kind. Thus, the beneficiaries were considered to have received a pro rata distribution of the notes and stock, followed by a deemed exchange between the beneficiaries of their respective shares of stock and notes. Rev. Rul. 69-486 therefore concluded that the individual recognized gain on the disposition of his shares of the common stock in an amount determined under § 1001.

A pro rata 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 thereof. Thus, neither gain nor loss is realized on a partition. Rev. Rul. 56-437, 1956-2 C.B. 507.

In contrast to the situation in Rev. Rul. 69-486, the division of the Trust into four successor trusts will be pro rata and each of the successor trusts will receive an equal share of each asset of the Trust. Under the order, the beneficiaries of the Trust will not acquire their interests in the four successor trusts as a result of the exchange of their interests in the Trust, but instead by reason of the trustees' exercise of their existing authority to distribute trust income or principal and to partition the Trust. Further, the beneficiaries of the Trust will not acquire a new or additional interest as a result of the division of the Trust into the four successor trusts; the successor trusts will distribute current income and principal on termination in the same manner as would occur under the Trust. In addition, there will be no shifting of beneficial interest to any beneficiary, nor will the time for vesting be extended under the successor trusts. Finally, the successor trusts will be subject to the same trust provisions applicable to the Trust.

Accordingly, based upon the facts submitted and the representations made, we conclude that the division of the Trust into four successor trusts will not be considered to be a sale or other disposition of Trust property, and thus will not cause any beneficiary,

the Trust, or any of the successor trusts to recognize any gain or loss from a sale or other disposition of the property under §§ 61 or 1001.

Ruling 4:

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 this case, based upon the facts submitted and the representations made, we conclude that because neither §§ 61 and 1001 applies to the proposed transaction, the basis of the assets for each of the successor trusts will be the same as the Trust's basis in the assets at the time of the transfer.

Ruling 5:

Under §§ 1223(2) and 1.1223-1(b), 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 subtitle A 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 his hands as it would have in the hands of such other person.

Therefore, since under § 1015 the basis of the assets received by the successor trusts is the same as the basis of those assets in the hands of the Trust at the time of the transfer, we conclude, based upon the facts submitted and the representations made, that, pursuant to § 1223(2), the holding periods of the assets in the hands of the successor trusts will include the holding periods of the assets in the hands of the Trust.

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.

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.

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

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

Enclosures: Copy for ' 6110 purposes

cc: