

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

February 9, 2000

Re:

LEGEND:

Decedent =

Spouse =

A =

B =

C =

D =

E =

Marital Trust =

Trust A =

Trust B =

Trust C =

Dear :

This is in response to the letter of December 7, 1999, and earlier correspondence in which rulings are requested on the application of section 1001 of the Internal Revenue Code and the generation-skipping transfer tax to the proposed transaction described below.

Facts

The facts submitted and representations made are as follows:

Decedent died in 1982. In his will, under Article Fifth, Decedent created the Marital Trust for the benefit of Spouse and designated Spouse, D, and E as

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the trustees. Under the terms of the Marital Trust, the trustees may not retain, beyond a reasonable time, any property which may at any time be or become unproductive nor may they acquire any unproductive property as an investment to be held in the trust. The trustees are to pay the net income to Spouse during her life. In addition, the trustees may pay to or for the use of Spouse such principal, including the whole thereof, as the trustees deem advisable for her support, maintenance, and medical needs.

Under Article Sixth, paragraph 1 of Decedent's will, on Spouse's death, 36 percent of the remaining Marital Trust principal is to be paid outright to A and, if he is not then living, to his living natural issue, per stirpes. If there are no living natural issue of A, the 36-percent share is to be distributed as follows: 33-1/3 percent (of the 36-percent share) to A's then living adopted issue; 50 percent of the balance to B; and 50 percent of the balance to C. If either B or C is not then living, the distribution is to be made to his or her then living issue, per stirpes.

Under Article Sixth, paragraph 2, on Spouse's death, 32 percent of the remaining principal is to be paid outright to B and, if B is not then living, to his living issue, per stirpes. If there are no living issue of B, one-half of this 32-percent share is to be distributed as set forth in Article Sixth, paragraph 1, above, and the other one-half is to be distributed as set forth in Article Sixth, paragraph 3, as described below.

Under Article Sixth, paragraph 3, the other 32-percent portion of the Marital Trust principal is to be paid outright to C if she and, if C is not then living, to her living issue, per stirpes. If there are no living issue of C, one-half of this 32-percent share is to be distributed as set forth in Article Sixth, paragraph 1, and the other half is to be distributed as set forth in Article Sixth, paragraph 2.

You propose to petition the appropriate court for approval of the partition the Marital Trust into three separate trusts, Trust A, Trust B, and Trust C, each of which would hold a pro rata portion of every asset now held in the Marital Trust. Trust A would hold a 36-percent share of each such asset. Trust B would hold a 32-percent share of each such asset, and Trust C would hold the other 32-percent share of each such asset.

In every other respect, the distributive and administrative provisions of each partitioned trust will correspond to those of the Marital Trust, and any distributions of principal to the Spouse will be charged proportionately to each of Trust A, Trust B, and Trust C (i.e., 36 percent, 32 percent, and 32 percent,

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respectively). All income of Trust A, Trust B, and Trust C will be distributed to Spouse during her lifetime.

On Spouse's death, the remainder of Trust A will be distributed in accordance with Article Sixth, paragraph 1, so that if A is living at Spouse's death, the Trust A principal will be distributed to him outright at that time. The remainder of Trust B will be distributed in accordance with Article Sixth, paragraph 2, so that if B is living at Spouse's death, the Trust B principal will be distributed to him outright at that time. The remainder of Trust C will be distributed in accordance with Article Sixth, paragraph 3, so that if C is living at Spouse's death, the Trust C principal will be distributed to her outright at that time. In addition, Spouse has filed an affidavit with this office stating that for purposes of includability of the three partitioned trusts in her gross estate under section 2044, the executor of her estate will not treat them as separate trusts for purposes of obtaining minority interest discounts.

Requested Rulings

You have asked us to rule that:

(1) The Marital Trust, Trust A, Trust B, Trust C, and the beneficiaries thereof will not realize gain or loss as a result of the partition of the Marital Trust.

(2) For generation-skipping transfer tax purposes, Trust A, Trust B, and Trust C will be considered to have been created and irrevocable prior to September 25, 1985, and the proposed transaction will not cause the loss of the "grandfathered" status of the Marital Trust, Trust A, Trust B, or Trust C.

(3) The proposed transaction will not cause any beneficiary to have made a transfer to Trust A, Trust B, or Trust C that constitutes a taxable termination, taxable distribution, or a direct skip subject to the generation-skipping transfer tax, and future distributions from those trusts will be similarly exempt from the generation-skipping transfer tax.

Law and Analysis

Ruling Request 1

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

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Section 1001(a) provides that the gain from the sale or other disposition of property will be the excess of the amount realized from the sale over the adjusted basis provided in section 1011 for determining gain, and the loss will be the 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 conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

An exchange of property results in the realization of gain or loss under section 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). There is a material difference when the exchanged properties embody legal entitlements “different in kind or extent” or if they confer “different rights and powers.” Id. At 565.

A pro rata 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 new or additional interests as a result thereof. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507. See also Rev. Rul. 69-486, 1969-2 C.B. 159.

Based upon the representations that the terms of Trust A, Trust B, and Trust C will remain the same as provided in Decedent’s will, and will not alter the dispositive terms of the will, we conclude that the partition of the Marital Trust into three trusts, one consisting of 36 percent of each of the assets of the Marital Trust, and the two others each consisting of 32 percent of each of the assets of the Marital Trust, based on a pro rata division of each of the assets in the Marital Trust on the date of division, does not result in the realization of gain or loss to the trusts or the beneficiaries thereof.

The proposed partition will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries. Spouse will remain the income beneficiary of Trust A, Trust B, and Trust C, and the trustees will have the power to invade the principal of the trusts in their discretion for her support, maintenance and medical needs, just as in the case of the original Marital Trust. Since the dispositive provisions of Trust A, Trust B, and Trust C

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remain the same as those of the original Marital Trust, Spouse's interests in Trust A, Trust B, and Trust C will not confer different rights and powers than her interest in the original Marital Trust. In addition, the remainder beneficiaries of Trust A, Trust B, and Trust C will not have different rights and powers than they had in the original Marital Trust. Under the original Marital Trust, the three remainder beneficiaries had a 36-percent, a 32-percent and 32-percent interest, respectively, in the principal of the trust upon the death of Spouse. When the trusts are divided, A will have a remainder interest equal to 36 percent of the pro rata assets of the original Marital Trust, and B and C will each have a remainder interest equal to 32 percent of the pro rata assets of the original Marital Trust.

Therefore, provided that any invasions of principal from the partitioned trusts are made on a pro rata basis, the properties exchanged are not materially different, and there is no realization of gain or loss.

Ruling Requests 2 and 3

Section 2601 imposes a tax on every generation-skipping transfer. Section 2611 defines a generation-skipping transfer to mean a taxable termination, a taxable distribution, or a direct skip.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act) and §26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations provide that the 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)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from chapter 13 (Tax on Certain Generation-Skipping Transfers) by section 1433(b)(2)(A) of the 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.

In the present case, the Marital Trust was irrevocable prior to September 25, 1985, and it is represented that no additions have been made to the Marital Trust after September 25, 1985.

The partitioning of a trust that does not otherwise change the quality, value, or timing of any of the powers, beneficial interests, rights, or expectancies

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originally provided for under the terms of the trust will not result in the loss of the trust's exempt GST status under § 1433(b)(2)(A) of the Act or § 26.2601-1(b)(1) of the regulations.

In the present case, the partition of the Marital Trust into Trust A, Trust B, and Trust C will not otherwise change the quality, value or timing of any of the powers, beneficial interests, rights, or expectancies originally provided for under the terms of the original Marital Trust. Therefore, the partition will not cause the Marital Trust to lose its exempt status and will not prevent Trust A, Trust B, and Trust C from being treated as irrevocable trusts in existence prior to September 25, 1985. Nor will the partition cause any beneficiary to be treated as having made a transfer to Trust A, Trust B, or Trust C that would constitute a taxable termination, a taxable distribution or a direct skip.

Therefore, based on the facts submitted and representations made, we conclude that the proposed partition, as described above, will not affect the exempt status of the Marital Trust, Trust A, Trust B, or Trust C with respect to the generation-skipping transfer tax and, if no additions are made, all distributions from and the termination of the trusts will be exempt from the generation-skipping transfer tax.

Except as we have specifically ruled herein, we express no opinion under the cited provisions or under any other provision of the Code.

This ruling is based on the facts and 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 transaction considered in this ruling takes effect, the ruling will have no force or effect. If the taxpayer is in doubt whether there has been a change in material fact or law, a request for reconsideration of this ruling should be submitted to this office.

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

Sincerely yours,
Assistant Chief Counsel
(Passthroughs and Special Industries)

By Katherine A. Mellody
Senior Technician Reviewer, Branch 4

Enclosure: copy for 6110 purposes