

Internal Revenue Service

Department of the Treasury

Number: **200213014**

Washington, DC 20224

Release Date: 3/29/2002

Index Number: 61.00-00; 1001.00-00;
1015.03-00; 1223.01-00;
2033.09-00; 2036.11-00;
2037.00-00; 2038.00-00;
2601.00-00; 2642.00-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:BR4 - PLR -144018-01

Date:

December 20, 2001

In Re:

LEGEND

Decedent	=
Trust A	=
Trust 1	=
Trust 2	=
GST Exempt A Trust	=
GST Nonexempt A Trust	=
GST Exempt B Trust	=
GST Nonexempt B Trust	=
Trustees	=
Beneficiary 1	=
Beneficiary 2	=
Date 1	=
Date 2	=
Date 3	=
State	=
State Code	=

Dear :

This is in reply to your letter of August 17, 2001, requesting the following rulings:

1. The division and severance of Trust 1 into GST Exempt A Trust and GST Nonexempt A Trust will constitute a "qualified severance" under section 2642(a)(3) of

PLR-144018-01

the Internal Revenue Code.

The division and severance of Trust 2 into the GST Exempt B Trust and the GST Nonexempt B Trust will constitute a “qualified severance” under section 2642(a)(3) of the Internal Revenue Code.

2. GST Exempt A Trust will have an inclusion ratio of zero for generation-skipping transfer tax purposes.

GST Exempt B Trust will have an inclusion ratio of zero for generation-skipping transfer tax purposes.

3. GST Nonexempt A Trust will have an inclusion ratio of one for generation-skipping transfer tax purposes.

GST Nonexempt B Trust will have an inclusion ratio of one for generation-skipping transfer tax purposes.

4. The proposed division and severance will not cause the interest of Beneficiary 1 in GST Exempt A Trust or the GST Nonexempt A Trust to be includible in his gross estate under section 2033 and sections 2036 through 2038 of the Code.

The proposed division and severance will not cause the interest of Beneficiary 2 in the GST Exempt B Trust or the GST Nonexempt B Trust to be includible in his gross estate under section 2033 and sections 2036 through 2038 of the Code.

5. The proposed division and severance will not cause Beneficiary 1 to have made a taxable gift for purposes of the Federal gift tax under Chapter 12 of the Code.

The proposed division and severance will not cause Beneficiary 2 to have made a taxable gift for purposes of the Federal gift tax under Chapter 12 of the Code.

6. Transfers to GST Exempt A Trust pursuant to the proposed division and severance will not be generation-skipping transfers and will not be subject to tax under section 2601 of the Code.

Transfers to GST Exempt B Trust pursuant to the proposed division and severance will not be generation-skipping transfers and will not be subject to tax under section 2601 of the Code.

7. The proposed division and severance will not cause GST Exempt A Trust, GST Nonexempt A Trust or any beneficiary of either of such trusts, to recognize gain or loss from the sale or other disposition of property under section 61 or section 1001 of the Code.

The proposed division and severance will not cause GST Exempt B Trust, GST

PLR-144018-01

Nonexempt B Trust or any beneficiary of either of such trusts, to recognize gain or loss from the sale or other disposition of property under section 61 or section 1001 of the Code.

8. Pursuant to section 1223(2) of the Code, the holding period with respect to each asset received by GST Exempt A Trust and GST Nonexempt A Trust will include Trust 1's holding period for each such asset.

Pursuant to section 1223(2) of the Code, the holding period with respect to each asset received by GST Exempt B Trust and GST Nonexempt B Trust will include Trust 2's holding period for each such asset.

9. Pursuant to section 1015 of the Code, the basis of each asset received by GST Exempt A Trust and GST Nonexempt A Trust from Trust 1 will be Trust 1's basis for each such asset.

Pursuant to section 1015 of the Code, the basis of each asset received by GST Exempt B Trust and the GST nonexempt B Trust from Trust 2 will be Trust 2's basis for each such asset.

FACTS

Decedent died testate on Date 1. Prior to her death, Decedent and her pre-deceased spouse had created Trust A, a revocable trust that became irrevocable on Decedent's death. Under the terms of Trust A, as amended on Date 2, on Decedent's death, the trust estate was to be divided into two equal shares, one share to be held in Trust 1 for the benefit of Beneficiary 1 and his descendants, and one share to be held in Trust 2, for the benefit of Beneficiary 2 and his descendants. Under the terms of Decedent's will, one-half of the residuary estate passed to Trust 1 and one-half passed to Trust 2.

Trust 1 provides that all trust income is to be distributed to Beneficiary 1 and/or his issue in such amounts as the Trustees deem advisable for their support and care. Trust 1 further provides for distributions of corpus to Beneficiary 1's issue as may be needed for their health, education and support. Upon Beneficiary 1's death, Trust 1 continues for the benefit of Beneficiary 1's issue, until each of Beneficiary 1's issue dies or reaches the age of 45 years. During the continuation of the trust, the Trustees are to administer Trust 1 for the equal use and benefit of said issue, distributing to each of them such part of the income or corpus of the trust estate belonging to such issue as may be needed for his or her health, education and support. One half of each issue's share is to be distributed when that issue reaches age 35, and the balance when that issue reaches 45. Upon the death of an issue before age 45, that issue's interest will pass to his or her issue free of trust, or if no issue are then living, to the other descendants of Beneficiary 1, per stirpes, to be administered as part of his or her trust.

Trust 2 provides that all trust income to be distributed to Beneficiary 2 and/or his

PLR-144018-01

issue in such amounts as the Trustees deem advisable for their support and care. Trust 2 further provides for distributions of corpus to Beneficiary 2's issue as may be needed for their health, education and support. After Beneficiary 2's death, Trust 2 continues for the benefit of Beneficiary 2's issue. During the continuation of the Trust, the Trustees are to administer Trust 2 for the equal use and benefit of the issue of Beneficiary 2. The Trustees are to distribute to each issue such part of the income or corpus of the trust estate belonging to such issue as may be needed for his or her health, education and support. One half of each issue's share is to be distributed as that issue reaches age 35, and the balance when that issue reaches 45. Upon the death of an issue before age 45, that issue's interest will pass to his or her issue per stirpes and free of trust, or if no issue are then living, to the other descendants of Beneficiary 2, to be administered as part of his or her trust.

The Trustees of Trust 1 propose to sever Trust 1 into two new trusts, GST Exempt A Trust and GST Nonexempt A Trust. The terms of the two new trusts will be identical to the terms of Trust 1 and will provide for the same succession of interests of beneficiaries as are provided for in Trust 1. Trust 1 will be divided and severed on a fractional basis and each severed trust will receive a pro rata portion of each asset held by Trust 1. GST Exempt A Trust will receive a fraction of each asset held by Trust 1, the numerator of which is equal to one-half of Decedent's available GST exemption, and the denominator of which is equal to the total fair market value, determined as of Decedent's date of death, of the assets passing to Trust 1. GST Nonexempt A Trust will be funded with the balance of the Trust 1 assets.

Similarly, the Trustees of Trust 2 propose to sever Trust 2 into two new trusts, GST Exempt B Trust and GST Nonexempt B Trust. The terms of the two new trusts will be identical to the terms of Trust 2 and will provide for the same succession of interests of beneficiaries as are provided for in Trust 2. Trust 2 will be divided and severed on a fractional basis and each severed trust will receive a pro rata portion of each asset held by Trust 2. GST Exempt B Trust will receive a fraction of each asset held by Trust 2, the numerator of which is equal to one-half of Decedent's available GST exemption, and the denominator of which is equal to the total fair market value, determined as of the date of Decedent's death, of the assets passing to Trust 2. GST Nonexempt B Trust will receive the balance of the Trust 2 assets.

Under State Code, the trustees "may, unless expressly prohibited by the terms of the instrument establishing the trust, divide a trust into two or more separate trusts without a judicial proceeding if the trustee reasonably determines that the division of the Trust could result in a significant decrease" in federal income or transfer taxes. Under the statute, the terms of the separate trusts must be identical to the terms of the original trust. Trust assets must be allocated to the separate trusts on a fractional pro rata basis.

The Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return has not yet been filed by Decedent's estate. The return is due on Date 3.

PLR-144018-01

LAW AND ANALYSIS

Rulings 1, 2, 3, and 6

Section 2601 imposes a tax on every generation skipping transfer (GST). The term "generation skipping transfer" is defined under section 2611 as a taxable distribution, a taxable termination, or a direct skip. Section 2603 provides that in the case of a taxable termination, the trustee is liable for the payment of the GST tax; in the case of a taxable distribution, the transferee is liable.

Under section 2602, the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Under section 2641, the applicable rate is the maximum rate of tax on an estate tax transfer, multiplied by the "inclusion ratio." The inclusion ratio is defined in section 2642 as the excess of 1 over the applicable fraction for the trust from which the transfer is made or for the direct skip. The applicable fraction is a fraction in which the numerator is the GST exemption (allowable under section 2631) allocated to the trust or direct skip, and the denominator is the value of the property transferred to the trust or involved in the direct skip, reduced by any Federal estate tax or state death tax actually recovered from the trust and any charitable deduction allowed under section 2055 or section 2522 with respect to such property. Under section 2631, for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of \$ 1,000,000, adjusted for inflation as provided in section 2631(c)(1), which may be allocated by the individual (or the individual's executor) to any property with respect to which the individual is the transferor for GST tax purposes.

Section 2642(a)(3)(A) provides that if a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of the GST tax. Section 2642(a)(3)(B) defines a "qualified severance" as:

the division of a single trust and the creation (by any means available under the governing instrument or by local law) of two or more trusts if –

- (I) The single trust was divided on a fractional basis, and
- (II) The terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

In this case, Trust 1 and Trust 2 will be severed in accordance with applicable State law. Further, as severed, GST Exempt A Trust and GST Nonexempt A Trust provide for the same succession of interests and beneficiaries as are provided in Trust 1. Similarly, GST Exempt B Trust and GST Nonexempt B Trust provide for the same succession of interests and beneficiaries as are provided in Trust 2. Finally, Trust 1 and Trust 2 will be severed on a fractional basis, and each severed trust will receive a pro rata portion of each asset held in Trust 1 or Trust 2, as the case may be.

PLR-144018-01

Accordingly, the severance of Trust 1 and Trust 2, as proposed, will be a qualified severance under section 2642(a)(3). Therefore, assuming sufficient GST exemption is allocated to GST Exempt A Trust and GST Exempt B Trust, as provided in section 2632(a), these trusts will have an inclusion ratio of zero.

Ruling 4

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.

Section 2036 generally requires the inclusion of property in the gross estate where a decedent has transferred property but retained the right to the income, possession, or enjoyment, of the property, or the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the transferred property or the income therefrom.

Section 2037 provides generally that the gross estate shall include the value at the date of decedent's death of any interest in property, transferred by the decedent, if the possession or enjoyment of the property can be obtained only by surviving the decedent, and the decedent must retain a reversionary interest in the property, and the value of the reversionary interest exceeds 5% of the value of the transferred property.

Section 2038 includes in the gross estate the value of all property transferred by the decedent where the enjoyment of the property was subject at the date of death to any change through the decedent's exercise of a power to alter, amend, revoke or terminate.

In the instant case, under the terms of Trust 1 and after the severance of Trust 1 into GST Exempt A Trust and GST Nonexempt A Trust, the interest of Beneficiary 1 will terminate on his death and the corpus will be held in further trust for the benefit of Beneficiary 1's issue. Similarly, under the terms of Trust 2 and after the severance of Trust 2 into GST Exempt B Trust and GST Nonexempt B Trust, the interest of Beneficiary 2 will terminate on his death and the corpus will be held in further trust for the benefit of Beneficiary 2's issue. Further, neither Beneficiary 1 nor Beneficiary 2 has transferred the property in Trust 1 or Trust 2, respectively, for purposes of sections 2036, 2037 or 2038.

Accordingly, we conclude that GST Exempt A Trust and GST Nonexempt A Trust will not be includible in Beneficiary 1's gross estate under sections 2033, 2036, 2037 or 2038. Further, GST Exempt B Trust and GST Nonexempt B Trust will not be included in Beneficiary 2's gross estate under sections 2033, 2036, 2037 or 2038.

Ruling 5

Section 2501 imposes a tax for each calendar year on the transfer of property by

PLR-144018-01

gift during such calendar year by any individual, resident or nonresident.

Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal tangible or intangible.

Following the division of Trust 1 into GST Exempt A Trust and GST Nonexempt A Trust, the Beneficiary 1 will have the same rights to the same property as he did prior to the severance of Trust 1, and no other individuals will have any additional rights with respect to the income or corpus of Trust 1. Therefore, no transfer of property will be deemed to occur as a result of the proposed severance of Trust 1 into GST Exempt A Trust and GST Nonexempt A Trust, and the proposed severance will not have any gift tax consequences with respect to Beneficiary 1.

Similarly, following the division of Trust 2 into GST Exempt B Trust and GST Nonexempt B Trust, the Beneficiary 2 will have the same rights to the same property as he did prior to the severance of Trust 2, and no other individuals will have any additional rights to the income or corpus of Trust 2. Therefore, no transfer of property will be deemed to occur as a result of the proposed severance of Trust 2 into GST Exempt B Trust and GST Nonexempt B Trust, and the proposed severance will not have any gift tax consequences with respect to Beneficiary 2.

Ruling 7

Section 61(a)(3) of the Code 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 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 either in kind or in extent, is treated as income or loss sustained.

For the 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 of the Income Tax Regulations.

An exchange of property results in the realization of gain under section 1001 if the properties exchanged are materially different. Cottage Savings Association 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.

PLR-144018-01

Based on the information submitted and the representations made in the ruling request, the assets and liabilities of the Trust 1 and Trust 2 will be divided and severed pursuant to the authority granted in State Code. The co-trustees will hold the same property after severance as before, and each beneficiary will possess the same succession of interests as under Trust 1 and Trust 2. Accordingly, no sale or exchange under section 1001 will occur as a result of the severance, and no gain or loss will be realized by the trusts or by Beneficiary 1 or Beneficiary 2 as a result of the severance.

Ruling 8

Section 1223(2) provides that in determining the period for which a taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person if such property has the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person. See also section 1.1223-1(b) of the regulations. Thus, to determine whether the new trusts will have holding periods in the assets received from the two original trusts which include the holding periods of the two original trusts in these assets, it is necessary to determine the basis of the new trusts in the assets received from the two original trusts.

Section 1015(b) provides the basis rules for property acquired by a transfer in trust. As discussed below, the basis of any property transferred to GST Exempt A Trust and GST Nonexempt A trust is the same as the basis in that property in the possession of Trust 1 immediately prior to the transfer, under section 1015. Furthermore, under section 1015, the basis of any property transferred to GST Exempt B Trust and GST Nonexempt B Trust is the same as the basis in that property in the possession of Trust 2 immediately prior to the transfer. Therefore, the holding periods of the two original trusts (Trust 1 and Trust 2) in their assets will be included in calculating the period for which the trust assets have been held by the new trusts under section 1223(2).

Ruling 9

Section 1015(b) provides that if property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest or devise), the basis shall be 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 on such transfer under the law applicable to the year in which the transfer was made.

In this case, the basis of any property transferred to GST Exempt A Trust and GST Nonexempt A Trust is the same as the basis in that property in the possession of Trust 1 immediately prior to the transfer.

The basis of any property transferred to GST Exempt B Trust and GST Nonexempt B Trust is the same as the basis in that property in the possession of Trust 2 immediately prior to the transfer.

Except as expressly provided herein, no opinion is expressed or implied

PLR-144018-01

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 taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Powers of Attorney on file with this office, copies of this letter are being sent to the taxpayers.

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

Enclosure

Copy for 6110 purposes