

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

January 2, 2001

Legend

Father =

Trust =

Date 1 =

Son =

Son's Wife =

Year 2 =

Trustee =

Grantor =

State 1 =

Daughter =

Foundation =

State 2 =

Discretionary Trustees =

Date 3 =

PLR-122150-00

Successor Trustee 1 =
 Committee =

 Reformed Trust 1 =
 Reformed Trust 2 =
 Asset A =

 Date 4 =
 State 1 Court =

Dear Sir:

We received your letter dated April 10, 2000, requesting rulings on the proper income and generation-skipping transfer tax treatment of the proposed partition of a trust into separate trusts. This letter responds to your request.

You represent that Father created and funded Trust on Date 1 for the benefit of Son, Son's Wife, and Son's descendants. You also represent that Trust was irrevocable before September 25, 1985, and that there have been no additions, actual or constructive, since that time. Father died in Year 2.

Section A of Article I of Trust provides that Trustee shall hold, manage, control and administer the above-described property, and such other money and property as the Grantor may assign, deliver or bequeath to him at any time(s) after the execution of this agreement, in trust, shall collect all the income thereof, out of such income shall pay or provide for all proper taxes, costs, charges and expenses of every kind imposed upon or incurred by Trust (other than those imposed upon or incurred by it upon or by reason of its termination, and other than capital losses), and all gift taxes on whomever imposed payable to State 1 by reason of the execution of this agreement or by reason of any assignments, transfers, or deliveries made by Grantor to Trustee at or within six months after the execution of this agreement and thereafter shall distribute the remaining net income and corpus of Trust as hereinafter provided.

Section B of Article I of Trust provides, in part, that the remaining net income of Trust for each calendar quarter shall be divided into equal shares, of which there shall be: (a) one share for Grantor's son, Son, so long as he is living; (b) one share for Grantor's said Son's Wife so long as they both are living and she is his wife; (c) one share for each of Grantor's said son's lawful children then living; and (d) one share for

PLR-122150-00

the then living descendants of each of Grantor's said son's lawful children then deceased.

Section C of Article I of Trust provides upon the death of Grantor's said son, Son, the corpus of Trust shall be distributed to such person or persons within a class including only the Grantor's lineal descendants other than his said son, and no other or others whatsoever, particularly and expressly excluding from said class the Grantor's said son, said son's estate, and said son's creditors and the creditors of his estate, and in such shares and proportions and at such time or times and in such manner, absolutely or in trust, as the Grantor's said son, Son, by his will shall appoint or direct, but not in such a way as to postpone the final distribution of this Trust beyond the expiration of twenty-one years after the death of the last survivor of all of Grantor's descendants living at the time this agreement is executed, and any later final distribution directed by said Son shall be accelerated accordingly; or, as to all or any portion of this Trust estate not so effectively appointed by Grantor's said son, this Trust shall continue until the death of the last survivor of the lawful children of Grantor's said son, Son, living at the time this agreement is executed, and the corpus shall then be distributed free of trust per stirpes to the then living descendants of Grantor's said son; or if none of such descendants is then living, then free of trust per stirpes to the then living descendants of Grantor's daughter, Daughter; or if none of her descendants is then living, then to Foundation, a charitable corporation organized under the laws of State 2 and having its principal office in State 1.

Article II provides that corresponding to each of the equal shares of Trust income specified in (a), (b) and (c) in Section B of Article I, there shall be, and the Grantor hereby establishes, one separate Discretionary Trust for each such share of Trust income as the same may vary in number from time to time; and said Discretionary Trustees, shall be the Trustees of each of said Discretionary Trusts and shall administer the same as follows.

Section A of Article II provides the right to receive the share of income of Trust allotted to Grantor's said son, Son, under Article I shall be held, managed, controlled and administered by the Discretionary Trustees in a separate Discretionary Trust for his benefit. Such share of income shall be paid by the Trustee of Trust to the Discretionary Trustees of this Discretionary Trust, and the latter shall receive the same as income of this Discretionary Trust, out of such income shall pay or provide for all proper taxes, costs, charges and expenses of every kind imposed upon or incurred by this Discretionary Trust, and thereafter from time to time shall distribute to Grantor's said son free of trust such amounts (whether of current income, accumulations, or both) as the Discretionary Trustees, in their sole discretion, shall determine to be in the best interests of the beneficiary. This Discretionary Trust shall terminate upon the death of Grantor's said son, and the entire remaining assets thereof shall be paid free of trust to his estate.

PLR-122150-00

Section B of Article II provides the right to receive the share of income of Trust allotted to said Son's Wife under Article I shall be held, managed, controlled and administered by the Discretionary Trustees in a separate Discretionary Trust for his benefit. Such share of income shall be paid by the Trustee of Trust to the Discretionary Trustees of this Discretionary Trust, and the latter shall receive the same as income of this Discretionary Trust, out of such income shall pay or provide for all proper taxes, costs, charges and expenses of every kind imposed upon or incurred by this Discretionary Trust, and thereafter from time to time shall distribute to said Son's Wife free of trust such amounts (whether of current income, accumulations, or both) as the Discretionary Trustees, in their sole discretion, shall determine to be in the best interests of the beneficiary. This Discretionary Trust shall terminate upon the death of said Son's Wife, and the entire remaining assets thereof shall be paid free of trust to her estate.

Section C of Article II provides so long as a child of the Grantor's said son, Son, is living and less than thirty-five (35) years of age, the right to receive the share of income of Trust allotted to such child under Article I shall be held, managed, controlled and administered by the Discretionary Trustees in a separate Discretionary Trust for the benefit of such child. Such share of income shall be paid by the Trustee of Trust to the Discretionary Trustees of this Discretionary Trust, and the latter shall receive the same as income of this Discretionary Trust, out of such income shall pay or provide for all proper taxes, costs, charges and expenses of every kind imposed upon or incurred by this Discretionary Trust, and thereafter from time to time shall distribute to such child free of trust such amounts (whether of current income, accumulations, or both) as the Discretionary Trustees, in their sole discretion, shall determine to be in the best interests of the beneficiary. Such Discretionary Trust shall terminate when such child attains the age of thirty-five (35) years or upon his earlier death, and the entire remaining assets thereof shall be paid free of trust to him if living; if he is not living, then in equal shares to his descendants then living; if there be no such descendants then living, then per stirpes to the then living descendants of Grantor's said son, Son; or if there be none of them, then to said Foundation.

Section C of Article III of Trust provides that if and when, for any reason whatever, the Grantor's said son, Son, shall cease to be the Trustee of Trust, he may in writing signed by him (including his will) appoint his successor trustee of such trust, and provide the manner in which further successors may be appointed thereafter, and the time at which the tenure of any such successor, however appointed, shall commence and terminate. If at any time there shall be a vacancy occasioned by a failure to appoint or provide for the appointment of a successor trustee of Trust, the Grantor, if then living, may appoint such successor, or, if the Grantor is not then living, or fails to make such appointment, such vacancy may be filled by order of any court of competent jurisdiction upon application of any interested party.

PLR-122150-00

Trust does not include among the trustee powers the power to sever the trust and administer separate trusts. Article I, Section E of Trust states that the trust is governed by the laws of State 1.

The shares for Son and Son's Wife currently are distributed to the individual Discretionary Trusts created for them under Article II. Son and Son's Wife are living and have four children and ten grandchildren living. Since Son's children have reached the age of thirty-five years, each of the Discretionary Trusts described in Section C of Article II has been terminated. The share for each of Son's children, therefore, is distributed free of trust to that child respectively. No child of Son is deceased. Trust does not provide for distributions of principal.

You represent that Son intends to exercise his power of appointment in his will, and the proposed exercise of the power of appointment will not extend the term of the trust beyond the maximum permissible term established in Trust.

In a designation instrument dated Date 3, Trustee exercised the right to appoint a successor trustee and set forth a method for the appointment of further successor trustees. Trustee appointed Successor Trustee 1 as successor trustee of Trust if Trustee ceases to act as trustee. Successor Trustee 1 may act until the earlier of (i) her death, (ii) her resignation, (iii) her disability, or (iv) the expiration of two years from the date she commences to act as successor trustee. The designation also provided that the appointment of further successor trustees and the removal of a successor trustee shall be determined by Committee. Currently, Committee consists of Son's Wife and Son's four children.

Trustee sought to partition Trust into two separate reformed trusts with terms identical to Trust except that different individuals may act as successor trustees of each resulting trust to facilitate different investment and management objectives. After the partition, Trustee would act as trustee of Reformed Trust 1 and Reformed Trust 2, and trustee succession would continue to be governed by the terms of Trust and Trustee's designation instrument dated Date 3. Trustee proposed to transfer all assets from Trust other than Asset A to Reformed Trust 1. Asset A would be transferred to Reformed Trust 2.

On Date 4, State 1 Court found that the proposed reformation of Trust by reason of changed circumstances comports with the intentions of the grantor of the trust and will have no effect upon the current or ultimate disposition of Trust. In addition, State 1 Court issued an order that authorized Trustee to partition Trust into two separate trusts, Reformed Trust 1 and Reformed Trust 2, with identical terms except that the separate trusts may provide that different individuals may act as successor trustee of each reformed trustee.

PLR-122150-00

You have requested the following rulings: (1) the proposed partition of Trust into two separate reformed trusts with identical terms except that each reformed trust may have different successor trustees will not affect the effective-date status of Trust under the effective date provisions in § 26.2601-1(b)(1)(ii), and (2) the proposed partition of Trust into two separate reformed trusts and the proposed non-pro rata allocation of Trust assets between the two reformed trusts will not result in the recognition of gain or loss, and that the basis of the assets as well as the holding periods will remain the same after the partition.

RULING REQUEST 1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term “generation-skipping transfer” to include a taxable distribution, a taxable termination, and a direct skip.

Section 2612(a)(1) provides that the term “taxable termination” means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that the term “taxable distribution” means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Section 2612(c) provides that the term “direct skip” means a transfer subject to a tax imposed by chapters 11 or 12 of an interest in property to a skip person.

Section 2613(a) defines the term “skip person” as (1) a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor, or (2) a trust if all interests in the trust are held by skip persons, or if there is no person holding an interest in such trust, and at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 2613(b) provides that, for purposes of the generation-skipping transfer tax, the term “non-skip person” means any person who is not a skip person.

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that the generation-skipping transfer tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable

PLR-122150-00

on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust.

An amendment to a trust, which was irrevocable on September 25, 1985, and thus, is exempt from the generation-skipping transfer tax, will cause the trust to lose its exemption if the amendment modifies or otherwise changes the quality, value or timing of any of the powers, beneficial interests, rights, or expectancies originally provided under the terms of the trust. A trust's exemption from the generation-skipping transfer tax is not affected, however, by amendments relating to the administration of the trust.

Based on the information submitted and the representations made, we conclude that Trust is a generation-skipping trust because it provides for distributions to more than one generation of beneficiaries below the grantor's generation. Trust was irrevocable on September 25, 1985, and there have been no additions, actual or constructive, since that date. Therefore, Trust is exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i).

Based on the information submitted and the representations made, we conclude that the proposed partition of Trust relates to the administration of the trust and will not modify or otherwise change the quality, value, or timing of any of the powers, beneficial interests, rights or expectancies originally provided under the terms of Trust. Thus, the proposed partition of Trust will not affect the exempt status of the trust for purposes of chapter 13. Accordingly, we conclude that neither distributions to skip persons nor terminations of interests of non-skip persons will be subject to the generation-skipping transfer tax.

RULING REQUEST 2

Section 61(a)(3) 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 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

PLR-122150-00

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 of the transaction. 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 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, an exchange that required recognition of gain under § 1001.

The present case is distinguishable from Rev. Rul. 69-486. Although the assets will not be distributed pro rata among the two reformed trusts, each beneficiary will continue to have the same interest in each asset of Trust after the proposed partition as the beneficiary had before the proposed transaction. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of Trust.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), concerns when a sale or exchange has taken place that results in realization of gain or loss under § 1001. 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 § 1.1001-1 of the regulations reasonably interprets § 1001(a) and stated that an exchange of property is a realization event under § 1001(a) if the properties exchanged are "materially different."

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" to the Code so long as they embody legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The 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. Id., at 566.

PLR-122150-00

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries in the reformed trusts will not differ materially from their interests in Trust. The two reformed trusts will have the same terms as Trust. While the assets will be grouped separately for management purposes, each beneficiary will have the same interests in the same assets as before. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

Based on the information submitted and the representations made, we conclude that the proposed partition of Trust into two separate reformed trusts and non-pro rata allocation of Trust assets between the two reformed trusts will not result in the realization of any income under § 61 and will not result in the realization of any gain or loss under § 1001.

Section 1015(a) provides that if property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss, the basis shall be such fair market value.

Section 1015(b) provides that if property is acquired by a transfer in trust (other than 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.

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 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 on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

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 the property has the same basis in whole or in part in the taxpayer's hands as it would have in the hands of the other person.

Based upon the information submitted and representations made, we conclude that because § 1001 does not apply to the division of Trust assets, the basis of Trust assets will be the same after the partition as the basis of those assets before the

PLR-122150-00

partition. We also conclude that the assets in the reformed trusts received from Trust will have the same holding periods as those assets had in Trust.

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

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

Sincerely,
Christine E. Ellison
Branch Chief
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy for § 6110 purposes