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Person to Contact:

Telephone Number:

Refer Reply To:

DD:PSI:4-PLR-116284-00

Date:

April 12, 2001

Re:

LEGEND:

- Decedent =
- Trust =
- Date =
- Sibling A =
- Sibling B =
- Sibling C =
- Child A =
- Child B =
- Child C =
- Child D =
- Child E =
- Child F =
- Child G =
- Grandchild H =
- Grandchild I =
- Grandchild J =
- Grandchild K =
- Grandchild L =
- Grandchild M =
- Grandchild N =
- Grandchild O =
- Grandchild P =
- Grandchild Q =
- Grandchild R =
- Grandchild S =
- Bank =
- Sibling A Family Trust=
- Sibling B Family Trust=
- Sibling C Family Trust=
- Local Court =

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Dear _____ :

This is in response to the April 6, 2001 letter and other correspondence requesting rulings concerning the generation-skipping transfer tax, income tax, and gift and estate tax consequences of the proposed division of the Trust.

The facts submitted are as follows:

Decedent died on Date survived by his three siblings, Sibling A, Sibling B, and Sibling C. Under Article Three of Decedent's will, the residue of his estate passed to the Trust, to be held for the benefit of Sibling A, Sibling B, Sibling C, and their issue.

It is represented that the Trust has not been amended and no additions (constructive or otherwise) have been made to the Trust since Decedent's death on Date.

Under Article Three, Paragraphs 1 and 2 of the will, the trustees are to distribute one-third of the net Trust income annually to each of Sibling A, Sibling B, and Sibling C living at the time of the annual payment. On the death of any one of them leaving issue, his or her one-third share of income is to be paid per stirpes to his or her issue living at the time of the annual payment. If all of the issue of the respective sibling has died, the one-third share of Trust income to which that issue would have otherwise been entitled is to increase pro rata the remaining share or shares for Decedent's siblings and their issue. If a sibling of Decedent dies without issue, the one-third share of Trust income otherwise payable to that sibling is to increase pro rata the remaining share or shares for Decedent's siblings and their issue.

Under Article Three, Paragraph 3, any income payable to a minor may be applied by the trustees for the minor's support, education, and welfare or paid to the minor's guardian.

Under Article Three, Paragraph 4, if, on account of long continued illness or serious physical incapacity or some other similar urgent need or emergency, it appears to the trustees to be expedient and necessary that some portion of the Trust principal be distributed to a beneficiary, other than the trustees themselves, the trustees are authorized to distribute to that beneficiary such part of the Trust principal as the circumstances appear to justify and require. However, the aggregate of such principal distribution to any one beneficiary shall not exceed an amount which bears the same ratio to the total principal of the Trust that such beneficiary's share of the income bears to the total shares of the income beneficiaries. Under no circumstances shall the trustees distribute any part of the Trust principal to themselves.

Under Article Three, Paragraph 5, the Trust is to continue until the death of the last survivor of Child A, Child B, Child C, Child D, Child E, and Child F.

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Under Article Three, Paragraph 5, on the termination of the Trust, the property will be distributed outright to those beneficiaries entitled to income at the time and in the same proportion as the income to which they are then entitled.

Under Article Three, Paragraph 6, neither Child G nor any of her issue are to be regarded as issue of Sibling C.

Under Article Four, if a beneficiary is a minor at the termination of the Trust, the trustees are to hold in further trust the principal to which the minor would otherwise be entitled and distribute so much of income and, if insufficient, so much of principal as the trustees deem necessary or advisable for the minor's support, education, and welfare. When the minor reaches age 21, the minor's trust will terminate and the principal and accumulated income will be distributed outright to him or her.

Under Article Six, Child A, Child B, and Child D were designated as the trustees, and Child F was designated as successor co-trustee in case of inability or refusal of Child A, Child B, or Child D to act. In case of the inability or refusal of another trustee to act as trustee, the remaining trustees are to appoint as successor co-trustee another of Decedent's nephews or nieces or one of his grandnephews or grandnieces. In default of any such individual will to act as co-trustee, the trustee vacancy shall not be filled. In case of the inability or refusal of all three of the individual trustees or successor trustees to act, Bank is designated to be the trustee. Since Child A and Child B have died, Child D and Child F are the current trustees of the Trust.

Sibling A, Sibling B and Sibling C have all died. Sibling A was survived by two children, Child A and Child B, who have also died. Child B was survived by four children, Grandchild H, Grandchild I, Grandchild J, and Grandchild K, and they are the current beneficiaries of the one-third income share attributable to Sibling A.

Sibling B was survived by Child C and Child D, and they are the current beneficiaries of the one-third income share attributable to Sibling B. Child D has two children, Grandchild L and Grandchild M. Child C also has two children, Grandchild N and Grandchild O.

Sibling C was survived by three children, Child E, Child F, and Child G. Child G and her issue were disinherited under Article Three, Paragraph 6 of the will. Therefore, Child E and Child F are the current pro rata beneficiaries of the one-third income share attributable to Sibling C. Child F has four children, Grandchild P, Grandchild Q, Grandchild R, and Grandchild S. Child E has no children,

The parties propose to divide the Trust equally into three separate trusts, the Sibling A Family Trust, Sibling B Family Trust, and Sibling C Family Trust. The trustees will file a petition with the Local Court requesting an order approving the division of the Trust and the appointment of additional trustees. The assets of the Trust will be

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allocated among the three new trusts on a pro rata basis and each new trust will receive an equal share of each asset in the Trust.

Child D and Child F will serve as co-trustees of each of the three trusts. In addition, Grandchild I and Grandchild J will serve as additional co-trustees of the Sibling A Family Trust. Grandchild L and Grandchild O will serve as additional co-trustees of the Sibling B Family Trust. Grandchild P will serve as an additional co-trustee of the Sibling C Family Trust.

The provisions of the Trust, as created in Decedent's will, will control in the administration of each of the three trusts. Thus, Grandchild H, Grandchild I, Grandchild J, and Grandchild K will be the current pro rata income beneficiaries of the Sibling A Family Trust. Child C and Child D will be the current pro rata income beneficiaries of the Sibling B Family Trust. Child E and Child F will be the current pro rata income beneficiaries of the Sibling C Family Trust. Upon the death of each such income beneficiary, the income otherwise distributable to him or her will be distributed pro rata to his or her issue, if any.

The Sibling A Family Trust, Sibling B Family Trust and Sibling C Family Trust will terminate on the death of the last survivor of Child A, Child B, Child C, Child D, Child E and Child F. On termination of each Family Trust, the trust principal will be distributed to the respective beneficiaries of each trust entitled to income at that time, in the same proportion as the income to which they are then entitled.

Rulings requested

You have requested the following rulings:

- (1) No gain will be recognized on the division of the Trust, and the basis and holding periods of each asset transferred to the new trusts will, for income tax purposes, be the same as the Trust's basis and holding period for each such asset at the time of transfer;
- (2) The proposed division of the Trust will not affect the exempt status with respect to the generation-skipping transfer tax and will not cause any distribution from, or termination of any interest in, the Trust or the resulting trusts to be subject to the generation-skipping transfer tax;
- (3) The proposed division will not cause any beneficiary to be considered as having made a taxable gift under section 2501 of the Internal Revenue Code; and
- (4) The proposed division will not cause the Trust or the new trusts to be includible in the gross estate of Child C, Child D, Child E, or Child F.

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Ruling Request 1:

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 will be the excess of the amount realized from the sale over the adjusted basis provided in § 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.

A partition of jointly-owned property is not a taxable 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 (severance of a joint tenancy in stock into a tenancy in common is a nontaxable transaction).

In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee. 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 §§ 1001 and 1002.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that the assets of the Trust will be allocated among the three new trusts on a pro rata basis, and each new trust will receive an equal share of each asset in the Trust. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of the Trust.

An exchange of property results in the realization of gain or loss under § 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. In Cottage Savings, 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. In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that

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is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 564-65. Thus, the question here is whether, after the division of the Trust into three separately administered trusts, the beneficiaries will have different rights to or interests in the trust income or principal than they presently have.

It is consistent with the Supreme Court's opinion in Cottage Savings to find here that the interests of the beneficiaries of the three trusts under the proposed division will not differ materially from their interests under the current administration of the Trust. The same substantive provisions of the Trust will continue to control the interests of the beneficiaries after the division.

The Trustees propose to divide the Trust assets into three separate trusts, one for each group of beneficiaries. The taxpayer represents that the division of trust assets will be pro rata among the three trusts. The timing for distribution of principal will be the same before and after the proposed division. Under the proposed division, the principal similarly will be distributed to the beneficiaries of the three trusts after the death of the last survivor of Child A, Child B, Child C, Child D, Child E and Child F. During the Trust term, the trustee has discretion under certain circumstances to distribute principal to an income beneficiary up to but no more than in the same proportion as the income beneficiary's share of the income. The Trust also provides that in the event an entire line of beneficiaries dies without issue during the Trust term, the one-third share of that line will pro rata increase the shares of the surviving lines. The taxpayer represents that, since the separate trusts will continue to be controlled by the terms of the Trust, these provisions will be unchanged by the division into separate trusts.

Therefore, we conclude that the interests of the Trust beneficiaries will not be materially different after the Trust assets are divided into separate trusts. With the exception of the assets sold by the Trust to effect a pro-rata division of all Trust property (gain or loss on which will be taxed at the Trust level), the proposed division of the Trust will not be a taxable exchange, and no gain or loss will be recognized under § 1001.

Ruling Request 2:

Section 2601 imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), the generation-skipping transfer (GST) tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985.

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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 under § 26.2601-1(b) 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 GST tax 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 a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from the GST tax is divided into two trusts. Under the facts presented, 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, and 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. Accordingly, the two partitioned trusts will not be subject to the provisions of chapter 13.

In this case, the division of the Trust by the trustees will not result in a shift of any beneficial interest in the Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division. Further, the proposed division will not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for in the original Trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division of the Trust into three separate trusts, the Sibling A Family Trust, Sibling B Family Trust, and Sibling C Family Trust, will not cause either the Trust or the new trusts to lose exempt status for generation-skipping transfer tax purposes.

Ruling Requests 3 and 4:

Section 2001(a) provides that a tax is imposed 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 death.

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

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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) under which the decedent has retained for life the possession or enjoyment of, or the right to the income from the property, or the right to designate the persons who shall possess or enjoy the property or the income from the property.

Section 2037 provides that the value of the gross estate includes 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, 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 then 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) 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 adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of death to any change through the exercise of a power by the decedent to alter, amend, revoke, or terminate the interest in the property or where the decedent relinquished such power within the three year period ending on the date of the decedent's death.

Sections 2036 through 2038 may apply only in circumstances where a decedent made a transfer of property or an interest therein.

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

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.

In this case upon the division of the Trust into the Sibling A Family Trust, Sibling B Family Trust, and Sibling C Family Trust, each beneficiary of a trust will have the same beneficial interest as he or she had under the Trust. Because the beneficial interests of the beneficiaries are substantially the same both before and after the proposed transaction, no transfer of property will be deemed to occur as a result of the division. Accordingly, we conclude that the proposed division will not cause a beneficiary to have made a transfer subject to the gift tax under § 2501.

Likewise, none of Child C, Child D, Child E, or Child F will be considered to have made a transfer for estate tax purposes, and the proposed division will not cause the

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value of the Trust or the new partitioned trusts to be includible in the gross estate of Child C, Child D, Child E, or Child F for federal estate tax purposes.

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

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to this matter.

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 the appropriate party. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

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

Sincerely yours,

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

Enclosure
copy for § 6110 purposes