

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:4-PLR-111020-00  
Date:

Re:

May 21, 2001

LEGEND:

- Parent =
- Child =
- Trust =
  
- Grandchild A =
- Grandchild B =
- Grandchild C =
- Grandchild B's Spouse =
- Date =
- Bank =
- Trust A =
  
- Trust B =
  
- Trust C =
  
- Other Bank =
- State =

Dear :

This is in response to the May 15, 2001 letter and other correspondence requesting rulings on the federal income tax, gift tax and generation-skipping transfer (GST) tax consequences of the proposed judicial modification of the Trust.

The facts submitted are as follows:

Parent died on Date. Under Article X, Clause 1 of his will, the residue of Parent's estate is to be held in trust (Trust). Child and Bank are designated as the trustees. Trust income is to be paid to Child during her life.

Under Article X, Clause 1(a), after Child's death, the Trust income is to be distributed to the then living descendants of Child, per stirpes. Under Clause 1(b), the Trust will terminate when the youngest of Child's lineal descendants living at Child's

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death reaches age twenty-one. At that time, the principal is to be distributed to the then current income beneficiaries. Clause 1(c) provides that Bank may, in its uncontrolled discretion, distribute to the current income beneficiaries such sums of Trust principal from time to time as it deems necessary for maintenance, comfort, education, or support.

Bank has resigned. Child is currently the sole trustee. Child has three adult children, Grandchild A, Grandchild B, and Grandchild C. Grandchild A and Grandchild B each have minor children. Grandchild C is handicapped, and Grandchild B is her guardian. No distributions of Trust principal have ever been made.

Child, as trustee, proposes to petition the local court of State to amend the Trust to provide that, upon Child's death, the Trust will be partitioned into three separate trusts, Trust A (to be held for the benefit of Grandchild A and his lineal descendants), Trust B (to be held for the benefit of Grandchild B and his lineal descendants), and Trust C (to be held for Grandchild C's benefit).

Each such trust will be funded with Trust assets on a pro rata basis. Each trust will pay the income to the then current income beneficiary of that trust (i.e., Grandchild A, Grandchild B, or Grandchild C, as the case may be) or, in the event of the death of the then current income beneficiary, to that beneficiary's then living lineal descendants, per stirpes. The governing instrument of each trust will provide that the corporate trustee (discussed below) may make distributions of principal, in its uncontrolled discretion, to any current income beneficiary (from time to time as it deems necessary) for the beneficiary's maintenance, comfort, education or support. The discretion to make principal distributions is to be exercised solely by the corporate trustee, and any beneficiary serving as a co-trustee can not participate in any decision to make discretionary distributions of principal.

Any distribution of principal to a current income beneficiary of a trust is to be made equally from the three separate trusts. To the extent any separate trust is exhausted, any such distribution of principal to the current income beneficiary of a separate trust (including to a current income beneficiary whose separate trust has been exhausted) is to be made equally from the remaining trusts.

In the event of the death of the last surviving beneficiary of a trust during the Trust term, the remaining assets of that trust will be distributed equally to the separate trusts still in existence. Each separate trust will terminate and distribution will be made to the then current income beneficiaries when the youngest of Child's lineal descendants, who is living at Child's death, attains age twenty-one.

Under the terms of each trust, a bank, trust company or corporation authorized to conduct a trust business will at all times serve as a trustee with the sole authority, in its uncontrolled discretion, to make the distributions of principal, as described above.

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In the case of Trust A, Other Bank (or any other bank, trust company or corporation authorized to conduct a trust business), as appointed by Grandchild A, will be the sole trustee. Grandchild A may remove and replace any corporate trustee and appoint a successor corporate trustee, but any such corporate trustee shall not be related or subordinate (within the meaning of § 672(c)) to Grandchild A.

Regarding Trust B, Grandchild B will be the individual trustee. If Grandchild B is unable or unwilling to serve, Grandchild B's Spouse will serve instead. Other Bank (or any other bank, trust company or corporation authorized to conduct a trust business) as appointed by Grandchild B will be the co-trustee. Grandchild B may remove and replace any corporate trustee and appoint a successor corporate trustee, but any such corporate trustee shall not be related or subordinate (within the meaning of § 672(c)) to Grandchild B. If Grandchild B and Grandchild B's Spouse are unable or unwilling to serve as the individual trustee, the corporate trustee will serve as the sole trustee of Trust B.

For Trust C, the then-serving legal guardian of Grandchild C will serve as Trust Advisor. Other Bank (or any other bank, trust company or corporation authorized to conduct a trust business) as appointed by the Trust Advisor will be the sole trustee. The corporate trustee may be removed as trustee by the Trust Advisor and a successor trustee will be appointed by the Trust Advisor so long as the successor trustee is a bank, trust company or corporation authorized to conduct a trust business. Any such corporate trustee so appointed shall not be related or subordinate (within the meaning of § 672(c)) to Grandchild C or the Trust Advisor.

You have asked for the following rulings:

- (1) The proposed division of the Trust into three separate trusts and the transfer of trust assets among the three separate trusts on a pro rata basis will not constitute a taxable disposition of the Trust assets for purposes of § 1001 of the Internal Revenue Code and will not result in the recognition of gain or loss.
- (2) The proposed division of the Trust will not result in a transfer subject to the gift tax under § 2501.
- (3) After the proposed division of the Trust is complete, each of the three separate trusts will be treated as a trust that was irrevocable on September 25, 1985, for purposes of § 1433(b)(2)(A) of the Tax Reform Act of 1986, and each of the three separate trusts will be exempt from the generation-skipping transfer tax imposed under § 2601.

#### RULING REQUEST 1

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the

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adjusted basis provided in such section for determining loss over the amount realized.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property. Section 1001(c) provides that, except as otherwise provided in subtitle A, the entire amount of the gain or loss determined under § 1001 on the sale or exchange of property shall be recognized. 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 for other property differing materially in kind or in extent is treated as income or loss sustained. Properties are viewed as “different” in a sense that is “material” to the Code when their possessors enjoy legal entitlements different in kind or extent from the properties given up. Cottage Savings Ass’n v. Commissioner, 499 U.S. 554, at 564-565 (1991).

Under the Trust and the successor trusts, the lineal descendants of Child will have similar rights to the net trust income. And, under the Trust and the successor trusts, principal can be distributed to a beneficiary for support in the uncontrolled discretion of the corporate trustee. Such a distribution of principal will have the same effect on the assets of the successor trusts as on the Trust because each successor trust will bear one-third of the amount of any distribution of principal. In addition, the successor trusts will terminate at the same time as would the Trust.

Accordingly, we conclude that the trust beneficiaries will not have materially different interests under the successor trusts as under the Trust. The proposed partition of the original trust with in kind and pro rata distribution of assets to successor trusts will not generate gain or loss under § 1001(a) to the Trust, the successor trusts, or to their beneficiaries.

## RULING REQUEST 2

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 Trust A, Trust B, and Trust C at Child’s death, 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 Child, Grandchild A, Grandchild B, or Grandchild C to have made a transfer subject to the gift tax under § 2501.

## RULING REQUEST 3

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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 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, except to the extent the transfer is made out of corpus added to the trust after that date.

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 at Child's death 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, and provided that no additions, either outright or constructive have been made to the Trust since September 25, 1985, after the proposed division of the Trust, Trust A, Trust B, and Trust C will be treated as trusts that were irrevocable on September 25, 1985, for purposes of § 1433(b)(2)(A) of the Tax Reform Act of 1986, and each of the three separate trusts will be exempt from the generation-skipping transfer tax imposed under

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§ 2601.

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