

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-115083-00
Date:

Attn:
Re:

May 29, 2001

LEGEND:

- Decedent -
- Trust -
- Trustee -
- Date 1 -
- Date 2 -
- Date 3 -
- Sibling A -
- Sibling B -
- Sibling C -
- Child A-1 -
- Child A-2 -
- Child B-1 -
- Child B-2 -
- Child C-1 -
- Child C-2 -
- Child C-3 -
- Child C-4 -
- Child C-5 -
- Child C-6 -
- Child C-7 -
- Grandchild -
- Local Court -

Dear :

This is in response to the July 21, 2000 letter and other correspondence requesting rulings concerning the generation-skipping transfer tax and income tax consequences of the proposed division of the Trust.

The facts submitted are as follows:

Decedent executed a will on Date 1 (prior to October 22, 1986), and did not amend the terms of the will prior to Decedent's death on Date 2 (after October 22, 1986, and before January 1, 1987). Decedent was a resident of Georgia at the date of her death. Trustee is the successor trustee of Trust.

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Under the provisions of Item Seven of Decedent's will, the residue of Decedent's estate, after payment of debts, taxes, and bequests of certain personal property, passed in Trust. Item Seven (a) of Trust provides that Trust will terminate twenty-one (21) years after the death of Decedent. Thus, the termination date of Trust is Date 3.

Item Seven (b) of Trust provides that, during the term of Trust, the trustee shall pay over and distribute the net income of Trust in four equal parts to Decedent's brother (Sibling A), Decedent's sister (Sibling B), Decedent's brother (Sibling C), and Decedent's grandchild (Grandchild). Item Seven (c) requires that the income be distributed quarterly or more frequently if, in the opinion of the trustee, it is expedient to do so.

Item Seven (d) states that:

Should [Grandchild] fail to survive the trust period, and should he fail to leave descendant or descendants surviving him, then his portion of the trust shall be added to the remaining three portions, and the income therefrom be distributed in equal amounts among those portions. Should [Grandchild] not survive the trust period, and should he leave a descendant or descendants surviving, then his descendant or descendants shall continue to receive the benefits herein provided for the remainder of the trust period.

Item Seven (e) states that:

Should either of [Sibling A, Sibling B, or Sibling C] not survive the trust period, then his or her part of the income shall be paid over to his or her children in equal parts during the remainder of the trust period.

Item Seven (f) states that:

Upon the trust terminating, then the principal of the trust, together with any undistributed income at the time remaining, shall be delivered to the original trust beneficiaries if they are in life. If [Grandchild] is not in life and he leaves descendant or descendants surviving him, then his part shall be delivered to his descendant or descendants. If he does not survive the trust period and leaves no descendant or descendants, then his part shall be paid over to the beneficiaries of the remaining three parts. Should either [Sibling A, Sibling B, or Sibling C] not survive the trust period, then the principal remaining at the end of the trust period shall be distributed to the children of any deceased brother or sister, per stirpes.

Sibling A, Sibling B, and Sibling C had all predeceased Decedent. Sibling A was survived by two children, Child A-1 and Child A-2; Sibling B was survived by two children, Child B-1 and Child B-2; and Sibling C was survived by seven children, Child C-1, Child C-2, Child C-3, Child C-4, Child C-5, Child C-6, and Child C-7. All of the

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children and Grandchild are currently living and adults. Consequently, pursuant to the terms of Trust, the income has been distributed as follows:

1. 25 percent to Grandchild;
2. 25 percent divided among the children of Sibling A, as follows:
 - A. 12.5 percent to Child A-1,
 - B. 12.5 percent to Child A-2;
3. 25 percent divided among the children of Sibling B, as follows:
 - A. 12.5 percent to Child B-1,
 - B. 12.5 percent to Child B-2; and
4. 25 percent divided among the children of Sibling C, as follows:
 - A. 3.5714285 percent to Child C-1,
 - B. 3.5714285 percent to Child C-2,
 - C. 3.5714285 percent to Child C-3,
 - D. 3.5714285 percent to Child C-4,
 - E. 3.5714285 percent to Child C-5,
 - F. 3.5714285 percent to Child C-6,
 - G. 3.5714285 percent to Child C-7.

You have represented that Trust has not been amended and no additions (including constructive additions) have been made to the Trust since Decedent's death on Date 2 (other than the initial funding of Trust).

The Trustee and each of the beneficiaries of Trust (the parties) propose to file a petition for partition of the Trust with Local Court, pursuant to Ga. Code Ann. § 53-12-152(b) (1999), which provides the following:

Upon petition by a trustee, beneficiary, or any party in interest for good cause shown, the court, after conducting a hearing with notice to all parties in interest, in such manner as the court may direct, may divide a trust into two or more single trusts or consolidate two or more trusts into a single trust, upon such terms and conditions as it deems appropriate. The court shall not approve any such consolidation or division unless such consolidation or division:

- (1) is not inconsistent with the intent of the grantor, donor, settlor, or other testator with regard to any trust to be consolidated or divided;
- (2) would facilitate administration of the trust or trusts; and
- (3) would be in the best interest of all beneficiaries, and not materially impair their respective interests.

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Under the proposal, Trust will be divided into twelve separate trusts, one each for Grandchild and the adult children of Sibling A, Sibling B, and Sibling C. Trustee will continue to be the trustee of each of the new trusts. The parties will file a petition with the Local Court requesting an order approving the division of the Trust into twelve separate trusts. The assets of the Trust will be allocated among the twelve new trusts on a pro rata basis. Each new trust will receive a percentage share of each asset in the Trust that corresponds to the percentage share held by each current income beneficiary of Trust. To the extent that such allocation of assets would result in the fractionalization of any share or unit of any security, cash will be used to supplement the allocation in order to equalize the values so that no share or unit of security will be fractionalized.

The administrative provisions of each of the twelve new trusts will be identical to those of Trust and Trustee will continue to be the trustee of each of the new trusts. Trustee will be required to continue to exercise the same standard of fiduciary responsibility over the separate trusts as Trustee previously exercised with respect to Trust. Each new trust will terminate on Date 3, the same termination date of Trust.

The dispositive provisions of each of the new trusts will differ from those of Trust in that each of the new trusts will have one primary beneficiary, as described above, who is a current income beneficiary of Trust. The terms of each of the twelve new trusts will provide that the trustee will pay the net income to the beneficiary quarterly or more frequently, if, in the opinion of the trustee, it is more expedient to do so.

Each of the new trusts will provide that, in the event that the primary beneficiary dies before the termination of the trust, the net income will be distributed to that beneficiary's lineal descendants, per stirpes. If the primary beneficiary dies before the trust terminates and is either not survived by lineal descendants or is survived by lineal descendants all of whom, in turn, die before the trust terminates, then at the death of the primary beneficiary or the later death of surviving lineal descendants prior to termination of the trust, the trust corpus will be distributed to the remaining new trusts proportionately based on the initial allocation of the assets of Trust to the remaining trusts. Upon termination of each new trust on Date 3, each trust corpus will be distributed to the respective primary beneficiary of that trust, if living on Date 3. If the primary beneficiary of a new trust is not living on Date 3, that trust corpus will be distributed to the lineal descendants of that primary beneficiary, per stirpes.

Rulings requested

You have requested the following rulings:

- (1) The proposed division of Trust into twelve separate trusts will not result in the realization of income under § 61 and will not result in the realization of gain or loss under § 1001.
- (2) The proposed division of Trust will not affect the exempt status of Trust with respect to the generation-skipping transfer tax and will not cause any distribution from, or termination of any interest in, Trust or the resulting twelve trusts to be

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subject to the generation-skipping transfer tax.

Ruling Request 1:

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

Section 1001(a) provides that a taxpayer's gain from the sale of property is the excess of the amount realized over the taxpayer's adjusted basis provided in § 1001 for determining gain and that the taxpayer's loss from the sale of property is the excess of the taxpayer's adjusted basis provided in § 1011 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 extent, is treated as income or loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the severance of a joint tenancy in stock under a partition action provided for by state law to compel the issuance of separate stock certificates is not a sale or exchange. Likewise, the conversion of a joint tenancy in stock into a tenancy in common is a nontaxable transaction. Under applicable state law, the right of the owners of the property to pursue such action is an inherent ownership right each party possessed with respect to the property involved.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), concerns whether 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 group of residential mortgage loans. The two groups of mortgage loans were considered "substantially identical" by the agency that regulated the financial institution.

In Cottage Savings, the Supreme Court concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different." In defining what constitutes "materially different" for purposes of § 1001(a), the Supreme Court stated that properties are "different" in a sense that is "material" so long as the respective parties enjoy legal entitlements that are different in kind or extent. 499 U.S. at 564-565. The Supreme Court held that mortgage loans made to different obligors and secured by different homes embodied distinct legal entitlements, and that the taxpayer realized losses when the loans were exchanged. Id. at 566.

Thus, in order for a transaction to result in a § 1001 taxable event, the transaction must be (1) a sale, exchange or other disposition, and (2), if an exchange, the exchange must result in the receipt of property that is "materially different" (as defined in Cottage Savings) from the property that was given up. In this case, the first element will not be present because the trust beneficiaries do not acquire their interest

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in the individual trusts as a result of an exchange of their interests in the trust, but rather by reason of the authority granted under the Georgia law. There is no exchange of property here; instead, the trustee is merely exercising a right to divide the trust as allowed by state law. In this case, the transaction is similar to Rev. Rul. 56-437 in which the joint owners of property exercised a right inherent in their ownership rights in the property to partition the property. Further, the interests that each of the beneficiaries will have in the separate trusts is the same as each currently has in Trust.

Therefore, the Trust, the 12 separate trusts, and the beneficiaries of these trusts will not realize gain or loss 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)(B) of the Act and § 26.2601-1(b)(2)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a will or revocable trust that was executed before October 22, 1986, provided that the document in existence on October 22, 1986, is not amended at any time after October 21, 1986, in any respect which results in the creation of, or an increase in the amount of, a generation-skipping transfer and the decedent dies before January 1, 1987.

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

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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, Decedent's will was executed before October 22, 1986, and Decedent died before January 1, 1987. You have represented that Decedent's will was not amended at any time after October 22, 1986, and before Decedent's date of death and that no additions (including constructive additions) have been made to Trust (other than the initial funding) since Decedent's death on Date 2.

Based on the submitted information, the division of 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 twelve separate trusts will not cause either Trust or the twelve new trusts to lose exempt status for generation-skipping transfer tax purposes and that distributions from Trust to the twelve new trusts and distributions from the twelve new trusts will not be subject to the GST tax.

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