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Date:

April 21, 2004

LEGEND

Beneficiary 1 =

Beneficiary 2 =

Trust 1 =

Trust 2 =

Date 1 =

Date 2 =

State Code =

Dear :

This letter responds to your letter, dated March 25, 2003, and prior correspondence, submitted on behalf of Beneficiary 2, requesting rulings regarding the proposed division of two grandfathered generation-skipping transfer (GST) trusts. Specifically, rulings are requested under §§ 61, 1001, and 2601 of the Internal Revenue Code.

Trust 1 was established on Date 1 and Trust 2 was established on Date 2. No additional contributions were made to either trust. The settlor of Trust 1 was the grandmother of Beneficiary 1 and Beneficiary 2, and the settlor of Trust 2 was the

grandfather of Beneficiary 1 and Beneficiary 2. Trust 1 and Trust 2 were set up to benefit the settlors and their descendants. The settlors and their children are deceased. Beneficiary 1 and Beneficiary 2 are the surviving grandchildren of the settlors of Trust 1 and Trust 2 and the current income beneficiaries of both trusts.

Under the terms of Trust 1 and Trust 2, Beneficiary 1 and Beneficiary 2 each receive one-half of the income from Trust 1 and Trust 2. Principal distributions are to be paid, at the trustee's discretion, to a group consisting of Beneficiary 1 and Beneficiary 2 and the children of each of them. Beneficiary 1 and Beneficiary 2 each have two children.

Under the terms of Trust 1 and Trust 2, upon the death of Beneficiary 1 or Beneficiary 2, the share of income that would have been payable to that beneficiary shall instead be payable, in equal shares, to the children of that beneficiary. Upon the death of Beneficiary 1 and Beneficiary 2, Trust 1 and Trust 2 are to be divided into as many shares as there are children of Beneficiary 1 and Beneficiary 2. The trustee may, at its discretion, distribute income and principal from the separate shares to each share's beneficiary. Upon a child attaining twenty-five years, one half of his or her share is required to be distributed to that child and upon a child attaining thirty years, the balance is to be distributed to that child. If any children die before distribution, that deceased child's share is to be held in trust for such deceased child's issue.

Beneficiary 1 and Beneficiary 2 propose to obtain a judicial reformation, pursuant to State Code. Pursuant to the proposed reformation, Trust 1 and Trust 2 each will be divided, on a pro rata basis, into two separate trusts. An undivided interest in fifty percent of the assets currently held in Trust 1 will fund a new trust created for the benefit of Beneficiary 1 (Trust 1A) and the other undivided fifty percent of the assets currently held in Trust 1 will fund a new trust to be created for the benefit of Beneficiary 2 (Trust 1B). An undivided interest in fifty percent of the assets now held in Trust 2 will fund a new trust created for the benefit of Beneficiary 1 (Trust 2A) and the other undivided fifty percent of the assets currently held in Trust 2 will fund a new trust to be created for the benefit of Beneficiary 2 (Trust 2B).

The terms of each of the four new trusts will be consistent with the terms of the original trusts. Under the terms of the new trusts, Beneficiary 1 and Beneficiary 2 will continue to be entitled to receive all of the income from their respective trusts, and the trustee will continue to have the discretion to pay principal to Beneficiary 1 and Beneficiary 2 and their children, from their respective trusts. At the death of Beneficiary 1 or Beneficiary 2, each of their new trusts will be divided into separate shares for their children. The dispositive terms of the separate shares created under the new trusts (1A, 1B, 1C, and 1D) at the death of Beneficiary 1 or Beneficiary 2, are consistent with the terms of the separate shares that were to be created upon the death of Beneficiary 1 and Beneficiary 2 under Trust 1 and Trust 2.

You have requested rulings that the proposed division of Trust 1 and Trust 2 and the proposed pro rata allocation of each existing asset among the resulting trusts: 1) will not cause any gain or loss by the original trusts or the resulting trusts or any of their respective beneficiaries under §§ 61 or 1001, and 2) will not affect Trust 1 or Trust 2's status as exempt from the GST tax and will not cause a distribution from, or termination of any interest in, Trust 1, Trust 2, or any of the resulting trusts to be subject to the GST tax.

State law authorizes trustees to divide a single trust into two or more separate trusts if the division is in the best interests of the beneficiaries of the trusts, is equitable and practicable, and will not defeat or substantially impair the accomplishment of the purpose of the trusts or the interests of the beneficiaries under the trusts. State law further provides that a trustee of any trust that is to be divided may seek approval of the division by filing a complaint with a court that has jurisdiction over the trust. The trustee of Trust 1 and Trust 2 intends to file such a complaint.

Income Tax Rulings

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 therefrom 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. Section 1001(c) provides that, except as otherwise provided, the entire amount of the gain or loss on the sale or exchange of property is recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides, as a general rule, 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 in either kind or in extent, is treated as income or as loss sustained.

For purposes of § 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 § 1001(a). See § 1.1001-1.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that 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 in order to extinguish their survivorship interests.

An exchange of property results in the realization of gain under § 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.

Based on the information submitted and the representations made in the ruling request, the proposed division of Trust 1 and Trust 2 on a pro-rata basis into four separate trusts will not cause the interests of the trust beneficiaries to differ materially. The trust beneficiaries will hold essentially the same interests before and after the pro-rata division. Accordingly, the proposed division of the Trust 1 and Trust 2 assets among the new trusts will not cause the trusts nor the beneficiaries to recognize gain or loss from a sale or other disposition of property under §§ 61 and 1001.

Generation-Skipping Tax Rulings

Section 2601 imposes a tax on every generation-skipping transfer.

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

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(ii)(A) 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 except as provided in §§ 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor’s gross estate under §§ 2038 and 2042. In the present case, Trust 1 and Trust 2 are considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(4) 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)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or

construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, 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 in the original trust. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

In this case, Trust 1 and Trust 2 are generation-skipping trusts because they each provide for distributions to more than one generation of beneficiaries below the generation of each trust's grantor. Date 1 and Date 2 are prior to September 25, 1985, and Trust 1 and Trust 2 were irrevocable on September 25, 1985. Trust 1 and Trust 2, therefore, are exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i).

The proposed division of Trust 1 and Trust 2 will result in four trusts, two each for Taxpayer 1 and Taxpayer 2. Because the dispositive terms of the resulting trusts will be the same as the terms of the original trusts, the proposed division of Trust 1 and Trust 2 and the pro rata allocation of assets among the resulting trusts of each divided trust does not shift a beneficial interest 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. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trusts. Based on the facts submitted and representations made, we conclude that the proposed division of Trust 1 and Trust 2 into two trusts each will not affect Trust 1 or Trust 2's status as exempt from the generation-skipping transfer tax. As a result neither the division of Trust 1 and Trust 2 nor the proposed pro rata allocation of the assets will cause a distribution from, or termination of any interest in, Trust 1, Trust 2, or any of the resulting trusts to be subject to GST tax.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 an appropriate party. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect. While this office has not verified any of the material submitted in support of the request for rulings it is subject to verification on examination.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to Beneficiary 2.

This ruling is directed only to the taxpayer(s) requesting it. Section 6100(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Melissa C. Liquerman
Chief, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy of this letter for § 6110 purposes