

Number: **200645005**
Release Date: 11/10/2006
Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Index Number: 2632.00-00, 1001.00-00,
61.00-00, 1223.00-00,
1015.00-00, 2501.01-00

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-109771-06

In Re:

Date:
August 04, 2006

Legend:

Decedent	=
Trust	=
State Statute	=
Year 1	=
Year 2	=
Date 1	=
Date 2	=

Dear Trustee:

This is in response to your letter dated January 30, 2006, and subsequent correspondence, requesting a ruling on the income, gift, and generation-skipping transfer (GST) tax consequences of certain proposed modifications to a trust.

Decedent died, testate, in Year 1, which is prior to 1985. Decedent's will established a trust (Trust) for the benefit of his nieces and nephews.

Article Sixth, Sections (a) and (c) of Trust provide that trust shares established for one of Decedent's nieces and one of Decedent's nephews (hereinafter referred to as Niece/Nephew) are to be administered as follows. The Niece/Nephew is to receive income from his or her share up to \$ 600 per month. Remaining income is to be distributed to his or her issue born before Date 1, by right of representation. In addition, principal of up to 5 percent of the Niece/Nephew's share may be distributed to the Niece/Nephew and his or her issue to provide for medical expenses, to maintain their standard of living, and to pay for a college education.

Upon the Niece/Nephew's death, the net income from his or her share is to be paid to his or her issue born before Date 1, by right of representation. Such issue also may receive distributions of principal to provide for medical expenses, to maintain their standard of living, and to pay for a college education. Upon the death of any of the issue, the trustee is to distribute the remaining balance of the deceased issue's share of the principal to the issue of the deceased issue born before Date 2, by right of representation. If none of the issue of the deceased issue is then living, then the deceased issue's share augments the other issue's share of the Niece/Nephew. If none of the Niece/Nephew's issue are alive, then the balance augments the then living beneficiaries of the other shares in equal share.

Article Sixth, Section (d) provides that the shares established for the remaining nieces and nephews (hereinafter referred to as Beneficiary) are to be administered as follows. Income from the Beneficiary's share is to be distributed to the Beneficiary's issue born before Date 1, by right of representation. Up to 5 percent of the principal of the Beneficiary's share may be distributed to the Beneficiary's issue to provide for their medical expenses, to maintain their standard of living, and to pay for a college education.

Upon the death of any of the Beneficiary's issue, the trustee is to distribute the remaining balance of the deceased issue's share of the principal to the issue's issue born before Date 2, by right of representation. If none of the deceased issue's issue is then living, then the deceased issue's share augments the Beneficiary's other issue's shares. If none of the Beneficiary's issue is then alive, then the balance augments the then living Beneficiaries of the other shares in equal shares.

Article Sixth, Section E(1) provides that all trusts established under Trust are to terminate upon the last to die of the nieces and nephews and their issue born before 1995.

It has been represented that no additions, actual or constructive, were made to Trust after Year 2.

The trustee proposes to divide Trust into nine separate trusts that will have the same beneficiaries and terms as they had prior to the division. Income and principal of each separate trust, however, will be paid to the beneficiaries of that separate trust only. If a beneficiary of a separate trust dies without issue, his or her trust will be divided into equal shares and allocated to the remaining trusts from which Trust was divided. The assets of Trust will be distributed on a pro-rata basis among the nine separate trusts.

The trustee has requested rulings that:

- (1) the division of Trust into nine separate trusts and the distribution of Trust's assets on a pro-rata basis among the nine separate trusts will not result in the realization of gain or loss under §§ 61 and 1001;
- (2) the assets distributed from Trust to the nine separate trusts will retain the same tax basis under § 1015 as the assets had in Trust before the division;
- (3) the assets distributed from Trust to the nine separate trusts will retain the same holding period under § 1223(2) as the assets had in Trust before the division;
- (4) the proposed division of Trust into nine separate trusts will not cause Trust or the separate trusts to lose their status as being exempt from the GST tax, and will not cause distributions from, or termination of any interest in, Trust or any of the separate trusts, to be subject to the GST tax under § 2601; and
- (5) the distribution of Trust's assets on a pro-rata basis from Trust to the nine separate trusts will not be deemed a taxable gift under § 2501.

Law and Analysis – Ruling 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 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 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.

In this case, Trust’s assets will be distributed on a pro-rata basis among the nine separate trusts. Accordingly, based on the information submitted and the representations made, we conclude that the proposed division of Trust into nine separate trusts to be funded on a pro-rata basis will not cause the interests of the beneficiaries of the separate trusts to differ materially. The beneficiaries will hold essentially the same interests before and after the pro-rata division. Therefore, the proposed division of Trust into nine separate trusts will not result in the realization of any gain or loss from a sale or other disposition of property under §§ 61 and 1001.

Ruling 2:

Section 1015 provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss recognized.

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 a 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 in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer is made.

In this case, based upon the facts submitted and the representations made, we conclude that because neither §§ 61 and 1001 applies to the proposed division, the basis of the assets for each of the nine separate trusts will be the same as Trust’s basis in the assets before the division.

Ruling 3:

Section 1223(2) provides that, in determining the period for which a taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person, if under chapter 1 such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer’s hands as it would have in the hands of the other person.

In the proposed division of Trust into nine separate trusts, the tax basis of the nine separate trusts in each property received from Trust will be the same as the tax basis of Trust in such property. Accordingly, based upon the facts submitted and the representations made, we conclude that the assets distributed from Trust to the nine separate trusts will retain the same holding period under § 1223(2) as the assets had in

Trust before the division.

Ruling 4:

Section 2601 imposes a tax on every GST made after October 26, 1986. A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term taxable termination means a termination (by death, lapse of time, release of a power or otherwise) of an interest in property held in trust where the property passes to a skip person with respect to the transferor of the property. 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. Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person.

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 GST 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 the 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 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), that relate to property includible in a grantor's gross estate under §§ 2038 and 2042.

Section 26.2601-1(b)(4)(i) provides that, in general, unless specifically provided otherwise, 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 GST tax purposes. Thus (unless specifically noted), 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 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 paragraph (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 for in the original trust.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of this section, a modification of an exempt trust will result in a shift in 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. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a 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 modification. 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 to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 5 provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. 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. In addition, 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. Therefore, the two partitioned trusts separate from the division will not be subject to the provisions of chapter 13.

State Statute 1 provides that upon petition by a trustee or beneficiary, the court, for good cause shown, may divide a trust into two or more separate trusts, if the court determines that dividing the trust will not defeat or substantially impair the accomplishment of the trust purposes or the interests of the beneficiaries.

In the present case, Trust was irrevocable on September 25, 1985. It has been represented that no additions, actual or constructive, have been made to Trust after that date. The proposed modification of Trust is similar to the modification described in § 26.2601-1(b)(4)(i)(E), Example 5. Therefore, based upon the facts submitted and the representations made, the proposed division will not shift a beneficial interest in any trust operating under Trust to a beneficiary who occupies a lower generation than the persons who held beneficial interests prior to the division. In addition, the division will not extend the time for vesting of any beneficial interest in the trusts operating under Trust beyond the period provided in Trust. Accordingly, the proposed division will not affect the status of any of the trusts operating under Trust as exempt from the GST tax under § 2601.

Ruling 5:

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.

In this case, upon division of Trust into nine separate trusts, each beneficiary will have substantially the same beneficial interest as he or she had under Trust prior to the division. Because the beneficial interests of the beneficiaries are substantially the same both before and after the proposed division, no transfer of property will be deemed to occur as a result of the division. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division will not cause any beneficiary to be considered as having made a taxable gift under § 2501.

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

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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. 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.

Sincerely,

James F. Hogan

James F. Hogan
Senior Technician Reviewer, Branch 9
(Passthroughs & Special Industries)

Enclosures: Copy for § 6110 purposes