

Internal Revenue Service

Number: **200708054**

Release Date: 2/23/2007

Index Number: 2601.00-00, 2501.00-00,
61.00-00, 661.00-00,
1001.00-00, 1031.08-00,
1031.00-00

Department of the Treasury
Washington, DC 20224

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

Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-145134-04

Date:
September 26, 2006

Re:

Legend:

Decedent	=
Date 1	=
Date 2	=
Date 3	=
Trust	=
Trust 1	=
Trustee	=
Property 1	=
Property 2	=
Charity 1	=
Charity 2	=
Child	=
Grandchild 1	=
Grandchild 2	=
Business	=
<u>W</u>	=
<u>X</u>	=
<u>Y</u>	=
<u>Z</u>	=
Court	=

Family Trusts =

Dear :

This is in response to a correspondence requesting rulings regarding the generation-skipping transfer (GST) tax, gift tax, and income tax consequences of a proposed transaction.

The facts submitted and representations made are as follows. Decedent's will was executed on Date 1. Decedent died on Date 2. Decedent's will provides that the residue of her estate will be placed in trust (Trust). Trustee is the trustee of Trust. The residue included sections of Property 1 and Property 2. Trust provides that Property 1 may not be sold, traded, or otherwise alienated.

Trust provides that Trustee is required to pay X% of Trust's income to Charity 1 and X% of Trust's income to Charity 2. Trust provides that Trustee is required to pay the remaining Y% of Trust's income in equal Z% portions to Decedent's child, Child, and to each of Decedent's grandchildren, Grandchild 1 and Grandchild 2. Child died on Date 3. Upon Child's death, her share of Trust's income passed to Grandchild 1 and Grandchild 2 in equal portions. Therefore, Grandchild 1 and Grandchild 2 each receive W% of Trust's income. Upon Grandchild 1's death, her share of Trust's income will pass to her descendants, per stirpes. Currently, Grandchild 1 has six children, seventeen grandchildren, and nine great-grandchildren. Upon Grandchild 2's death, her share of Trust's income will pass to her descendants, per stirpes. Currently, Grandchild 2 has four children, seven grandchildren, and two great-grandchildren.

Trust provides that if a child of Grandchild 1 or Grandchild 2 dies during the existence of Trust, the income that such deceased child would have received passes to his or her issue, per stirpes. If the deceased child has no issue, then such income passes to the surviving brothers and sisters of the deceased child, per capita.

Trust provides that principal can be paid out for the benefit of a trust beneficiary (1) if an emergency or unforeseen calamity befalls a trust beneficiary; and (2) if a trust beneficiary incurs reasonable expenses for education, maintenance, or support. Any such amounts paid must be charged to the trust share of the beneficiary for whose benefit the amount was paid.

Trust provides that Trust will terminate on the death of the last surviving great-grandchild of Decedent living at the time of Decedent's death. Therefore, Trust will terminate upon the death of the last child of Grandchild 1 and Grandchild 2 that was alive on the date that Decedent died. Five of Grandchild 1's children and all of

Grandchild 2's children were living at that time. Upon termination, Trust's corpus will pass to the then living descendants of Decedent.

Decedent's will provides that as soon as Trustee comes into possession of the trust estate, "it is my desire, and I so direct, that the trustee, . . . shall separate the accounts of each of the beneficiaries hereunder so as to constitute a separate trust as to each beneficiary and to accomplish this result may assign undivided interests in the trust property, both land and personal property, to each account so that as to each beneficiary there shall be a separate trust." Trustee did not partition Trust because it believed that administering a separate trust for each trust beneficiary would require separate accounting and separate trust statements and maintenance of separate trusts would increase the cost of administering Trust to the detriment of its beneficiaries. In addition, Trustee believed that Decedent's will required Trustee to retain its sections of Property 1 until Trust is terminated and to continue Business operations of Property 1 in order to preserve its sections of Property 1 for the remainder beneficiaries of Trust.

Originally, Property 1 was owned by its founder. Over the years, Property 1 was partitioned into sections through various transfers. Currently, Trust owns sections of Property 1. Four trusts (Family Trusts) for the benefit of each of Grandchild 2's children, each own an undivided interest in sections of Property 1. Grandchild 1 owns the remaining sections of Property 1 indirectly through a partnership. Trust also holds Property 2, livestock, equipment, other tangible personal property, and cash and cash equivalents.

Trustee now believes it must carry out the instructions in the will to partition Trust. Trustee proposes to do so in a manner consistent with the Decedent's intent to preserve Trust's sections of Property 1 for her descendants. Currently, sections of Property 1 held in Trust about sections of Property 1 held by Family Trusts. Further, sections of Property 1 held in Trust are not adjacent to sections of Property 1 held by Grandchild 1's partnership because sections of Property 1 held by Family Trusts are interposed between Trust's sections of Property 1 and Grandchild 1's partnership sections of Property 1. Accordingly, Trustee has consulted with Grandchild 1 and Grandchild 2 regarding a plan to first transfer sections of Property 1 held by Family Trusts to Trust and transfer sections of Property 1 and Property 2 held by Trust to Family Trusts (Exchange). After the Exchange, Trustee will partition Trust (Partition). In the Partition, Trust will retain certain sections of Property 1 and Property 2 in Trust for the benefit of Grandchild 1 and her descendants and transfer the balance to Trust 1, a newly-created trust, to benefit Grandchild 2 and her descendants. After the Exchange and Partition, sections of Property 1 held by Trust will be adjacent to sections of Property 1 owned by Grandchild 1's partnership, and sections of Property 1 held by Trust 1 will be commonly owned by Family Trusts as tenants in common and will be adjacent to sections of Property 1 held by Family Trusts. In addition, in the Partition, the personalty of Trust will be divided into 2 portions of equal value with one portion retained in Trust and the other portion transferred to Trust 1. No separate subtrusts will

be created for Charity 1 or Charity 2. Rather, Trust and Trust 1 will each be required to pay X% of their annual income to each of Charity 1 and Charity 2.

You have requested the following rulings:

1. The Exchange will not cause Trust to become subject to the generation-skipping transfer (GST) tax under § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations.
2. Sections of Property 1 owned by Family Trust and transferred into Trust pursuant to the Exchange will not be deemed an addition to Trust 1 within the meaning of § 26.2601-1(b)(1)(i).
3. The Exchange will qualify as a nonrecognition transaction within the meaning of § 1031 of the Internal Revenue Code and the basis of the property transferred from the Family Trusts to Trust in the Exchange will be the same as the combined basis of the property transferred by Trust in the Exchange pursuant to § 1031(d).
4. The Exchange will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries of Trust and Trust 1.
5. The Partition will not cause Trust or Trust 1 to become subject to any provision of the GST tax.
6. The Partition will not cause Trust or Trust 1 or any beneficiary thereof to realize gain or loss under §§ 61 or 1001.
7. The Partition will not be viewed as a distribution or termination under § 661, nor as a distribution for purposes of § 1.661(a)-2(f) and, therefore, will not result in the realization by Trust or Trust 1, or by any beneficiary of Trust or Trust 1 of any income, gain, or loss.
8. The Partition will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries of Trust or Trust 1.

RULINGS 1, 2, & 5

Section 2601 imposes a tax on each generation skipping transfer.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) 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 regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

Section 26.2601-1(b)(2) contains rules relating to the exception in § 1433(b)(2)(B) of the Act. Section 26.2601-1(b)(2)(i) provides that the GST tax provisions will not apply to any GST under a will or revocable trust executed before October 22, 1986, provided that (A) the document that was in existence on October 21, 1986, was not amended at any time after October 21, 1986, in any respect that results in the creation of, or an increase in the amount of, a GST, (B) in the case of a revocable trust, no addition was made to the revocable trust after October 21, 1986, that results in the creation of, or an increase in the amount of, a GST, and (C) the decedent died 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 GST tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(A) provides that the distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the GST provisions, if the terms of the governing instrument of the exempt trust authorize distribution to a new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust 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 section 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 that does not result in an increase in the amount of a GST transfer or the creation of a new GST transfer will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(E), Example 5, involves an irrevocable trust that was established in 1980. 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 is to terminate and the principal distributed to A's issue per stirpes. The terms of the trust for B and B's issue are identical except for the beneficiaries. The example concludes that 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 section 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 resulting from the division will not be subject to the provisions of chapter 13.

Trustee will seek Court approval of the Exchange and Partition. Trustee will join all living beneficiaries of Trust in the proposed Court proceeding. A guardian ad litem will be appointed to represent the interests of the minor, unborn and unascertained Trust beneficiaries.

In this case, Decedent's will was executed before October 21, 1986, was not amended after October 21, 1986 and Decedent died prior to January 1, 1987. Therefore, Trust is currently exempt from GST tax.

The Exchange will be made pursuant to Court order and agreed upon by the beneficiaries of Trust. The Exchange will not shift a beneficial interest in 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 Exchange. Further, the Exchange does not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. Trustee is authorized under Decedent's will to carry out the Partition without Court approval or the consent of Trust beneficiaries. The Partition will not shift a beneficial interest in 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 Partition. Further, the Partition does not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust.

Based on the facts submitted and the representations made, we conclude that the Exchange will not cause Trust to become subject to the GST tax and the transfer of property to Trust pursuant to the Exchange will not be deemed an addition to Trust for purposes of § 26.2601-1(b)(1)(i). Further, we conclude that the Partition will not cause Trust or Trust 1 to become subject to any provision of the GST tax.

RULINGS 4 & 8:

Section 2501 imposes a tax for each calendar year 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 2512(a) provides that, if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

In this case, each beneficiary of Trust and Trust 1 will have the same beneficial interest as he or she had under Trust. Because the beneficial interests of the beneficiaries are substantially the same both before and after the Exchange and

Partition, no transfer of property will be deemed to occur as a result of the Exchange and the Partition.

Based upon the facts submitted and representations made, we conclude that the Exchange will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries of Trust and the Partition will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries of Trust or Trust 1.

RULING 3:

Section 1031(a)(1) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

The exchange contemplated is a simultaneous exchange of real property for real property. For gain or loss to be deferred as a like-kind exchange, § 1031 establishes the following requirements:

1. The transaction must be an exchange of property for property rather than a sale of property for money;
2. The property relinquished or transferred by the taxpayer and the property that the taxpayer receives in the exchange must be held for productive use in a trade or business or for investment; and
3. The relinquished and the replacement properties must be of like kind

. Section 1031(d) provides, in part, that if property was acquired on an exchange described in this section then the basis shall be the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange.

Generally, the replacement property received in an exchange for which gain or loss is deferred under § 1031 is the same as the property relinquished in the exchange. However, as provided in § 1031, this transferred basis must undergo certain adjustments depending on the facts and circumstances of the transaction. Section 1031(d) also requires that the transferred basis be decreased by the amount of any money received by the taxpayer in the exchange, then increased by the amount of the gain to the taxpayer that was recognized, or decreased by the amount of any loss that was recognized in the exchange. If there is no money received by the taxpayer in the exchange and if the taxpayer does not recognize any gain or loss in the transaction, so that no adjustments to the basis are required, then the basis of the replacement property will be the same as the old basis of the property relinquished in the exchange.

Under the facts presented, real property will be exchanged for real property. Thus, the first and third requirement will be satisfied. The transaction will be an exchange rather than a sale and the property to be exchanged is of like kind. In addition, the second requirement is satisfied because the relinquished property was held by Trust for productive use in Business and the replacement property will be retained by Trust for the benefit of Grandchild 1's family for productive use in Business.

Based upon the facts submitted and representations made, we conclude the Exchange qualifies as a tax deferred exchange under §1031 and the basis of the property received by Trust in the Exchange will be the same as the combined basis of the property transferred by Trust under § 1031(d).

RULING 6:

Section 61(a)(3) provides that, except as otherwise provided in Subtitle A (pertaining to income taxes), gross income includes gains derived from dealings in property. Section 102(a) provides that gross income does not include the value of property acquired by gift, bequest, or devise or inheritance. 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 section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

Section 1001(b) provides, in part, 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 (other than money) received.

Section 1001(c) provides that except as otherwise provided in Subtitle A, the entire amount of the gain or loss, determined under this section, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that 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.

While not specifically defined in the Code or regulations, for most purposes the term "income" is generally defined as an undeniable accession to wealth over which the taxpayer has complete control or dominion. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). Trust recognized no gain or loss from the exchange of property because the exchange was within the coverage of § 1031 as explained. Also, Trust

had no gain or income from the transfer of property to Trust 1 because it did not receive anything in return for this transfer. There was no accession to wealth. Similarly, neither Trust nor any of the beneficiaries of Trust or of Trust 1 will have income as a result of the transfer of property to Trust 1 because this transfer will be made pursuant to the specific requirements set forth in Decedent's will. Trust 1 and the beneficiaries will receive neither more nor less than what they were entitled to receive under the will.

Rev. Rul. 69-486, 1969-2 C.B. 159, holds that where the trustee was not authorized to make a non-pro rata distribution of property in kind but did so as a result of the mutual agreement between the beneficiaries, the non-pro rata distribution is equivalent to a distribution to the beneficiaries of all types of trust property by the trustee, followed by a taxable exchange between the beneficiaries of one type of trust property for another. By negative inference, when the trustee is authorized to make non-pro rata distribution, the non-pro rata distribution is not taxable to the beneficiaries.

In her will, Decedent stated that "it is my desire, and I so direct, that the trustee, . . . shall separate the accounts of each of the beneficiaries hereunder so as to constitute a separate trust as to each beneficiary and to accomplish this result may assign undivided interests in the trust property, both land and personal property, to each account. . . ." [Emphasis added.] Therefore, a distribution of a tract of land to Trust 1 for the benefit of some but not all the beneficiaries of Trust would not be a taxable event to Trust, Trust 1 or any of the beneficiaries.

Based upon the facts submitted and representations made, we conclude that the Partition will not cause Trust or Trust 1 or any beneficiary thereof to realize gain or loss under §§ 61 or 1001.

RULING 7:

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year, but such deduction shall not exceed the distributable net income (DNI) of the estate or trust.

Section 1.661(a)-2(f) of the Income Tax Regulations provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be

distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

Based solely on the facts submitted and the representations made, we conclude that the Partition will not be viewed as a distribution or termination under § 661, nor as a distribution for purposes of § 1.661(a)-2(f) and, therefore, will not result in the realization by Trust or Trust 1, or by any beneficiary of Trust or Trust 1 of any income, gain, or loss.

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.

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.

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.

Sincerely yours,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy for 6110 purposes