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Person To Contact:

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Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-147287-10

In Re:

Date:
April 19, 2011

Legend:

| | |
|-------------|---|
| Grantor | = |
| Daughter | = |
| Trust | = |
| State Law 1 | = |
| State Law 2 | = |
| Date | = |
| Court | = |
| State | = |

Dear :

This letter responds to a letter dated November 12, 2010, and other correspondence, requesting rulings regarding the income, estate, gift, and generation-skipping transfer (GST) tax consequences of a proposed division of an irrevocable trust.

The facts submitted and representations made are as follows. On Date, a date prior to September 25, 1985, Grantor created an irrevocable trust ("Trust") for the benefit of Daughter's issue. It is represented that no additions have been made to Trust since September 25, 1985. Daughter has three children, all adults, and one minor grandchild now living, and no deceased children.

Section 3.01 of Trust provides that the primary beneficiaries of Trust are Daughter's children. Section 3.02 provides (subject to section 3.02(1)) that the trustee is to distribute all of the net income of Trust to Daughter's children and the descendants of any deceased child of Daughter at least annually. Section 3.02(1) provides that the trustee may, in the trustee's discretion, withhold all or any part of the net income.

Withheld income may be: (1) accumulated and added to principal, (2) set aside for future distribution in any subsequent annual period, or (3) in whole or in part distributed to or for the benefit of the beneficiaries then entitled to the income of Trust under section 3.02, in such proportions or amounts as the trustee may from time to time determine.

Section 3.02(2) provides that in exercising this power to withhold and accumulate or distribute, the trustee is to consider the current needs and other income and resources of the beneficiaries including those for health, medical care, support, and education. The trustee is also to consider the beneficiary's accustomed standard of living without regard to the availability of income from Trust.

Section 3.03 provides that one year after Daughter's death, Trust will terminate and principal and any accumulated income are to be distributed in equal shares, *per stirpes*, to Daughter's children.

Section 3.04 provides that when Trust terminates, if a child predeceased Daughter without leaving surviving descendants, that child's share is to be reallocated to the child's siblings and their descendants, *per stirpes*. If Daughter is not survived by descendants, the principal and any accumulated income are to be allocated in equal shares to other trusts created by Grantor for the children of Daughter's siblings.

Section 3.05 provides that if at the time of any distributions, a beneficiary is under the age of 21, such beneficiary's share will be held by the trustee for the benefit of such beneficiary until the beneficiary attains age 21. Such beneficiary's share will be distributed to the beneficiary on the date the beneficiary attains age 21. The trustee shall apply for such beneficiary's use so much of the income of such beneficiary's share as the trustee deems necessary for the beneficiary's education, support, and maintenance, and may accumulate income to provide for such uses. If the beneficiary dies prior to attaining age 21, the separate share will be distributed to the beneficiary's intestate heirs.

Section 3.07 provides that the terms "child," "children," "grandchildren," "descendant," or "heirs" includes legally adopted children. Section 3.08 provides that the trustee has the discretion to distribute trust principal to provide for a child of Daughter's proper care, education, and support (taking into consideration his or her station in life and the other property and income available to such child) and in particular cases of severe or protracted illness or great necessity. The trustee may, as a condition of payment, require that such advances or any part thereof are to be restored from future income.

Section 2.02 provides, that if Trust is not terminated as provided under section 3.03, Trust shall terminate upon the date which is 21 years after the death of the last survivor of a class consisting of Grantor, Grantor's children, and Grantor's

grandchildren who are living on Date, in which event the beneficiaries shall all be presumed to have attained the necessary age to, and shall be entitled to, immediate distributions of principal.

In order to make unequal distributions to children while ensuring that the ultimate distribution of Trust's assets is equitable, and to allow the trustee to pursue different investment objectives with respect to each child's interest in Trust, the trustee proposes to divide Trust into three separate trusts (hereinafter "Subtrust" or "Subtrusts"), one for the benefit of each of Daughter's three children and his or her descendants. The trustee will fund each Subtrust with a pro rata share of each asset held in Trust.

It has been represented that the terms of each Subtrust will be the same as Trust, except that each Subtrust will be held exclusively for the benefit of the child (and his or her descendants) for whom the Subtrust was created. In addition, each Subtrust will have a provision to the effect that if Daughter gives birth to or adopts another child (After-Born Child) prior to the termination of the Subtrusts, all of the Subtrusts then held for a child of Daughter will be reallocated to create a new Subtrust for the After-Born Child. This new Subtrust will receive a fraction of the aggregate value of the Subtrusts then existing. The numerator of the fraction will be one and the denominator will be one plus the number of Subtrusts held for Daughter's children immediately before the birth or adoption. Each existing Subtrust will contribute to the new Subtrust for the After-Born Child in proportion that its value bears to the aggregate value of all of such Subtrusts.

If a child and all descendants of the child die before the termination of the Subtrusts, the deceased child's Subtrust will be reallocated so as to be added to or used to fund the Subtrusts held for that child's siblings or their descendants or, if there are no other descendants of Daughter then living, will remain in existence until the termination of the Subtrusts with the income being payable to any After-Born Child, or to the descendants of any deceased After-Born Child, or accumulated if there is no After-Born Child or descendant of a deceased After-Born Child.

State Law 1 provides that an irrevocable trust may be terminated or its dispositive provisions modified by the court with the consent of all of the beneficiaries if continuance of the trust on the same or different terms is not necessary to carry out a material purpose.

State Law 2 provides that on petition by a trustee or beneficiary, the court may divide a trust into two or more separate trusts, whether or not their terms are similar, if the court determines that dividing the trust is in the best interest of the beneficiaries and will not defeat or substantially impair the accomplishment of the trust purposes or the rights of the beneficiaries. To facilitate the division, the trustee may divide the trust assets in kind, by pro rata or non-pro rata division, or by any combination of the methods.

The following representations have been made: (i) the trustees will initiate a judicial proceeding in Court to divide Trust, as described above, (ii) Daughter's children will be given notice of the proceeding, and (iii) Daughter's children will act for any minor, unborn or contingent beneficiaries, including Daughter's minor grandchild, pursuant to State's virtual representation statute.

The trustee has requested the following rulings:

1. The division of Trust into Subtrusts will not cause Trust or any of the Subtrusts to lose their status as exempt from the GST tax or otherwise become subject to the GST tax;
2. The Subtrusts will be treated as separate trusts for federal income tax purposes;
3. The division of Trust into Subtrusts will not cause Trust or any of the Subtrusts or their beneficiaries to recognize any gain or loss from a sale or other disposition of property under § 61, 662, or 1001;
4. The tax basis of the assets the Subtrusts receive from Trust will be the same as the tax basis of Trust in such assets;
5. The holding period of the Subtrusts in each asset received from Trust will include the holding period of Trust in that asset;
6. The division of Trust into Subtrusts will not cause any portion of the assets of Trust or any Subtrust to be includible in the gross estate of any beneficiary of Trust or any Subtrust; and
7. Neither the division of Trust into Subtrusts nor the pro rata allocation of the assets of Trust among the Subtrusts will constitute a transfer by any beneficiary that will be subject to federal gift tax under § 2501.

Law and Analysis

Ruling 1:

Section 2601 of the Internal Revenue Code (Code) imposes a tax on each generation-skipping transfer which is defined under § 2611 as a taxable distribution, taxable termination, or a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (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 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. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the grantor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the grantor had died on September 25, 1985.

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. The regulation provides that the rules contained in the paragraph are generally applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. 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 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 by judicial reformation, or nonjudicial reformation that is valid under applicable state law, 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.

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 will not be considered to shift a beneficial interest in the trust.

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. The facts set forth in Example 5 are 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 resulting from the division will not be subject to the GST tax.

In this case, Trust is exempt from the GST tax because it was irrevocable before September 25, 1985, and it is represented that no additions have been made to Trust since Date, a date prior to September 25, 1985. The proposed division of Trust is similar to the facts set forth in Example 5 of § 26.2601-1(b)(4)(i)(E). Thus, based upon the facts submitted and the representations made and, assuming the proposed division is approved by Court, we rule that the proposed division of Trust into Subtrusts will not cause Trust or any of the Subtrusts to lose their status as exempt from the GST tax or otherwise become subject to the GST tax.

Ruling 2:

Section 643(f) provides that under regulations prescribed by the Secretary, two or more trusts shall be treated as one trust if: (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) the principal purpose of such trusts is the avoidance of the tax imposed by Chapter 1 of the Code.

Section 1806(b) of the Act provides that in the case of a trust which was irrevocable on March 1, 1984, § 643(f) shall apply only to that portion of the trust which is attributable to a contribution to corpus after March 1, 1984.

In this case, the Subtrusts created upon the division of Trust will be separately managed and administered by the trustee. While the Subtrusts have the same grantor, they will have different primary beneficiaries. Therefore, based on the facts submitted

and the representations made, we rule that the Subtrusts will be treated as separate trusts for federal income tax purposes under § 643(f).

Rulings 3, 4, and 5:

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

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 of the estate or trust.

Section 1.661(a)-2(f)(1) 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 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.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized 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. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for cash or for other property differing materially either in kind or in extent is treated as income or loss sustained.

Section 1015(b) provides that if property is acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis shall be 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 by the grantor on such transfer.

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 on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by a transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

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 of subtitle A the property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his or her hands as it would have in the hands of such other person. See also § 1.1223-1(b).

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature and the partition of a joint tenancy in stock are not sales or exchanges. Similarly, divisions of trusts are also not sales or exchanges of trust interests where each asset is divided pro rata among the new trusts. See Rev. Rul. 69-486, 1969-2 C.B. 159 (pro rata distribution of trust assets not a sale or exchange).

In this case, Trust's assets will be distributed in kind on a pro rata basis among the three Subtrusts. Accordingly, based upon the facts submitted and the representations made, we rule that the proposed division of Trust will not result in the realization of gain or loss by Trust or any of the Subtrusts, or their beneficiaries, under §§ 61 and 1001. Because § 1001 does not apply to the division of the Trust's assets, we rule that under § 1015 the basis of the Trust's assets will be the same after the division as the basis of those assets before the division.

Since the basis of each asset in the hands of the Subtrust is the same as the basis of that asset in the hands of Trust, we rule that the holding period of each asset in the hands of a Subtrust will be the same as the holding period of that asset in the hands of Trust immediately before the distribution to the Subtrust pursuant to § 1223(2).

Finally, since the proposed division will not result in the realization of gain or loss under §§ 61 and 1001 and because the creation of the Subtrusts is a modification of Trust, for federal income tax purposes, the Subtrusts are treated as a continuation of Trust. Therefore, we rule that the transfer of assets from Trust to the Subtrusts will not be treated as a distribution or termination under § 661.

Ruling 6:

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death: (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if: (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds five percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, revoke, or terminate, or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

In order for §§ 2036 through 2038 to apply, the decedent must have made a transfer of property or any interest therein (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. In the present case, the proposed division of Trust does not constitute a transfer within the meaning of §§ 2036 through 2038. The beneficiaries of the Subtrusts will have the same interest after the division as they had as beneficiaries before the division. Therefore, based upon the facts submitted and the representations made, we rule that the proposed division will not cause the interest of any beneficiary of Trust or the Subtrusts to be includible in the beneficiary's gross estate under §§ 2036 through 2038.

Ruling 7:

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual, resident or nonresident.

Section 2511(a) 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 the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

In this case, the beneficiaries of the Subtrusts will have the same beneficial interests in the Subtrusts after the proposed division that they had as beneficiaries under Trust. Accordingly, based upon the facts submitted and the representations made, we rule that the proposed division of Trust and the pro rata allocation of Trust's assets among the Subtrusts is not a transfer, direct or indirect, of property that will be subject to the gift tax imposed by § 2501.

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.

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

Sincerely,

Lorraine E. Gardner

Lorraine E. Gardner
Senior Counsel, Branch 4
(Passthroughs & Special Industries)

Enclosures

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Copy of this letter