

## Internal Revenue Service

Department of the Treasury  
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RE:

### Legend

Donor

Trust

Grandchild

Great-grandchild 1

Great-grandchild 2

Great-grandchild 3

Great-grandchild 4

Date 1

Date 2

State 1

State 2

State 1 Statute 1

State 1 Statute 2

State 1 Statute 3

State 2 Statute 1

State 2 Statute 2

State 2 Statute 3

Court

Dear :

This letter responds to your authorized representative's letter dated March 5, 2012, requesting income, estate, gift, and generation-skipping transfer (GST) tax rulings with respect to the proposed division of Trust.

The facts and representations submitted are summarized as follows:

Trust was created by Donor under an agreement effective Date 1, a date prior to September 25, 1985, for the benefit of individual beneficiaries and charitable beneficiaries. Trust is for the primary benefit of the Class 1 individual beneficiaries, which are defined by Trust as the class consisting of the living issue, the spouses of the living issue, and all spouses of the deceased issue of Donor's grandchild, Grandchild. To the extent that all the Class 1 individual beneficiaries are all deceased, Trust provides that the trustees may benefit other specified classes of individual beneficiaries. Trust is administered under the laws of State 2 and is governed by the laws of State 1.

Trust gives the trustees absolute discretion to distribute income or principal among the individual beneficiaries as well as charitable beneficiaries on an equal or unequal basis, to divide the trust, and to allocate assets on a pro rata or non-pro rata basis. Specifically, Paragraph 3.02 states in relevant part:

3.02. Nature of Benefits. The payment of any benefits hereunder, whether of income, principal or otherwise, shall be vested in the sole discretion of the trustees from time to time. No potential Individual Beneficiary or Charitable Beneficiary shall ever have any right, title, or interest in or claim to any part of any income, principal or distribution which could have been made hereunder unless and until actually received by such Individual Beneficiary or Charitable Beneficiary. Amounts of net income, capital gains or other proceeds or amounts of principal not paid out to a beneficiary shall be accumulated and added to principal.... Such payments among the members of a class of Individual Beneficiaries and Charitable Beneficiaries need not be equal either at the time of payment or at any future time and may be made to none, to one, to all or to any number of members of the class in any proportions both as between beneficiaries of the same class and as between Individual Beneficiaries and Charitable Beneficiaries, all as determined by the trustees, in their sole discretion.

Section 3.03(4) provides that upon termination of Trust, whether by the trustees' election to distribute all remaining assets or due to applicable state law limiting the duration of trusts, the trustees shall distribute the remaining assets "to any or all members of the class of individual beneficiaries and Charitable Beneficiaries then eligible under the other provisions of this Article 3, as determined by the trustees, in their sole discretion."

Article 5 authorizes the trustees to divide the trust and to allocate assets among divided trusts on a pro rata or non-pro rata basis. Specifically, Section 5.04(9) authorizes the trustees “[t]o divide the trust, determining values and designating particular assets for my beneficiaries, to assign like or unlike properties to different beneficiaries or trusts, to create or hold undivided interests in any property of the trust, and to make distributions and payments in cash or in kind or both.”

Great-grandchild 1, Great-grandchild 2, Great-grandchild 3, and Great-grandchild 4 are currently the only children of Grandchild. Great-grandchild 1 is married and has two minor children. Great-grandchild 2, Great-grandchild 3, and Great-grandchild 4 are not married and have no issue. At the request of Great-grandchild 1, Great-grandchild 2, Great-grandchild 3, and Great-grandchild 4, one of the trustees petitioned Court to divide Trust. Subject to adjustment for prior distributions to individual beneficiaries, the trustees propose to divide Trust on a pro rata basis, to the extent possible, into four approximately equal separate trusts, to be known as the “Divided Trusts,” one for each respective great-grandchild’s family line. Each Divided Trust will be for the primary benefit of the class consisting of: the child of Grandchild, the spouse of that child, the living issue of that child, the spouses of the living issue of that child, and all spouses of the deceased issue of that child, and charitable beneficiaries. The dispositive provisions of each Divided Trust are the same except that the beneficiaries of each trust include each respective great-grandchild’s family line. If all members of the class are deceased, then the Divided Trust will terminate and the remaining assets and liabilities of the Divided Trust will be distributed to the then living issue of Grandchild, *per stirpes*. The trustees of Trust will continue to be the trustees of the Divided Trusts. On Date 2, Court issued an order that authorized the trustees to divide Trust upon the receipt of a favorable private letter ruling from the Internal Revenue Service.

You have requested the following rulings:

1. After the proposed division, the Divided Trusts will continue to be exempt from the GST tax.
2. The proposed division will not cause any beneficiary to have made a taxable gift.
3. The proposed division will not cause any portion of the assets of the Divided Trusts to be includible in the gross estate of any beneficiary.
4. The allocation of assets and liabilities of Trust in approximately equal shares, whether done on a pro rata or a non-pro rata basis, will not cause Trust, the Divided Trusts, or any beneficiary to recognize any ordinary income or loss or capital gain or loss.

5. The adjusted basis of the assets received by the Divided Trusts will be the same as the respective adjusted basis of the assets held by Trust pursuant to § 1015.
6. The holding periods of the assets received by the Divided Trusts will be the same as the holding periods of the assets in Trust pursuant to § 1223(2).

## LAW AND ANALYSIS

### Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer. The term "generation-skipping transfer" is defined in § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, 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), the GST tax does not apply to a transfer under a trust 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)(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 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 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)), 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. 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 GST transfer or the creation of a new GST transfer.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's 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 in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

State 1 Statute 1 authorizes a trustee to divide any trust, whenever created, into two or more separate trusts if the trustee determines that dividing the trust is in the best interests of all persons interested in the trust and will not substantially impair the accomplishment of the purposes of the trust.

State 1 Statute 2 authorizes a trustee to petition the court for an order “to construe, interpret, or reform the terms of a trust, or authorize a deviation from the terms of a trust[.]”

State 2 Statute 1 provides that “[a]n irrevocable trust may be modified or terminated upon the consent of all of the beneficiaries if continuance of the trust on its existing terms is not necessary to carry out a material purpose.”

State 2 Statute 2 provides that if any beneficiary does not consent to a requested modification or termination of a trust by the other beneficiaries, the court, with the consent of the other beneficiaries, may approve a requested modification or partial termination if the rights or interests of the beneficiaries who do not consent are not significantly impaired or adversely affected.

State 2 Statute 3 provides that “[w]ithout approval of court and except as otherwise provided by the terms of the trust, a trustee may combine two or more trusts into a single trust or divide a trust into two or more separate trusts, if the combination or division does not impair the rights of any of the beneficiaries or substantially affect the accomplishment of the trust purposes.”

In this case, Trust will be divided into four Divided Trusts. The proposed division will not result in a shift of any beneficial interest in the trusts to any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed division will not extend the time for vesting of any beneficial interest in the Divided Trusts beyond the period provided for in Trust. Accordingly, based on the facts submitted and the representations made, we conclude that after the proposed division, the Divided Trusts will continue to be exempt from the GST tax.

### Ruling 2

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511(a) provides that the gift tax 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 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 Divided Trusts will have the same interests after the division that they had as beneficiaries under Trust. 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 have made a taxable gift.

### Ruling 3

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of death.

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 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 5 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 an 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 Divided Trusts will have the same interests after the division that they had as beneficiaries under Trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division will not cause any portion of the assets of the Divided Trusts to be includible in the gross estate of any beneficiary.

#### Ruling 4

Section 61(a)(3) provides that gross income includes gains derived from dealings in property and, under § 61(a)(15), from an interest in a trust.

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 § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) states 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. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, 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 loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, provides that a partition of jointly owned property pursuant to state law is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests, but do not acquire a new or additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition.

State 1 Statute 3 authorizes trustees to distribute property and money in divided or undivided interests and adjust resulting differences in valuation.

In this case, the trustees have authority under Trust, state law, and Court order to divide Trust and to allocate assets on a pro rata or non-pro rata basis. The beneficiaries do not acquire their interest in the Divided Trusts as a result of the exchange of their interests in Trust, but by reason of the trustees' exercise of their existing authority to allocate assets on a pro rata or non-pro rata basis in further trust. The proposed transaction is analogous to the partition of a joint interest under Rev. Rul. 56-437.

Accordingly, based on the facts submitted and the representations made, we conclude that the division of Trust and allocation of assets and liabilities of Trust to each Divided Trust in approximately equal shares will not cause Trust, the Divided Trusts, or any beneficiary to recognize any ordinary income or loss or capital gain or loss

#### Rulings 5 and 6

Section 1015(b) 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 a transfer in trust (other than 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 by 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 was made.

Section 1.1015-2(a)(2) applies the uniform basis principles in § 1.1015-1(b) for determining the basis of property where more than one person acquires an interest in property by transfer in trust.

Under § 1.1015-1(b), property acquired by gift has a single or uniform basis although more than one person may acquire an interest in the property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017.

Section 1223(2) provides that in determining the period for which the 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 the Code 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 such other person.

In this case, § 1001 does not apply to the proposed transaction. Thus, after the division of Trust and transfer of the assets into the Divided Trusts, the adjusted basis of the assets received by the Divided Trusts will be the same as the respective adjusted basis of the assets held by Trust pursuant to § 1015. Furthermore, we conclude that, under § 1223(2), the holding periods of the assets received by the Divided Trusts will be the same as the holding periods of the assets in Trust.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion 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,

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

Enclosures

Copy for § 6110 purposes  
Copy of this letter