Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201436043**
Release Date: 9/5/2014

Index Number: 61.00-00, 643.00-00, 661.00-00, 662.00-00, 1001.00-00, 1015.00-00, 1223.00-00, 2036.00-00, 2037.00-00, 2038.00-00, 2501.00-00, 2601.00-00

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-149735-13

Date:
June 02, 2014

In Re:

Legend

Grantor	=
Trustee	=
Daughter	=
Child 1	=
Child 2	=
Child 3	=
Child 4	=
Trust 1	=
Trust 2	=
Date 1	=
Date 2	=
Date 3	=
State	=
Court	=
State Statute	=
X	=

Dear :

This responds to a letter dated November 20, 2013 from your authorized representative, requesting rulings on the income, gift, estate, and generation-skipping transfer (GST) tax consequences of the proposed division of two trusts.

Facts

The facts and representations submitted are summarized as follows: Grantor established two irrevocable trusts (Trust 1 and Trust 2) for the benefit of Daughter's children, Child 1, Child 2, Child 3, and Child 4 (Children) and their descendants. All of the Children are over 21 years of age. Trust 1 was established on Date 1, and Trust 2 was established on Date 2. Both Date 1 and Date 2 are dates prior to September 25, 1985. No additions have been made to Trust 1 or Trust 2 since September 25, 1985. Trustee is the sole trustee of Trust 1 and Trust 2. Grantor died on Date 3.

Section 3.02 of Trust 1 provides that the Trustee shall distribute the income to Daughter's Children and to the descendants of any deceased child annually.

Section 3.02 of Trust 2 provides that the Trustee shall distribute income to Daughter's Children annually. Section 3.02 of Trust 2 also provides that the Trustee may also pay to Daughter's Children such amounts of principal as such Children shall from time to time request in writing, not to exceed the lesser of that child's pro rata share of gifts made to Trust 2 during that calendar year and the sum of $X.

Section 3.02(1) in both Trust 1 and Trust 2 also provide the Trustee with discretion to withhold income by adding it to principal, setting it aside for future distribution, or distributing some or all of it in such proportions or amounts as the Trustee may determine.

Section 3.08 of Trust 1 provides that if the share of income to which any child of Daughter is entitled, in the sole opinion and discretion of the Trustee, is insufficient for his proper care, education and support, and in particular cases of severe or protracted illness or great necessity the Trustee may make up the deficiency by payments from or use of principal. The Trustee, may as a condition of such payments, require that such advances or any part thereof be restored, in such manner as the Trustee may determine, from future income.

Section 3.08 of Trust 2 provides that if the share of income to any beneficiary then entitled to income, in the sole opinion and discretion of the Trustee, is insufficient for his proper care, education and support, and in particular cases of severe or protracted illness, the Trustee may make up the deficiency by payments from or use of principal. The Trustee, may as a condition of such payments, require that such

advances or any part thereof be restored, in such manner as the Trustee may determine, from future income.

Section 3.10 of each trust agreement provides that each separate share of principal that is directed to be set aside for a child of Daughter, or the income of which is directed to be paid to such beneficiary, is to constitute a separate trust. However, Section 3.10 also authorizes the Trustee to maintain each separate trust as a single fund. Additionally, paragraph 5 of Exhibit A of Trust 1 and Trust 2, which is incorporated into each of the two trust agreements by reference, expressly recognizes and anticipates that the trustee may be "required or permitted" to divide, distribute, or partition property held in the trusts into separate shares or trusts. To date, no separate trusts have been created.

Trust 1 and Trust 2 both terminate one year after Daughter's death. The trust agreements generally provide for equal distribution to each of Daughter's Children and their descendants, *per stirpes*, and if there are no descendants of Daughter living upon termination, then equally among the separate trusts for descendants of Children of Daughter, *per stirpes*.

Section 2.02 of each Trust provides that the trust will terminate when the trust fund has been distributed in accordance with the terms of the trust, provided if the trust has not been previously terminated, the trust will terminate upon the date which is 21 years after the death of the last survivor of Grantor, Grantor's children, and Grantor's grandchildren who are living at the date of the creation of Trust.

Currently, each child receives an equal share of the income of Trust 1 and Trust 2. During the term of the current Trustee, the Children have received unequal principal distributions from Trust 1; however, the Children have received no principal distributions from Trust 2.

Pursuant to the terms of each trust, if the Children request distributions from Trust 1 and Trust 2 and the requested funds are distributed in unequal amounts to Children as is now permitted, then, when the balance of the trust property is ultimately distributed after Daughter's death, those Children who received larger distributions from Trust 1 and Trust 2 prior to termination (or their descendants if they are deceased) will receive – in the aggregate – disproportionately greater shares of the trust assets over the life of the trusts than the other children.

Presently, Children have the same investment objectives; but in the future, the Children may have differing investment objectives. In order to meet the current needs of the beneficiaries (which may result in Trustee making unequal distributions to Children) while simultaneously ensuring that the ultimate distribution of trust property is equitable, and to allow Trustee to pursue different investment objectives with respect to each child's interest in the trusts, Trustee proposes to divide both Trust 1 and Trust 2

into separate trusts. Trust 1 will be divided into four separate trusts, one for the benefit of each child and his or her descendants. Likewise, Trust 2 will be divided into four separate trusts, one for the benefit of each child. Thus, there will be eight separate trusts (Successor Trusts) in the place of the two original trusts, and each child will be the beneficiary of two Successor Trusts, one derived from Trust 1 and the other derived from Trust 2. Each Successor Trust will continue to be governed by the same terms and provisions of the trust from which it was divided, except that each Successor Trust will be held exclusively for the benefit of the Child (and his or her descendants) for whose benefit the Successor Trust was initially created. Trustee will continue to serve as the trustee of the Successor Trusts.

Taxpayer represents that State law would govern the division of Trust 1 and Trust 2. In order to accomplish the division of Trust 1 and Trust 2 into Successor Trusts, Trustee will initiate a judicial proceeding in Court requesting an order approving the division of Trust 1 and Trust 2 into Successor Trusts for the benefit of Children. Therefore, the order will be binding upon all current and future beneficiaries of those trusts. Trustee will fund each Successor Trust created upon the division of Trust 1 and Trust 2 with a pro rata share of each asset contained in those trusts.

State Statute provides that upon petition by a trustee, beneficiary or any other interested person, the court may, for good cause shown, divide a trust into two or more separate trusts if the court finds that it is not inconsistent with the intent of the settlor, would facilitate the administration of the trust, and would be in the best interests of the beneficiaries and not materially impair their respective interests.

You have requested the following rulings:

1. The division of Trust 1 and Trust 2 into Successor Trusts will not cause Trust 1, Trust 2 or any of the Successor Trusts to lose their status as grandfathered trusts or otherwise become subject to GST tax.

2. The Successor Trusts resulting from the division of Trust 1 and Trust 2 will be treated as separate trusts for federal income tax purposes.

3. The division of Trust 1 and Trust 2 into Successor Trusts will not cause Trust 1, Trust 2, or any of the Successor Trusts 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 of the Successor Trusts received from Trust 1 and Trust 2 will be the same as the tax basis of Trust 1 and Trust 2 respectively, in the assets, and the holding period of the Successor Trusts in each asset received from Trust 1 and Trust 2 will include the holding period of Trust 1 and Trust 2 in that asset.

5. The division of Trust 1 and Trust 2 into Successor Trusts will not cause any portion of the assets of Trust 1 and Trust 2 or any of the Successor Trusts to be includible in the gross estate of any beneficiary of Trust 1 or Trust 2 or any of the Successor Trusts.

6. Neither the division of Trust 1 or Trust 2 into Successor Trusts nor the pro rata allocation of the assets of Trust 1 and Trust 2 among the Successor Trusts will constitute a transfer by any beneficiary that will be subject to federal gift tax under § 2501.

Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer made after October 22, 1986.

Section 2611(a) provides that the term "generation-skipping transfer" means a tax distribution, a taxable termination, and a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the 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 under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after 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 generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) 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, but only 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 a 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.

Section 26.2601-1(b)(4)(i)(E), *Example 5*, considers a situation in which, 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 provisions of chapter 13.

In this case, based upon the facts submitted and the representations made, we conclude that Trust 1 and Trust 2 are exempt from GST tax because Trust 1 and Trust 2 were irrevocable prior to September 25, 1985, and no additions have been made to Trust 1 or Trust 2 since that date.

The proposed division of Trust 1 and Trust 2 into Successor Trusts will result in eight trusts, two each for the benefit of Daughter's Children and their descendants. The dispositive terms of each Successor Trust of Trust 1 will be substantially the same as the dispositive terms of Trust 1, although limited to each Child and their descendants. Similarly, the dispositive terms of each Successor Trust of Trust 2 will be substantially the same as the dispositive terms of Trust 2, although limited to each Child and their descendants. Each resulting trust will terminate no later than the original termination date of Trust 1 and Trust 2. Accordingly, the proposed division of Trust 1 and Trust 2 into the Successor Trusts will not shift a beneficial interest to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modifications and division, and will not extend the time for the vesting of any

beneficial interest in a Successor Trust beyond the period provided for in Trust 1 or Trust 2.

Accordingly, based on the facts submitted and the representations made, and provided that Court issues an order approving the division of Trust 1 and Trust 2, the division of Trust 1 and Trust 2 into Successor Trusts will not cause Trust 1, Trust 2, or any of the Successor Trusts to lose their status as grandfathered trusts or otherwise become subject to GST tax.

Ruling 2

Section 643(f) provides that, for purposes of Subchapter J of Chapter 1 of Subtitle A, 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) a principal purpose of such trusts is the avoidance of the tax imposed by Chapter 1.

Section 1806(b) of the Tax Reform Act of 1986 provides that § 643(f) shall apply to taxable years beginning after March 1, 1984; except that, in the case of a trust that was irrevocable on March 1, 1984, it shall apply only to that portion of the trust that is attributable to contributions of corpus after March 1, 1984.

Trustees represent that each Successor Trust will have different beneficiaries. The trustees also represent that no portion of the principal of Trust 1 and Trust 2 was contributed after March 1, 1984. Based on the facts submitted and the representations made, we conclude that as long as the Successor Trusts are separately managed and administered, they will be treated as separate trusts for federal income tax purposes.

Ruling 3

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. However, 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 § 66), 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. If the sum of (A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and (B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries exceeds the DNI of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to DNI (reduced by the amounts specified in (A)) as the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized on the disposition 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(b) defines the amount realized from the sale or disposition of property as the sum of any money received plus the fair market value of any property received.

Section 1001(c) provides that, except as otherwise provided in subtitle A, the entire amount of gain or loss determined under § 1001 on the sale or exchange of property must be 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 either in kind or in extent, is treated as income or loss sustained.

An exchange of property results in the realization of gain under § 1001 if the properties exchanged are materially different. *Cottage Savings Ass'n v. Comm'r*, 499 U.S. 554 (1991). There is a material difference when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." 499 U.S. at 565.

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 property sever their joint interests in order to extinguish their survivorship interests.

Trustee will divide Trust 1 and Trust 2 by allocating a pro rata portion of each and every asset of Trust 1 to four Successor Trusts and each and every asset of Trust 2 to four Successor Trusts. Since the trust beneficiaries will hold essentially the same interests before and after the division of Trust 1 and Trust 2 into the Successor Trusts, there will be no exchange of property interests that can be characterized as materially different under § 1001, nor any amount includible in gross income under § 61.

Moreover, § 1.1001-1(h) expressly provides that the pro rata division (or severance) of any trust pursuant to authority in an applicable state statute is not an exchange of property differing materially either in kind or extent. In this case the applicable statute of State permits the severance of Trust 1 and Trust 2. In addition, section 3.10 of Trust 1 and Trust 2 anticipates the possible division of both trusts. Also, Paragraph 5 of Exhibit A of each trust (which is incorporated by reference within each trust) permits the trustee to make any division, distribution or partition of property, in cash or otherwise, to any trust or share.

Therefore, based on the facts submitted and the representations made, and provided Court issues an order approving the division of Trust 1 and Trust 2, we conclude that the division of Trust 1 and Trust 2 into Successor Trusts for the benefit of Daughter's Children, will not cause Trust 1, Trust 2, or any of the Successor Trusts or their beneficiaries to recognize any gain or loss from the sale or other disposition of property under § 61 or 1001. We also conclude that the proposed division is not a distribution under § 661 or 1.661(a)-2(f). Accordingly, the proposed division will not cause Trust 1, Trust 2, or any of the Successor Trusts or their beneficiaries to recognize any income, gain, or loss under § 1.661(a)-2(f) or 662.

Ruling 4

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, provided that Court issues an order approving the division of Trust 1 and Trust 2, § 1001 will not apply to the proposed transaction. Thus, after the division of Trust 1 and Trust 2 and the transfer of the assets into the Successor Trusts, the adjusted basis of the assets received by the Successor Trusts will be the same as the respective adjusted basis of the assets held by Trust 1 and Trust 2 pursuant to § 1015. Furthermore, we conclude that, under § 1223(2), the holding periods of the assets received by the Successor Trusts will be the same as the holding periods of the assets in Trust 1 and Trust 2, respectively.

Ruling 5

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 his 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 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 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 after September 7, 1916, 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 (in whatever capacity exercisable) by the decedent alone or in conjunction with any other person (without regard to when or from what source the decedent acquired such power) to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In order for §§ 2035 through 2038 to apply, a 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.

Based on the facts submitted and the representations made, and provided that Court issues an order approving the division of Trust 1 and Trust 2, we conclude that the proposed division of Trust 1 and Trust 2 into Successor Trusts does not constitute a transfer by any beneficiary within the meaning of §§ 2036 through 2038. The beneficiaries of the Successor Trusts have the same interests after the division as they had prior to the division. Therefore, nothing will be transferred by them by reason of the proposed division. Accordingly, we conclude that the division of Trust 1 and Trust 2 into Successor Trusts will not cause any portion of the assets of Trust 1, Trust 2, or the Successor Trusts to be includible in the gross estate of any beneficiary under §§ 2035, 2036, 2037, or 2038.

Ruling 6

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

Section 2511 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.

In this case, provided the proposed division of Trust 1 and Trust 2 is pursuant to Court order, the proposed division of Trust 1 and Trust 2 into the Successor Trusts does not increase, decrease, or otherwise change any beneficiary's beneficial interest in Trust. Accordingly, based upon the facts submitted and the representations made, we conclude that neither the proposed division of Trust 1 and Trust 2 into Successor

Trusts, nor the pro rata allocation of assets will cause any beneficiary to have made a taxable gift under § 2501.

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,

_____

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

cc: