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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B9-PLR-148838-02

Date:
December 13, 2002

Re:

Legend

Date 1	=
Grantor	=
Original Trust	=
A	=
B	=
State	=
State Statute	=

Dear :

In a letter dated August 12, 2002, you requested rulings concerning the income and generation-skipping transfer ("GST") tax consequences of the proposed division of an irrevocable trust into two separate and equal successor trusts. This letter responds to your request.

The information submitted and the representations made are summarized as follows: On Date 1, Grantor created the Original Trust, an irrevocable trust, for the benefit of Grantor's children, A and B. Under the provisions of the Original Trust, the trust will terminate at the death of the survivor of A and B.

Paragraph I of the Original Trust provides that during the trust term, the trustee shall pay the net income of the trust to the children of Grantor, or the surviving issue, equally, per stirpes, and upon the expiration of the trust term, pay the principal of the trust, equally, per stirpes, to the children of Grantor, or their surviving issue, or if none of the foregoing survive, to the next of kin of Grantor as determined under the laws of State, equally, per stirpes.

Paragraph II provides that any beneficiary, who is a child of Grantor or an issue thereof, leaving a surviving spouse may appoint in his or her will that upon his or her death the trustees shall pay to the spouse so much or the whole of the share of income to which the deceased beneficiary was entitled to at his or her death for so much of the spouse's life that does not exceed the term of the trust, and provided the spouse survives the term of the trust, then upon the expiration of the trust term shall pay to the spouse so much or the whole of the share principal that the deceased beneficiary would have been entitled to if he or she survived until distribution. No appointment shall be valid for more than one-half of the share of income or principal if the deceased beneficiary is survived by issue as well as by a spouse. In default of the appointment, and so far as the appointment does not extend, or if there is no surviving spouse or upon the subsequent death of the surviving spouse within the term of the trust, the trustees shall pay over the income or principal as though the spouse predeceased the beneficiary.

Under Paragraph XV, the governing law is that of State. Section 7-1.13(a)(2) of the State Statute provides that the trustee of an express trust may divide a trust into two or more separate trusts, with the consent of all persons interested in the trust but without prior court approval, for any reason which is not directly contrary to the primary purpose of the trust.

All interested persons have consented to a proposed division of the Original Trust into two, separate successor trusts: one for the benefit of A and her issue and another for the benefit of B and her issue. The provisions of each of the successor trusts would be identical to those of the Original Trust and to each other except that each would only have one of Grantor's children and her issue as beneficiaries. In their ruling request, the trustees assert that the purpose of the successor trusts is to provide administrative convenience and to enable each successor trust to pursue different investment goals. The trustees have represented that each successor trust will be funded with a pro rata portion of each asset in the Original Trust.

The trustees requested the following rulings:

1. The proposed division of the Original Trust into two separate and equal trusts will not cause the resulting two separate trusts to lose their exempt status for GST tax purposes and will not subject the Original Trust, the two successor trusts, or distributions from any of these trusts to the GST tax under § 2601 of the Internal Revenue Code.

2. The proposed division and the distribution of the Original Trust assets to the two successor trusts will not cause any beneficiary, the Original Trust, or the two successor trusts to recognize any gain or loss from a sale or other disposition of the property under § 61 and §1001.

3. The proposed division and distribution will not result in a transfer subject to gift tax under § 2501.

4. The basis of each successor trust in each asset received from the Original Trust will be the same as the Original Trust's basis in that asset pursuant to § 1015.

5. The holding period of each successor trust for each asset received from the Original Trust will include the Original Trust's holding period for that asset according to § 1223(2).

Ruling Request 1

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) provides that, for purposes of the GST tax, the term "generation skipping-transfer" means (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides in part that the GST tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in §§ 26.2601-1(b)(1)(ii)(B) or (C), any trust (as defined in § 2652(b)) in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy §§ 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.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of § 26.2601-1(b)(4)(i)(D)(2), 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. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from the GST tax is divided into two trusts. Under the facts presented, 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, and 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. Accordingly, the two partitioned trusts will not be subject to the provisions of chapter 13.

In this case, the proposed division of the Original Trust into two separate and equal trusts will not result in a shift of any beneficial interest in the Original Trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the persons who held the beneficial interest prior to the division. Further, the proposed division will not extend the time for vesting of any beneficial interest in the two successor trusts beyond the period provided for in the Original Trust.

Accordingly, based on the information submitted and representations made, we conclude that the proposed division of the Original Trust into two separate and equal trusts will not cause the Original Trust and the two separate successor trusts to lose their exempt status for generation-skipping transfer tax purposes. Furthermore, as long as there are no additions to the Original Trust or the successor trusts, any distributions from these trusts will not be subject to the GST tax.

Ruling Request 2

Section 61 provides that gross income means all income from whatever source derived.

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

Section 1001(a) provides that the gain from the sale or other disposition of property 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 such section for determining loss over the amount realized.

Section 1001(b) provides 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. Section 1001(c) provides that, except as otherwise provided in subtitle A, the entire amount of the 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 as loss sustained.

Rev. Rul. 69-486, 1969-2 C.B. 159, involved two beneficiaries of a trust who by mutual agreement, requested that the trustee distribute all of the trust corpus consisting of notes to one of the beneficiaries and all of the trust corpus consisting of common stock to the other beneficiary. The trust instrument as well as local law was silent regarding whether the trustee had the authority to make such a non-pro rata distribution of property in kind. Because the trustee was not specifically authorized to make an allocation of specific property in kind, the beneficiaries were treated as having an absolute right to a ratable in-kind distribution. Rev. Rul. 69-486 treated the beneficiaries as receiving the notes and common stock pro rata, followed by an exchange between the beneficiaries giving all of the common stock to one and all of the notes to the other. Since, in substance, an exchange between the beneficiaries was deemed to occur, Rev. Rul. 69-486 held that the beneficiaries recognized gain under §§ 1001 and 1002.

The present case is distinguishable from Rev. Rul. 69-486 because the assets of the Original Trust will be distributed pro rata in kind and in extent to the successor trusts. In addition, although the original trust instrument does not address whether the trustee is permitted to make a pro rata distribution of property in kind, a pro rata in extent distribution of property is expressly permissible under applicable state law.

Rather than assessing tax liability on the basis of annual fluctuations in the value of a taxpayer's property, tax consequences of a gain or loss in property value are deferred until the taxpayer realizes the gain or loss. Eisner v. Macomber, 252 U.S. 189 (1920) (holding a pro rata stock dividend merely reflected the increased worth of the taxpayer's stock and the taxpayer realizes increased worth of property only by receiving something of exchangeable value proceeding from the property).

In Cottage Savings Assoc. v. Commissioner, 499 U.S. 554 (1991), the Supreme Court addressed whether a sale or exchange has taken place that results in a realization of gain or loss under § 1001. The Court stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are materially different. Consequently, the Court held that an exchange of mortgages constituted a realization event under § 1001(a) because the exchanged interests - loans that were made to different obligors and secured by different homes - were legally distinct entitlements.

In this case, the provisions of each of the successor trusts would be identical to those of the Original Trust and to each other except that each would only have one child and her issue as beneficiaries. The beneficiaries of each successor trust would have the same property interests and legal entitlements as they had under the Original Trust. Accordingly, it is consistent with Cottage Savings to find that the beneficiaries' interests after the proposed distribution of the original trust corpus into two successor trusts will not differ materially from the beneficiaries' interests under the Original Trust. Thus, the division of the Original Trust into two successor trusts will not be a sale, exchange, or other disposition of property of the Original Trust and will not give rise to a realization of income to any beneficiary, the Original Trust or the successor trusts under §§ 61 or 1001.

Ruling Request 3

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

Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

In this case, upon the division of the Original Trust into the two separate successor trusts, each beneficiary of the successor trusts will have the same beneficial interest as he or she had under the Original Trust. Because the beneficial interests of the beneficiaries are substantially the same both before and after the proposed transaction, no transfer of property will be deemed to occur as a result of the division. Accordingly, we conclude that the proposed division of the Original Trust and the distribution of the assets of the Original Trust among the two successor trusts will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries.

Ruling Request 4 and 5

Section 1015(b) provides that, if the property was acquired 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 to the grantor on the transfer.

Section 1.1015-2(a) provides that, in the case of property acquired by transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. In addition, the principles in § 1.1015-1(b) concerning the uniform basis are applicable in determining the basis of property where more than one person acquires an interest in property by transfer in trust. Section 1.1015-1(b) provides that 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.

Because § 1001 will not apply to the proposed division of the Original Trust, the basis of the assets in the two successor trusts will be the same as the basis of the assets currently held in the Original Trust.

Section 1223(2) provides, in part, 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 subtitle A 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 taxpayers hands as it would have in the hands of such other person.

Accordingly, based on facts submitted and the representations made, we conclude that, after the division of the Original Trust into two separate trusts, the basis and holding periods of the assets held in the two separate trusts will be the same as the basis and holding periods of the assets held in the Original Trust.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal 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.

Pursuant to the Power of Attorney and Declaration of Representative on file with this office, a copy of this letter is being sent to taxpayer’s representative.

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

Sincerely,

James F. Hogan

James F. Hogan
Senior Technician Reviewer, Branch 9
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for 6110 purposes