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Date: OCTOBER 29, 2004

Re:

LEGEND

Grantor	=
Spouse	=
Child A	=
Child B	=
Child C	=
Grandchild A	=
Grandchild B	=
Trust	=
Grandchild A Trust	=
Grandchild B Trust	=
Child C Trust	=
Article Seventh	=
Year	=
a	=
b	=
c	=
State	=
Local Court	=
State Statute	=

Dear :

This is in response to your correspondence dated March 25, 2004, requesting rulings on the generation-skipping transfer (GST) tax, income tax, gift tax and estate tax consequences of a proposed judicial modification of the Trust.

The facts submitted and representations made are as follows. Grantor died in Year, prior to September 25, 1985. He was survived by his spouse, Spouse, and their three children, Child A, Child B, and Child C (the youngest child).

The Trust was created in Article Seventh of Grantor's will, and will continue until both Spouse and Child C have died. Under Article Seventh, paragraph I of the will, the net income of the Trust is to be paid quarterly. One-half is to be paid to Grantor's and Spouse's then living issue per stirpes and one-half is to be paid to Spouse. After Spouse's death, the one-half portion of income otherwise payable to Spouse is to be paid to the issue, per stirpes. On termination of the Trust, the remaining property is to be distributed in equal shares to Grantor's and Spouse's then living issue, per stirpes.

Spouse has died. Child C is living, and the Trust will terminate on her death. Child C has b children and c grandchildren. Child A has died. He is survived by Grandchild A and Grandchild A's a children. Child B has died. She is survived by Grandchild B, Grandchild B's b children and b grandchildren. Grandchild A and Grandchild B are the current trustees.

Proposed transaction

It is represented that the current beneficiaries have differing personal and financial situations, and, as a result, have differing needs and desires concerning the Trust. The trustees propose to divide the Trust into three separate trusts of equal value. One of each such trusts will be held for the benefit of a Grantor's child and that child's issue per stirpes. For a child who has died, the trust will be held for that child's issue per stirpes. That is, the Grandchild A Trust will held be for the benefit of Grandchild A and his descendants, the Grandchild B Trust will be held for the benefit of Grandchild B and his descendants, and the Child C Trust will be held for the benefit of Child C and her descendants. The division will be accomplished by a pro rata division of each asset of the Trust. Grandchild A Trust, Grandchild B Trust, and Child C Trust are referred to in this letter as the "resulting trusts."

The dispositive terms of each resulting trust will be identical to the dispositive terms of the Trust and to each other, except that the distributees of income will be limited to the child or child's issue for whom the trust is set aside. Specifically, each resulting trust will provide for the quarterly distribution of income to the child or grandchild for whom the trust is named and, if he or she is deceased, to his or her issue per stirpes. The resulting trusts will not allow for the payment of principal. Upon the death of the last survivor of the family line for whom the trust is named, the trust will terminate (if not already terminated) and be divided equally among the remaining trusts in existence. Each trust must terminate no later than upon Child C's death. At that time, the principal of each trust will be distributed to the persons then receiving the income from the trust, per stirpes, or, if any such person is not then living, to his or her

issue then living per stirpes. If neither the beneficiary for whom the trust is named nor any of his or her issue is then living, one-half of the trust property will be distributed as part of each of the other trusts.

Grandchild A will be the trustee of the Grandchild A Trust. Grandchild B will be the trustee of the Grandchild B Trust and may appoint a corporate co-trustee. Child C or one of her children will be the trustee of the Child C Trust, and she may appoint a corporate co-trustee. Each individual trustee will appoint his or her successor trustee.

The partitioning of the Trust and the appointment of the trustees of the resulting trusts will be effected under State law by the trustees' petitioning the Local Court.

State Statute

Under State Statute, the court having jurisdiction of an express trust, upon the petition of the trustee or of any person interested in the trust and upon notice to all such persons, may direct the establishment of two or more separate trusts for any reason not directly contrary to the primary purpose of the trust.

Rulings requested

You have asked that we rule that the proposed division of the Trust and the pro rata allocation of each Trust asset among the three resulting trusts:

(1) will not cause the Trust or the three resulting trusts to lose their status as grandfathered trusts exempt from the GST tax and will not cause a distribution from, or termination of any interest in, the Trust, or any of the three resulting trusts to be subject to the GST tax;

(2) will result in the resulting trusts being treated as separate trusts under § 643(f);

(3) will not result in the realization by the Trust, the resulting trusts, or a beneficiary of the Trust or the resulting trusts of any income, gain or loss under § 661;

(4) will not result in the realization of any income, gain, or loss under § 61 or § 1001 by the Trust, the resulting trusts, or a beneficiary of the Trust or the resulting trusts;

(5) will result in the resulting trusts holding assets with the same basis they had at the time of the division under § 1015, and holding periods for all the assets allocated to each resulting trust that include the Trust's holding period under § 1223.

(6) will not cause any portion of the assets of the Trust or any of the resulting trusts to be includible in the gross estate of any beneficiary of the Trust or the resulting trusts under §§ 2036 through 2038; and

(7) will not constitute a transfer by any beneficiary of the Trust or the resulting trusts that will be subject to gift tax under § 2501.

Ruling 1 – the GST Tax

Section 2601 imposes a tax on each generation-skipping transfer. Section 2611(a) provides that the term "generation-skipping transfer" means a taxable distribution, a taxable termination, and a direct skip.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping transfer tax shall not apply to any generation-skipping 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)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

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 will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer 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 –

(1) 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

(2) 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.

In this case, the Trust was created and irrevocable before September 25, 1985. Also, it is represented that no additions have been made to the Trust since September 25, 1985. Consequently, the Trust is currently exempt from GST tax.

The proposed partition of the Trust will result in three trusts, one for each of Grantor's children's family lines, i.e., for the child or, if the child is deceased, for the child's issue per stirpes. Because (i) the dispositive terms of each resulting trust will be the same as the dispositive terms of the Trust, although limited to a particular family line, (ii) each resulting trust will terminate no later than on Child C's death, and (iii) the distributees of the property on termination of each resulting trust will be the respective child's issue per stirpes, the proposed partition of the Trust and pro rata allocation of the Trust assets among the three resulting 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 partition, and will not extend the time for the vesting of any beneficial interest in a resulting trust beyond the period provided for in the Trust.

Accordingly, based on the facts submitted and the representations made, provided that the Local Court issues an order approving the partition of the Trust, the partitioning of the Trust into the three resulting trusts and the pro rata allocation of the assets will not affect the status of the Trust or the resulting trusts as exempt from the GST tax. Likewise, neither the partitioning nor the pro rata allocation of assets will cause a distribution from, or termination of any interest in, the Trust or any of the three resulting trusts to be subject to the GST Tax.

Ruling 2 – section 643(f)

Section 643(f) provides that, for purposes of subchapter J, 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.

In this case, each resulting trust will have different beneficiaries and be managed and administered separately. Therefore, based solely on the facts and representations submitted, we conclude that the resulting trusts created by the division of the Trust will be treated as separate trusts for federal income tax purposes.

Ruling 3 - section 661

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.

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, or specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

Based solely on the facts and representations submitted, we conclude that the division of the Trust into the resulting trusts is not a distribution under § 661 or § 1.661(a)-2(f).

Rulings 4 and 5 – sections 61, 1001, 1015, 1223

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.

Section 1015(a) provides that if the property was acquired by gift, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by

whom it was not acquired by gift, except that if the basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be the fair market value.

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 the 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 hands as it would have in the hands of such other person. See also § 1.1223-1(b).

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), concerns the issue of when a sale or exchange has taken place that results in realization of gain or loss under § 1001. In Cottage Savings, a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Court in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different." In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. The Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Cottage Savings, 499 U.S. at 566.

It is consistent with the Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the resulting trusts will not differ materially from their interests in the Trust. In the proposed transaction, the Trust will be severed in accordance with State law on a pro rata basis. Except for the changes described above, all other provisions of the Trust will remain unchanged. The proposed transaction will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries.

A partition of jointly owned property 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. See Rev. Rul. 56-437, 1956-2 C.B. 507.

If under § 1015 the basis of assets received by the new trusts is the same as the basis of those assets in the hands of the original trust at the time of the transfer,

pursuant to § 1223(2), the holding periods of the assets in the hands of the new trusts will include the holding periods of the assets in the hands of the original trust.

Accordingly, the division of the Trust and the pro rata allocation of each Trust asset among the three resulting trusts will not result in the realization of income, gain or loss under § 61(a) or § 1001 by the Trust, the resulting trusts, or any beneficiary of those trusts. The basis of each asset held by the three resulting trusts immediately after the division will have the same basis as determined under § 1015 as that asset had in the hands of the Trust immediately before the division. The holding period for all the assets allocated to each resulting trust will include the Trust's holding period under § 1223.

Ruling 6: sections 2036 through 2038

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 consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for life or for any period not ascertainable without reference to the decedent's death or for any period which does not in fact end before the decedent's 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 the possession or enjoyment thereof can, through ownership of such interest be obtained only by surviving the decedent, and the decedent has retained a reversionary interest in the property and the value of the reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of the property.

Section 2038(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, where the enjoyment thereof was subject at the date of the decedent's death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent 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.

Sections 2036, 2037, and 2038 apply to situations in which a decedent transferred property or an interest in property and retained an interest, right, or power with respect to the income or principal of the transferred property or interest. In this case, the beneficiaries of the resulting trusts will have the same interests after the division as they had as beneficiaries of the Trust. Therefore, nothing will be transferred by them by reason of the proposed division. Accordingly, the division of the Trust and the pro rata allocation of each Trust asset among the three resulting trusts will not cause any portion of the assets of the Trust or any of the resulting trusts to be includible in the gross estate of any beneficiary of the Trust or the resulting trusts to be includible in that beneficiary's gross estate under § 2036, 2037, or 2038.

Ruling 7: the gift tax

Section 2501 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 transferred is real or personal, tangible or intangible.

In this case, the Trust will be divided into three trusts to represent the three family lines of Grantor's children. The dispositive provisions of each trust will be identical to the dispositive provisions of the Trust, except each resulting trust will be limited to the respective child's family line for which it is held. Each resulting trust will terminate no later than Child C's death. The distributees on termination of each trust will be the respective child's issue per stirpes.

Based on the facts submitted and the representations made and assuming the transaction is carried out as proposed and is effective under the law of State, we conclude that the division of the Trust and the pro rata allocation of each Trust asset among the three resulting trusts will not result in a transfer by any of the beneficiaries of the Trust or the resulting trusts that is subject to federal gift tax under § 2501.

A copy of this letter should be attached to any income, gift, estate, or generation-skipping transfer tax returns that you may file relating to this matter.

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 the appropriate party. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

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

Sincerely,

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

Enclosure:
copy for 6110 purposes