Internal Revenue Service

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Person To Contact:
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Telephone Number:

Refer Reply To:
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Date:
December 20, 2006

Legend

Grantor =
Trust =

Date 1 =
Date 2 =
Spouse =
Child 1 =
Child 2 =
Child 3 =
Child 4 =
Date 3 =
Date 4 =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Grandchild 5 =
Grandchild 6 =
Grandchild 7 =
Grandchild 8 =
Grandchild 9 =
Date 5 =
Great-Grandchild 1 =
Great-Grandchild 2 =
Great-Grandchild 3 =
Great-Grandchild 4 =
Great-Grandchild 5 =

Great-Grandchild 6 =
Great-Grandchild 7 =
Date 6 =
Great-Grandchild 8 =
Great-Grandchild 9 =
Date 7 =
Great-Grandchild 10 =
Great-Grandchild 11 =
Great-Grandchild 12 =
Great-Grandchild 13 =
Great-Grandchild 14 =
Date 8 =
Date 9 =
Court 1 =

Court 2 =
Date 10 =
State =

Dear :

This letter responds to your letter, dated June 13, 2003, and prior correspondence, requesting rulings under §§ 61, 661, 1001, 1015, 1223, 2036, 2037, 2038, 2501, and 2601 of the Internal Revenue Code.

Grantor created Trust on Date 1. Trust was amended on Date 2. Both Date 1 and Date 2 are prior to September 25, 1985. The taxpayer represents that Trust was irrevocable on September 25, 1985 and no additions, actual or constructive, have been made to Trust after September 25, 1985.

Trust was created for the benefit of Spouse and the issue of Grantor and Spouse. Grantor and Spouse had four children: Child 1, Child 2, Child 3, and Child 4. Spouse died on Date 3. The last surviving child of Grantor died on Date 4. Grantor had nine grandchildren: Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, Grandchild 5, and Grandchild 6, Grandchild 7, Grandchild 8, and Grandchild 9. Grandchild 1 died on Date 5 survived by seven children: Great-Grandchild 1, Great-Grandchild 2, Great-Grandchild 3, Great-Grandchild 4, Great-Grandchild 5, Great-Grandchild 6, and Great-Grandchild 7. Grandchild 7 died on Date 6 survived by two children: Great-Grandchild 8 and Great-Grandchild 9. Grandchild 8 died on Date 7 survived by five children: Great-Grandchild 10, Great-Grandchild 11, Great-Grandchild 12, Great-Grandchild 13, and Great-Grandchild 14. Grandchild 9 died on Date 8 without issue. Accordingly, the current income beneficiaries of Trust are: Grandchild 2, Grandchild 3, Grandchild 4, Grandchild 5, Grandchild 6, Great-Grandchild 1, Great-Grandchild 2, Great-Grandchild 3, Great-Grandchild 4, Great-

Grandchild 5, Great-Grandchild 6, Great-Grandchild 7, Great-Grandchild 8, Great-Grandchild 9, Great-Grandchild 10, Great-Grandchild 11, Great-Grandchild 12, Great-Grandchild 13, and Great-Grandchild 14.

Article First (e) of the Trust Agreement provides that upon the death of the survivor of the group consisting of the Spouse, Child 1, Child 2, Child 3, and Child 4, Trust shall continue for a period of twenty-one years and shall be held for the benefit of the lawful issue of Grantor's children. During that period, income from Trust shall be paid to the issue at least quarterly, per capita. Trust will terminate on the expiration of the twenty-one year period and the principal shall be distributed in equal shares among the lawful issue of Grantor's children in direct proportion to their respective shares of the trust income immediately prior to termination. If any of the lawful issue of Grantor's children die while receiving income from Trust, then that person's lawful issue shall take, in equal shares if more than one, the share of the income that the issue's parent was receiving at the time of death. On termination, that "latter issue" shall take that proportionate part of corpus equivalent to the proportionate part of the income from the trust they were receiving immediately prior to the termination of Trust.

The beneficiaries have engaged in extensive litigation to determine the proper interpretation of Article First (e) relating to distribution of the principal on termination of Trust. On Date 9, Court 1 held that the Trust agreement was ambiguous and could be interpreted in many conflicting ways. Court then held, based on extrinsic evidence including Grantor's contemporaneously executed will, that Grantor intended to include only his immediate grandchildren when he referred to the issue of his children in Article First(e). Accordingly, on termination, Trust principal should be distributed in equal shares to Grantor's grandchildren. The issue of a deceased grandchild will share, per stirpes, the share that their deceased parent would have taken if living. Court 2 affirmed this decision on Date 10 and the Supreme Court of State denied further appeal.

Court 1 has directed the trustee, subject to a favorable private letter ruling from the Service, to divide Trust into nineteen separate shares in direct proportion to each current income beneficiary's share of income (collectively "the nineteen subtrusts"). Accordingly, the subtrusts created for Grandchild 2, Grandchild 3, Grandchild 4, Grandchild 5, and Grandchild 6 will each receive 1/8 of the principal of Trust. The subtrusts created for Great-Grandchild 8 and Great-Grandchild 9 will each receive 1/16 of the principal of Trust. The subtrusts created for Great-Grandchild 10, Great-Grandchild 11, Great-Grandchild 12, Great-Grandchild 13, and Great-Grandchild 14 will each receive 1/40 of the principal of Trust. The subtrusts created for Great-Grandchild 1, Great-Grandchild 2, Great-Grandchild 3, Great-Grandchild 4, Great-Grandchild 5, Great-Grandchild 6, and Great-Grandchild 7 will each receive 1/56 of the principal of Trust. The taxpayer represents that the distribution of assets among the trusts will be made on a pro rata basis. The terms of the nineteen subtrusts will be identical to the terms of Trust, except that the sole current income beneficiary of each subtrust will be the beneficiary for whom the subtrust is held. Following the death of any

income beneficiary, the successor beneficiaries of his or her subtrust shall be determined under Article First (e) in the same manner and with the same effect as if Trust had not been divided into the nineteen subtrusts.

Rulings Requested

The trustee of Trust has requested the following rulings that the proposed division of Trust into nineteen subtrusts: (1) will not affect the status of Trust as exempt from the GST tax and will not cause any distributions from or termination of any interests in Trust or any of the nineteen subtrusts to be subject to the GST tax; (2) will not cause any beneficiary to be considered as having made a taxable gift and will not constitute a taxable gift to any beneficiary under § 2501; (3) will result in each of the nineteen subtrusts being treated as a separate taxpayer under § 643(f); (4) will not result in any amount of Trust property having been deemed to be paid, credited or distributed to any beneficiary under § 661 or § 1.661(a)-2(f); (5) will not result in the realization by Trust or any beneficiary of any income, gain or loss under §§ 61 or 1001; (6) will result in the assets of each of the nineteen subtrusts having the same basis under § 1015 and the same holding period under § 1223 as the assets had in Trust; and (7) will not cause the value of Trust or any of the nineteen subtrusts to be includible in the estate of any beneficiary under §§ 2036, 2037, or 2038.

Ruling 1

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

Section 2611(a) defines the term “generation-skipping transfer” to include a taxable distribution, taxable termination, and a direct skip.

Under § 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, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) 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) of the Generation-Skipping Transfer Tax Regulations provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor’s gross estate under §§ 2038 and 2042. In the present case, is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(4) 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)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) 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)(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) 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, 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 in the original trust. Furthermore, 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 a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), Example 5 provides that 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 section 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the divisions 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 of the Internal Revenue Code.

In this case, Trust is a generation-skipping transfer trust because it provides for distributions to more than one generation of beneficiaries below the grantor's generation. Date 1 and Date 2 are prior to September 25, 1985, and Trust was irrevocable on September 25, 1985. Trust, therefore, is exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i).

The facts in this case are similar to those presented in Example 5. The trustee proposes to divide Trust into nineteen subtrusts, one for each current income beneficiary. Trust will be split based on each beneficiary's proportionate interest in Trust and the assets will be divided on a pro-rata basis. The proposed division of Trust into nineteen subtrusts does not shift a beneficial interest in any trust to a beneficiary who occupies a lower generation than the person who held the beneficial interest prior to the modification. In addition, the division does not extend the time for vesting of any beneficial interest in Trust beyond the period provided in the original trust. We therefore conclude that the proposed division of Trust into nineteen subtrusts will not affect Trust's status as exempt from the GST tax. Accordingly, distributions from or terminations in interest in Trust or any of the subtrusts will not be subject to the GST tax.

Ruling 2

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

Section 2511(a) provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

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

In this case, the beneficiaries of the resulting subtrusts will have the same interests after the proposed division that they had as beneficiaries under Trust so there is no direct transfer of assets. Because the beneficial interests, rights, and expectancies of the beneficiaries are substantially similar, 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 division of Trust and the pro rata allocation of assets among the nineteen subtrusts as proposed is not a transfer, direct or indirect, of property that will be subject to the gift tax imposed by § 2501.

Rulings 3 and 4

Section 643(f) provides that 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 the trusts is the avoidance of federal income tax.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year, but such deduction shall not exceed the distributable net income (DNI) of the estate or trust.

Section 1.661(a)-2(f)(1) of the Income Tax Regulations provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 662(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 submitted and the representations made, we conclude that while the nineteen subtrusts will have the same grantor, they will have different primary beneficiaries. Therefore, based on the facts and representations submitted, the nineteen subtrusts will be treated as separate trusts for federal income tax purposes under § 643(f). Additionally, because the creation of the nineteen subtrusts is a modification of Trust, for federal income tax purposes, the nineteen subtrusts are treated as a continuation of trust. Therefore, the transfer of assets from Trust to the nineteen subtrusts will not be treated as a distribution or termination under § 661, and will not result in the realization by Trust, the subtrusts, or by any beneficiary of Trust or the subtrusts, of any income, gain, or loss.

Rulings 5 and 6

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

Section 1015(b) provides that if property is acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized by the grantor on such transfer.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by a transfer in trust by gift, bequest, or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by a transfer in trust, this basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to termination of the trust and distribution of the property, or thereafter.

Section 1223(2) provides that, in determining the period for which a taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person, if under chapter 1 of subtitle A the property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person. See also § 1.1223-1(b).

A partition of jointly owned property is not a sale or other disposition of property if 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.

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 Supreme Court in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 of the regulations reasonably interprets § 1001(a) and stated than an exchange of property gives rise to a realization event under § 1001 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" so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. In Cottage Savings, 499 U.S. at 566, 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.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the resultant trusts will not differ materially from their interests in the original trust. The proposed transaction will not change the interests of the beneficiaries. Instead, the beneficiaries will be entitled to the same benefits after the proposed transaction as before. The proposed transaction is similar to the kinds of transactions discussed in Rev. Rul. 56-437, since the original trusts are to be divided, but all other provisions of the trusts will remain substantially identical. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

Based upon the facts submitted and the representations made, we conclude that the division of Trust with the pro rata division of the assets of the trusts among the nineteen subtrusts will not cause gain or loss to be realized by the Trust or the beneficiaries for purposes of § 1001. Because § 1001 does not apply to the division of the trust assets, under § 1015 the basis of the trust assets will be the same after the partition as the basis of those assets before the partition. Furthermore, pursuant to § 1223, the holding periods of the assets in the hands of the new trusts will include the holding periods of the assets in the original trust.

Ruling 7

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

or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

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

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

In order for §§ 2036-2038 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 §§ 2036-2038. The beneficiaries of the resulting trusts will have the same interest after the division as they had as beneficiaries before the division. We therefore conclude that the proposed division will not cause the interest of any beneficiary of Trust or the resulting trusts to be includible in the beneficiary's gross estate under §§ 2036-2038.

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.

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.

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

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

Enclosure
Copy for § 6110 purposes