

Internal Revenue Service

Department of the Treasury

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Person to Contact:
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Re:

Legend

Settlor	=
Daughter	=
Child A	=
Child B	=
Child C	=
Trust	=
State	=

This is in response to your letter dated February 17, 1999, and prior correspondence, submitted by your authorized representatives, in which you request several rulings concerning the partition of Trust.

On July 26, 1928, Settlor established a revocable trust (Trust). Trust became irrevocable on December 11, 1941. Under the terms of Trust, the income may be distributed, in the trustee's discretion, to Settlor's daughter (Daughter) for life. Under Article I(b), upon the death of Daughter, the income may be distributed, in the trustee's discretion, to Daughter's descendants, per stirpes, or accumulated for their benefit. Any income that is accumulated as to any beneficiary may, in the discretion of the trustees, either be added to corpus or held for future distribution to such beneficiary. Article I(b) further provides that it is the intent of the Settlor that no beneficiary or class of beneficiaries shall be prejudiced by reason of the fact that, in the discretion of the trustees, income that might otherwise have been distributed to them is accumulated. Accordingly, the trustees are directed to maintain accounts of such income such that, when the trust terminates and principal is distributed any accumulated income which shall not have been

either added to principal or distributed is to be added to the distributable share of the respective beneficiary or class of beneficiaries. There is no power to invade corpus for any beneficiary. Trust also provides that upon the death of the last survivor of the children of Daughter living on the date the trust is executed (Child A, Child B, and Child C), the trust is to terminate and the trust estate is to be distributed outright to the descendants of Daughter, per stirpes.

Daughter died on November 13, 1988. Since that date, the trustees have distributed all the income, in equal shares, to Daughter's three children, Child A, B, and C. Because all the income has been distributed, there is no accumulated income being held for future distribution to any beneficiary.

The trustees propose to partition Trust equally into three partitioned trusts, one trust for each child of Daughter (and that child's descendants). The terms of each partitioned trust will be similar to the terms of Trust. In general, the trustees of each trust will have the discretion to distribute trust income per stirpes to the child with respect to whom the trust was established, and that child's descendants. Trust income not distributed can be added to principal or held for future distributions to that beneficiary (or that beneficiary's descendants). Trust income that is added to principal will be held separately and upon the termination of the trusts, distributed per stirpes to Daughter's descendants. The trustees will have no power to invade principal. Each trust will terminate on the death of the last to die of Child A, Child B, and Child C. On termination, the corpus of each trust will be distributed to the respective child's then living descendants per stripes, or, if none, then to Daughter's then living descendants, per stirpes. If a child and all that child's descendants die prior to the termination of the trust then the corpus of the deceased child's trust will be distributed in equal shares to the other two trusts.

In particular, if the beneficiaries of a partitioned trust die before the trust terminates, the trust property held in the partitioned trust will pass to the remaining partitioned trusts. It is proposed that the current property held in Trust will be divided, pro rata, among the three trusts. It is represented that under state law, Trust may be partitioned in a pro rata manner.

Each of the partitioned trusts will be administered under the laws of State. You represent that the proposed partition is authorized under the laws of State. Specifically, § 5/4.25 of the State Trusts and Trustees Act, provides the trustee may "sever any trust estate on a fractional basis into 2 or more

separate trusts for any reason." A separate trust "must be held on terms and conditions which are substantially equivalent to the terms of the trust from which it was severed or segregated so that the aggregate interests of each beneficiary in the several trusts are substantially equivalent to the beneficiary's interests in the trust before severance...". Section 5/16.1 provides that if all the current beneficiaries of a trust are adult, they may enter into a written agreement relating to the trust which does not accelerate the trust's termination, and such agreement is binding under state law.

It is represented that no additions have been made to the trusts after September 25, 1985.

The following rulings have been requested:

1. The proposed division of the Trust will not cause the Trust to lose its exempt status for generation-skipping transfer tax purposes under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i), nor will the proposed division into partitioned trusts subject either the Trust or the resulting partitioned trusts to the generation-skipping transfer tax.

2. The partition of Trust into three partitioned trusts and the pro rata allocation of the Trust assets among the partitioned trusts will not be a transfer by the Child A, Child B, or Child C that will be subject to gift tax under § 2501.

3. After the partition of the Trust into three partitioned trusts, each of the partitioned trust will be treated as a separate taxpayer under § 643(f).

4. The partition of Trust into three partitioned trusts and the pro rata allocation of each existing asset among the three partitioned trusts does not result in the realization by the Trust of any income under § 61 of the Internal Revenue Code and does not result in the realization of any gain or loss under § 1001 of the Code.

5. After the partition of the Trust into three partitioned trusts, the assets of the three partitioned trusts received from the Trust will have the same basis and same holding periods as the assets had in the Trust.

Issues 1 & 2:

You request rulings that the proposed partition of the Trust pursuant to the terms of the petition, will not result in either the Trust or the partitioned trusts created by the partition being subject to the generation-skipping transfer tax imposed

under § 2601.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made after October 26, 1986.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST 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. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust that is otherwise exempted from the application of Chapter 13 (the GST tax) by § 1433(b)(2)(A) of the Act, a prorata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of Chapter 13.

A modification of a trust that is otherwise exempt for GST tax purposes under the 1986 Act will generally result in a loss of its "grandfathered" exempt status if the modification changes the quality, value, or timing of any powers, beneficial interests, rights or expectancies originally provided for under the terms of the trust.

You have represented that the Trust was irrevocable on September 25, 1985, and no additions have been made to the Trust after that date.

We conclude that the proposed partition will not alter the quality, value or timing of any powers, or beneficial interests, rights or expectancies originally provided for under the terms of the Trust. Therefore, the partition, as proposed, will not subject the Trust, or any trust created under the partition, to the generation-skipping transfer tax.

Accordingly, the terms of the Trust, as proposed to be modified, will not affect the GST status of the Trust and, thus, will not result in a transfer of property that will subject the Trust to the generation-skipping transfer tax imposed under § 2601. In addition, the proposed partition of the Trust into partition trusts will not subject the partitioned trusts to the generation-skipping transfer tax.

In addition, we conclude that proposed partition will not constitute a transfer of property subject to gift tax under

§ 2501 by Child A, Child B, or Child C.

Issue 3:

The partitioned trusts that are created as a result of the division are created as of the date of the division and, therefore, are subject to section 643(f) of the Code. Section 643(f) provides that, under regulations to be 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 federal income tax.

Although, the partitioned trusts will have the same grantor, each trust will have different primary beneficiaries. Provided that each of the partitioned trusts is separately managed and administered, each of the partitioned trusts will be treated as a separate trust for federal income tax purposes.

Issue 4:

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 § 1011 for determining loss over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations provides that except as otherwise provided in subtitle A of the Code, 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.

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 thereof. Thus, neither gain nor loss is realized on the partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not give the trustee authority to make a non-pro rata distribution of property

in kind. The distribution was effected as a result of a mutual agreement among the trustees and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries and was subject to the provisions of §§ 1001 and 1002.

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 mortgage loans were considered "substantially identical" by the agency that regulated the financial institution. The Supreme Court 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 Supreme Court stated that properties are "different" in a 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, at 564-565. The Supreme Court held that mortgage loans made to different obligors and secured by different homes embodied distinct legal entitlements, and that the taxpayer realized losses when it exchanged the loans.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the three partitioned trusts will not differ materially from their interests in the Trust. The proposed transaction will not change the interests of the beneficiaries, who 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 Trust is to be partitioned, but all other provisions of the Trust will apply to determine the beneficiaries' respective interests in the three partitioned trusts. Thus, the transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries. The conclusion that the proposed partition will not result in a material change is unaffected by the fact that it is anticipated that after the partition, the trustees of the three partitioned trusts may cause the trusts to invest in dissimilar assets.

Therefore, the Trust, the three partitioned trusts, and the

beneficiaries of any of these trusts will not realize gain or loss under § 1001 as a result of the proposed transaction.

Accordingly, the partition of Trust into three partitioned trusts and the pro rata allocation of each existing asset among the three partitioned trusts does not result in the realization by the Trust of any income under § 61 of the Internal Revenue Code and does not result in the realization of any gain or loss under § 1001 of the Code

Issue 5:

Section 1015(b) provides that if property is acquired by a transfer in trust (other than a transfer in trust by gift, bequest or devise), the basis shall be 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 by the grantor on the transfer.

Section 1.1015-2(a) provides that, in the case of property acquired by a transfer in trust the basis rules of s 1015(b) apply whether the property is in the hands of the trustee or the beneficiary, and whether acquired prior to the termination of the trust and distribution of the property, or thereafter. In addition, the principles in § 1.1015-1(b) concerning uniform basis are applicable in determining the basis of property where more than one person acquires an interest in the property by a 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 trust, the basis of the assets in the three separate partitioned trusts will be the same as the basis of the assets currently held in Trust.

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 the Internal Revenue 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.

As noted above, the basis of the assets held by the three partitioned trusts will be the same as the assets currently held

by Trust. Accordingly, under § 1223(2), the holding period of the assets in each of the partitioned trusts will include the holding periods of the same assets in Trust.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Chief, Branch 4

Enclosure
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