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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4/PLR 118655-99
Date:
July 26, 2000

Re:

Legend:

| | |
|----------------------|---|
| Decedent | = |
| Spouse | = |
| Trust | = |
| Trustee | = |
| Date 1 | = |
| Date 2 | = |
| Date 3 | = |
| Date 4 | = |
| State X | = |
| State X law | = |
| State X Court | = |
| Beneficiary A | = |
| Income Beneficiaries | = |

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2

Remainder Beneficiaries =

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Dear :

This is in response to your letter dated November 19, 1999, and subsequent correspondence, in which you requested rulings concerning the income and generation-skipping transfer tax consequences of a proposed division of a trust.

Facts

According to your submission, Decedent died testate on Date 1, a resident of State X. Article III of Decedent's will provides that the residue of Decedent's estate shall be distributed to a testamentary trust (Trust).

Article IV of Decedent's will provides that the Trust income, after the payment of Trust expenses and monthly distributions to Beneficiary A, is to be distributed to Decedent's surviving spouse (Spouse) during her lifetime. Article IV authorizes the Trustee to invade the Trust corpus in order to maintain Spouse in her customary standard of living and/or make the specified monthly payments to Beneficiary A. Article IV also authorizes the Trustee to purchase an annuity to fund the monthly distributions to Beneficiary A.

Article V provides that upon the death of Spouse, the Trust income, after the payment of Trust expenses and monthly distributions to Beneficiary A, shall be divided into eighteen equal parts, one for each of Decedent's grandchildren (referred to, collectively, as Remainder Beneficiaries). The income designated for each grandchild will be paid to the grandchild's "Income Beneficiary", that is, the parent of such grandchild who is also Decedent's natural child (or, if Decedent's said child is not living, the other natural parent of such grandchild), so long as said Income Beneficiary lives.

Article IX states that the Trust share benefitting each Remainder Beneficiary will continue until either the death of the last surviving Income Beneficiary of that Remainder Beneficiary or until such Remainder Beneficiary becomes twenty-one years of age, whichever occurs later. Upon the termination of each Remainder Beneficiary's share of Trust, the Trustee will distribute such Trust share outright, either in cash or in kind, to the Remainder Beneficiary whose interest in Trust has been terminated.

Spouse died on Date 2. It is represented that during Spouse's lifetime, the Trustee did not invade the Trust corpus to maintain Spouse in her customary standard of living. It is also represented that during Date 3, Trustee purchased an annuity to

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fund the monthly payment obligation to Beneficiary A.

Pursuant to the terms of Article V of Decedent's will, the Trustee has apportioned the net income of Trust into eighteen equal shares, one share for each Remainder Beneficiary living at the time of Decedent's death. The Trustee has not distributed any Trust income or principal to any Remainder Beneficiary. In accordance with Article V, the Trustee has allocated and distributed all of the Trust income to the Income Beneficiaries according to the number of Remainder Beneficiaries who are the children of such Income Beneficiaries. For example, an Income Beneficiary who is the parent of three Remainder Beneficiaries will receive three-eighteenths of the Trust income.

As of the date of this ruling request, there were five living Income Beneficiaries, three of whom are surviving children of Decedent and two of whom are the widows of two deceased children of Decedent. There were also sixteen living Remainder Beneficiaries as of the date of the request. The two deceased Remainder Beneficiaries died intestate without leaving either a surviving spouse or issue. Decedent's will is silent regarding the distribution of shares of deceased Remainder Beneficiaries. It is represented that the income attributable to the deceased Remainder Beneficiaries continues to be distributed according to Article V of Decedent's will to each of the deceased Remainder Beneficiary's respective Income Beneficiary.

By order of State X Court on Date 4, the assets of Trust will be partitioned into five separate trusts. Each separate trust will benefit a distinct family group, which consists of an Income Beneficiary and such Income Beneficiary's children who are also Remainder Beneficiaries. State X Court determined that under State X law, the share of Trust assets distributed to each of the five separate trusts is to be determined by the number of Remainder Beneficiaries who were living at Decedent's death and are members the family group benefitting from such separate trust. The assets of Trust, consisting of cash, cash equivalents, and marketable investment securities, are to be allocated among the five separate trusts in a pro rata manner so that each separate trust will receive its proportionate share of each of the Trust assets.

It is represented that after the division of Trust, there will be no change in the identity of the Income Beneficiaries and Remainder Beneficiaries comprising each of the five family groups. The existing administrative and dispositive provisions of Trust will continue to govern each of the five separate trusts. The Trustee, however, will hold and administer the assets of each separate trust for the exclusive use and benefit of the family group for which such trust was established. No Income Beneficiary or Remainder Beneficiary will have any interest in any trust other than the separate trust created for the benefit of the family group of which such Income Beneficiary or Remainder Beneficiary is a member.

Upon the termination of the trust share established for the benefit of each

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Remainder Beneficiary, the Trustee will distribute to such Remainder Beneficiary his or her trust share. If the Remainder Beneficiary has died prior to the termination of his or her respective trust share, such share will be distributed according to the terms of the predeceased Remainder Beneficiary's will or according to the intestacy laws of the Remainder Beneficiary's domicile, if such Remainder Beneficiary dies intestate.

It is represented that there have been no actual or constructive additions to Trust since Decedent's death on Date 1.

Ruling Requests

1. The proposed division of Trust into five separate trusts, and the division of the Trust assets, pro rata, among the five separate trusts will not constitute a sale or other taxable disposition of the Trust assets under § 1001 of the Internal Revenue Code.

2. The division of Trust into five separate trusts, and the division of the Trust assets, pro rata, among the five separate trusts will not result in a transfer subject to gift tax under § 2501 by any of the Remainder Beneficiaries.

3. The five separate trusts resulting from the division of Trust will be considered to have been created prior to September 25, 1985, for purposes of the GST tax provisions in Chapter 13 of the Internal Revenue Code, and will, therefore, be exempt from the generation-skipping transfer tax under § 2601.

Law and Analysis

Ruling Request 1

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

Section 1001(a) provides that gain from the sale or other disposition of property is the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in such section 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 exchange of property for other property differing materially either in kind or in extent is treated as income or as 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 a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

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In Rev. Rul. 69-486, 1969-2 C.B. 159, distinguished by, Rev. Rul. 83-61, 1983-1 C.B. 78, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee 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.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that the assets of the Trust will be allocated among the five separate trusts in a pro rata manner and each separate trust will receive its proportionate part of each of the assets of Trust. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of the three original trusts.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), addresses 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 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. 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 five separate 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 because the original Trust is to be partitioned, but all other provisions of Trust will remain unchanged. Further, the assets of the Trust will be distributed among the five separate trusts in proportions that

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are consistent with the share of the income and principal of the Trust to which each beneficiary is entitled under the original Trust. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

Although Decedent's will does not specify how to distribute the share of a predeceased Remainder Beneficiary upon the termination of such Remainder Beneficiary's trust share, it is represented that the distribution of such shares will be consistent with the predeceased Remainder Beneficiary's will or according to the intestacy laws of the Remainder Beneficiary's domicile, if such Remainder Beneficiary dies intestate. Therefore, the division of the Trust into the five separate trusts and the division of the assets of the Trust, pro rata, among the five separate trusts will not constitute a sale or other taxable disposition of the assets of the Trust under § 1001.

Ruling Request 2

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

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 25.2511-1(a) of the Gift Tax Regulations provides that the gift tax applies to a transfer by way of gift 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. For example, a taxable transfer may be effected by the creation of a trust. Section 25.2511-1(c)(1) provides that the gift tax also applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

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

In this case, the interest of each Remainder Beneficiary remains the same after the proposed division. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division will not cause any Remainder Beneficiary to be considered as having made a taxable gift under § 2501.

Ruling Request 3

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act), 1986-3 (Vol. 1) C.B.1, and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations

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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 the transfer is not made out of principal added to the trust after September 25, 1985 (or out of income attributable to principal 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)(ii)(B) or (C) (relating to property includible in a grantor's gross estate under §§ 2038 and 2042). The existing trust in this case (Trust) is irrevocable because neither § 2038 nor § 2042 apply under the facts of this case.

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 exempt from the application of Chapter 13 by § 1433(b)(2)(A) of the Act, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of Chapter 13.

It has been represented that there have been no additions to Trust after September 25, 1985. However, whether Trust retains its exempt status for generation-skipping transfer tax purposes depends upon whether the proposed division of Trust into five separate trusts will change the substantive provisions of Trust in a manner such that it can no longer be considered to be the same trust that was exempt under § 1433(b)(2)(A) of the Act. In general, modifications that change the quality, value, or timing of any of the powers, beneficial interests, rights, or expectancies originally provided for under the terms of a trust will cause an exempt trust to lose its exempt status.

In this case, the proposed division of Trust into five separate trusts in the manner described above will not change the quality, value, or timing of any of the beneficial interests, rights, or expectancies provided for under the terms of Trust. Accordingly, we rule that the separate trusts created by the proposed transaction will not lose their exempt status with respect to the generation-skipping transfer tax under § 2601. Provided that there are no additions, constructive or otherwise, to the separate trusts after September 25, 1985, distributions from these separate trusts will not be subject to the generation-skipping transfer tax.

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.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Sincerely,
Associate Chief Counsel
Passthroughs and Special Industries
By: George Masnik
Chief, Branch 4

Enclosure (1)
Copy for section 6110 purposes