Internal Revenue Service

Number: **200402020**
Release Date: 1/9/2004
Index Number: 2601.00-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:
CC:PSI:BO9/PLR-132328-03
Refer Reply To:

Date:

September 24, 2003

Legend

Grantor	=
Trust	=
Date 1	=
Bank	=
Beneficiary 1	=
Date 3	=
Beneficiary 2	=
Beneficiary 3	=
Date 4	=
Beneficiary 4	=
Beneficiary 5	=
Beneficiary 6	=
Measuring Life 1	=
Measuring Life 2	=
Measuring Life 3	=

Measuring Life 4 =

Measuring Life 5 =

Dear :

This letter responds to your letter, dated May 1, 2003, requesting rulings under §§ 1001, 2501, and 2601 of the Internal Revenue Code.

Grantor created Trust, an inter vivos trust, on Date 1. Trust was created to benefit Grantor's daughter, Beneficiary 1, and her issue. Grantor died in 1953 and Trust became irrevocable on Grantor's death. Beneficiary 1 died on Date 3, survived by her daughter, Beneficiary 2, and her son, Beneficiary 3. Beneficiary 3 died on Date 4 survived by three sons: Beneficiary 4, Beneficiary 5, and Beneficiary 6. Beneficiary 2 has three living children and two living grandchildren. Beneficiary 5 has two living children.

Article First of Trust provides that the trustees shall pay three-quarters of the net income in quarterly installments to Beneficiary 1 during her life. Upon her death, three-quarters of the net income shall be paid to Beneficiary 1's issue, per stirpes, until the death of the last survivor of Beneficiary 1's children, or until the expiration of twenty years, eleven months, after the death of the last survivor of Beneficiary 1, Measuring Life 1, Measuring Life 2, Measuring Life 3, Measuring Life 4, and Measuring Life 5.

Article First of Trust further provides that income payable during minority to any minor issue of Beneficiary 1 shall be invested by the trustee and shall be accumulated for the benefit of the minor issue, except for payments to his or her guardian(s), necessary in the discretion of the guardian(s) and requested from the trustee in writing, for the minor issue's proper care, maintenance and education of the minor. If it is lawful to do so, the accumulated income shall be held by the trustee as a separate trust fund for the benefit of the minor issue, under the same trusts and conditions affecting his or her individual interest in the trust estate. Otherwise, it shall be paid over to the minor issue upon his or her arriving at the age of twenty-one years.

Article Third of Trust provides that the trust shall terminate as to the one-quarter interest (not referenced in Article First) shall be conveyed and delivered to the person(s) and subject to any lawful conditions as she may appoint, designate and select by her last will and testament. Beneficiary 1 appointed one-fourth of the trust on her death pursuant to her power of appointment.

After Beneficiary 1's death, the remaining three-quarters of the trust corpus continued in trust for the benefit of Beneficiary 1's issue as provided in Article First of Trust.

Bank currently serves as trustee of Trust. The current trustee proposes to partition Trust into four separate fractional interest trusts, one for each current beneficiary. The partition will be pro rata in accordance with each beneficiary's respective interest. The partition would allow the trustee to pursue different investment objectives for each trust and better serve the beneficiaries of each trust. Each resulting trust will be administered as a separate trust named for the respective current income beneficiary and there will be no invasion of trust corpus. Upon the death of the named income beneficiary, the trust, if not otherwise terminated, will be subdivided, per stirpes, into a subtrust for each descendant of the deceased beneficiary. If the deceased beneficiary has no living descendants, then the trust shall be divided per stirpes among the descendants of the deceased beneficiary's ancestor, either Beneficiary 2 or Beneficiary 3. If there are no living descendants of the respective ancestor, then the trust shall be divided among the descendants of Beneficiary 1, per stirpes. The termination of the resulting trusts will be the same as provided in Trust: upon the earlier of the death of Beneficiary 1's children or upon the expiration of 20 years and eleven months from the date of the last to die of Beneficiary 1, Measuring Life 1, Measuring Life 2, Measuring Life 3, Measuring Life 4, and Measuring Life 5. Bank has filed a petition in Court to permit it to divide Trust as described above. The petition is submitted on condition of approval by Court and with a condition precedent that the Internal Revenue Service issue a favorable private letter ruling.

The trustee has requested the following rulings: (1) The division of Trust on a pro rata basis will not be considered a sale or other disposition of property and will not cause Trust, the resulting trusts, or any of the beneficiaries of the trusts to realize any gain under § 1001. (2) Neither the partition of Trust nor the distribution of the assets to the resulting trusts will cause a taxable gift to be made by any beneficiary of the Trust under § 2501. (3) Assuming that no additions are made to the resulting trusts, the resulting trusts will be exempt from the generation-skipping transfer tax.

Ruling 1

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 received.

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.

An exchange of property results in the realization of gain or loss under § 1001 of the Code if the properties exchanged are materially different. See section 1.1001-1(a) of the Income Tax Regulations. Properties exchanged are materially different if the properties embody legal entitlements "different in kind or extent" or if the properties confer "different rights and powers." See Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991) at 565. In Cottage Savings, the 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 interests in the loans. Id. at 566. In defining what constitutes a "material difference" for purposes of § 1001(a) of the Code, 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. Id. at 564-65.

In analyzing the instant trust division, to have a taxable disposition under § 1001 of the Code and the Income Tax Regulations thereunder there must be (1) a sale or disposition of an interest in property and (2) the property interests exchanged must be materially different.

A sale or disposition of an interest in property is required in order to have a taxable disposition under § 1001 of the Code. In the instant case, the trust division is not prescribed by the original trust document or by state law, but rather, pursuant to a petition to a state court. Under these facts, the division of the trust is a deemed sale or disposition of an interest in property.

A deemed sale or disposition of an interest in property, as is the case here, is a taxable disposition under § 1001 of the Code and the Income Tax Regulations thereunder if the property interests exchanged are materially different. See Section 1.1001-1(a) of the Income Tax Regulations. Generally, a trust division results in the exchange of materially different property interests if either (A) the original trust assets are allocated to the post severance trusts in a non-pro rata manner or (B) the post-severance trusts contain new or additional terms and conditions.

Rev. Rul. 69-486, 1969-2 C.B. 159, distinguished by, Rev. Rul. 83-61, 1983-1 C.B. 78, provides that a trust division results in an exchange of materially different interests in property if the original trust assets are allocated in a non-pro rata manner. The instant case is distinguishable from Rev. Rul. 83-61 because the trust will be divided in a pro rata manner.

A trust division may also result in the exchange of materially different interests in property if a post severance trust contains new or additional terms and conditions. Under the proposed trust division, the original Trust is to be divided but all provisions are identical in form and in effect. Thus, in the instant case, the post severance trusts will not contain any new or additional terms and conditions.

Accordingly, the proposed pro rata division into post severance trusts, which do not contain any new or additional terms and conditions, will not result in the exchange of materially different interests in property.

The proposed division of the original Trust is a deemed sale or disposition. However, since the interests of the beneficiaries in the post-severance trusts, will not differ materially from their interests in the original Trust, the proposed division of Trust will not constitute a taxable disposition under § 1001 of the Code.

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 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 trusts will have the same interest after the division that they had as beneficiaries under Trust so there is no direct transfer of assets. 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 division of Trust and the pro rata allocation of assets among the four resulting trusts as proposed is not a transfer, direct or indirect, of property that will be subject to the gift tax consequences under § 2501.

Ruling 3

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 the 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, 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.

Potential beneficiaries include individuals who are two or more generations below the grantor’s generation, therefore, distributions from Trust may be subject to the generation-skipping transfer tax. Date 2 is prior to September 25, 1985. In the present case, the trusts created under Trust Agreement are considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies. Trust, therefore, is exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i). The trustee represents that no additions have been made to the trusts since September 25, 1985.

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 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.

The proposed severance of Trust does not shift a beneficial interest in any trust to a beneficiary who occupies a lower generation than the persons who held the beneficial interest prior to the modification. In addition, the severance does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. We therefore conclude that the proposed severance will not change Trust's status as exempt from the generation-skipping transfer tax.

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 on file with this office, a copy of this letter is being sent to your attorney.

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
Acting Branch Chief, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy of this letter for § 6110 purposes