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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

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Date:
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Legend:

Decedent =
Date 1 =
Date 2 =
Date 3 =
Trust =

Grandniece =
Niece =
Nephew 1 =
Nephew 2 =
Nephew 3 =
Date 4 =
Child 1 =
Child 2 =
Child 3 =
Date 5 =
Trustee =
State =
Statute =
State =

Dear _____ :

This is in response to your authorized representative's letter dated November 11, 2005, requesting rulings on the income, gift, estate, and generation-skipping transfer (GST) tax consequences of a proposed judicial division of a trust that is exempt from the application of the GST tax under § 2601 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: Decedent died on Date 1, leaving a last will and testament dated Date 2, as amended by a codicil dated Date 3 (collectively referred to as the "Will"). Article IV of the Will established Trust for the benefit of Grandniece, Niece, Nephew 1, Nephew 2, and Nephew 3 (collectively referred to as the "Initial Beneficiaries").

Article IV of the Will provides that the trustees shall distribute the balance of the trust income remaining after the payment of certain charges and expenses as follows: (a) 7/14ths to Grandniece during her life, and after her death, or if she should predecease Decedent, then to the children of Grandniece, share and share alike during the term of the trust; (b) 2/14ths to Niece during her natural life, and after her death, or if she should predecease Decedent, then to Grandniece during her natural life, and after her death, or if she should predecease Decedent, then to the children of Grandniece, share and share alike during the term of the trust; (c) 2/14ths each to Nephew 1 and Nephew 2 during their respective lives, and after their deaths, or if they should predecease Decedent, then to Grandniece during her life, and after her death, or if she should predecease Decedent, then to the children of Grandniece, share and share alike, during the term of the trust; (d) 1/14th to Nephew 3 during his life, and after his death, or if he should predecease Decedent, then to Grandniece during her life, and after her death, or if she should predecease Decedent, then to the children of Grandniece share and share alike during the term of the trust.

Article IV of the Will further provides that the trust shall terminate twenty-one years after the death of the last survivor of the Initial Beneficiaries. Upon termination of the trust, the trustees are directed to deliver all of the property and all undistributed net income and accumulations constituting the trust at that time, after the payment of all charges and expenses, to the children of Grandniece, share and share alike.

It is represented that no additions have been made to Trust since September 25, 1985. The Initial Beneficiaries are all deceased. The last survivor of the Initial Beneficiaries was Grandniece, who died on Date 4. Grandniece was survived by Child 1, Child 2, and Child 3 (collectively referred to as the "Current Beneficiaries"). Accordingly, Trust will terminate on Date 5 (twenty-one years after the date of Grandniece's death), and the trust estate will be distributed to the Current Beneficiaries share and share alike, if they are then living.

The parties represent that the Current Beneficiaries have differing personal and financial situations, and, as a result, have differing needs and desires concerning Trust. Because the Current Beneficiaries have differing investment goals, Trustee proposes petitioning the local court to divide Trust into three separate trusts of equal value ("Resulting Trusts"). Each Resulting Trust will be held, respectively, for the benefit of Child 1 and his issue, Child 2 and his issue, and Child 3 and her issue. The division will be accomplished by a pro rata division of each asset of Trust. Trustee will continue to serve as the trustee of the Resulting Trusts. The dispositive terms of each Resulting Trust will be identical to the dispositive terms of Trust, except that the distributees of income will be limited to the Current Beneficiary for whom a Resulting Trust is set aside, or his or her respective issue. Upon the death of the last survivor of the family line for whom a Resulting Trust is set aside, the Resulting Trust will terminate (if not already terminated) and be divided equally among the remaining Resulting Trusts then in existence. Each Resulting Trust must terminate no later than Date 5, which is the termination date of Trust. Upon termination, the principal of each Resulting Trust will be distributed to the Current Beneficiary for whom the Resulting Trust is established, or, if he or she is deceased, to his or her then living issue per stirpes. If neither the Current Beneficiary for whom the Resulting Trust is established nor any of his or her issue is then living, the trust property will be distributed one-half to each of the other Resulting Trusts.

State Statute provides, in part, that upon petition by a trustee, beneficiary, or any other interested person, the court may, for good cause shown, after a hearing and upon notice to those interested persons as the court may direct, divide a trust into two or more separate trusts, or may consolidate two or more separate trusts into a single trust, upon such terms and conditions as it deems appropriate, if the court finds that such consolidation or division: (a) is not inconsistent with the intent of the settlor or testator with regard to any trust to be consolidated or divided; (b) would facilitate administration of each trust; and (c) would be in the best interest of all the beneficiaries of each trust and not materially impair their respective interests.

The following rulings have been requested:

(1) The proposed division of Trust and the pro rata allocation of each Trust asset among the three Resulting Trusts will not cause 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, Trust, or any of the three Resulting Trusts to be subject to the GST tax;

(2) The proposed division of Trust and the pro rata allocation of each Trust asset among the three Resulting Trusts will result in the Resulting Trusts being treated as separate trusts for federal income tax purposes;

(3) The proposed division of Trust and the pro rata allocation of each Trust asset among the three Resulting Trusts will not result in the realization by Trust, the Resulting Trusts, or a beneficiary of Trust or the Resulting Trusts of any income, gain or loss;

(4) The proposed division of Trust and the pro rata allocation of each Trust asset among the three Resulting Trusts will result in the Resulting Trusts holding assets with the same basis they had at the time of the division, and holding periods for all the assets allocated to each Resulting Trust that include Trust's holding period;

(5) The proposed division of Trust and the pro rata allocation of each Trust asset among the three Resulting Trusts will not cause any portion of the assets of Trust or any of the Resulting Trusts to be includible in the gross estate of any beneficiary of Trust or the Resulting Trusts for federal estate tax purposes; and

(6) The proposed division of Trust and the pro rata allocation of each Trust asset among the three Resulting Trusts will not constitute a transfer by any beneficiary of Trust or the Resulting Trusts that will be subject to federal gift tax.

Ruling Request 1:

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

Section 2611(a) defines the term "generation-skipping transfer" as a taxable distribution, a 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. However, this exemption does not apply if additions (actual or constructive) are made to the trust after September 25, 1985.

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), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, the trust 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. In general, unless specifically provided otherwise, 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. Unless specifically noted, 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 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)) 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 for in the original trust.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. 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 to shift a beneficial interest in the trust. In addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of § 1.643(b)-1 of the Income Tax Regulations.

Section 26.2601-1(b)(4)(i)(E), Example 5, involves a trust that is irrevocable on or before September 25, 1985. 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 terms are identical except for the identity of the beneficiaries. 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 § 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division 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 the present case, Trust was established and became irrevocable on Date 1, and there have been no additions made to the trust after September 25, 1985. Accordingly, Trust is exempt from the GST tax under § 26.2601-1(b)(1).

Based on the facts submitted and the representations made, and provided that the appropriate State court permits Trustee to divide the trust into three separate trusts, the division of the trust into three separate sub-trusts, as described above, will not result in a shift of any beneficial interest in the trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division. Further, the division will not extend the time for vesting of any beneficial interest beyond the period originally provided for under the terms of the trust. Accordingly, the proposed division of Trust will not cause 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, Trust or any of the three Resulting Trusts to be subject to the GST tax.

Ruling Request 2:

Section 643(f) provides that, for purposes of subchapter J of chapter 1 of subtitle A, 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.

Section 1806(b) of the Tax Reform Act of 1986 provides that § 643(f) shall apply to taxable years beginning after March 1, 1984; except that, in the case of a trust which was irrevocable on March 1, 1984, it shall apply only to that portion of the trust which is attributable to contributions to corpus after March 1, 1984.

Based solely on the facts submitted and representations made, we conclude that as long as the Resulting Trusts are separately managed and administered, they will be treated as separate trusts for federal income tax purposes.

Ruling Request 3:

Section 661(a) provides, generally, that in any taxable year there shall be allowed as a deduction in computing the taxable income of a trust (other than a trust to which subpart B applies), the sum of: (1) any 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 of the trust.

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, 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 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) 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.

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.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991). 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." Id. at 565. In Cottage Savings, 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. Id. at 566. 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. Id. at 564-65.

Based on the information submitted and the representations made, the division of Trust into three Resulting Trusts is not a distribution under § 661 or § 1.661(a)-2(f). In addition, the division of Trust will not result in a material difference in the legal entitlements enjoyed by any of Trust beneficiaries. Accordingly, no gain or loss is recognized on the division of Trust for purposes of § 1001.

Ruling Request 4:

Section 1015(b) provides that if property is acquired by a transfer in trust (other than 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 to 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 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 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 the 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 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 his hands as it would have in the hands of such other person. See also § 1.1223-1(b).

Based upon the information submitted and representations made, we conclude that because § 1001 does not apply to the proposed division of Trust assets, under

§ 1015, the basis of the assets received by the three Resulting Trusts from Trust will be the same after the division as the basis of those assets before the division.

Furthermore, pursuant to § 1223(2) the holding period of each asset in the Resulting Trusts will include the holding period of that asset in the hands of Trust, the original trust.

Ruling Request 5:

Section 2036 provides, generally, 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 provides, generally, 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: (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, generally, 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 his 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.

In order for §§ 2036-2038 to apply, the decedent must have made a transfer of property of any interest therein (except in case of a bona fide sale for 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 prior to the division. We therefore conclude that the proposed division of Trust 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.

Ruling Request 6:

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

Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations provides, in part, that 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.

In this case, upon the proposed division of Trust into three Resulting Trusts, each beneficiary will have substantially the same beneficial interest as he or she had under Trust prior to the division. Thus, because the beneficial interests of the beneficiaries are substantially the same both before and after the proposed division, no transfer of property will be deemed to occur as a result of the division. Accordingly, the proposed division of Trust and the pro rata allocation of the assets of Trust to the three Resulting Trusts will not result in a transfer subject to gift tax under § 2501 by any of the beneficiaries.

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. 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. 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.

These rulings are 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.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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

Enclosures

Copy of letter for § 6110 purposes
Copy of letter