Internal Revenue Service

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Person To Contact:
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Telephone Number:

Refer Reply To:
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Date:
August 27, 2004

Re:

LEGEND

Decedent	=
Date 1	=
State A	=
Child 1	=
Child 2	=
Child 3	=
Date 2	=
Trust 1	=
Wife	=
Year 1	=
Grandchild 1	=
Grandchild 2	=
Year 2	=
Great-Grandchild 1	=

Great-Grandchild 2 =

Great-Grandchild 3 =

Trust 1-A =

Trust 1-B =

Dear :

In a letter dated December 18, 2003, you requested rulings regarding the gift tax, generation-skipping transfer (GST) tax, and income tax consequences of a proposed partition of a trust. This letter responds to that request.

The facts and representations are as follows: Decedent died on Date 1, a date prior to September 25, 1985. Decedent, a resident of State A, was survived by three children: Child 1, Child 2, and Child 3. Decedent's last will and testament, as modified by the several codicils thereto, was admitted to probate on Date 2.

Clause 4(a) of Decedent's will directs the trustee to divide the residuary estate into three equal shares and to assign and set apart one share in trust for each of Child 1, Child 2, and Child 3. The trust created for the benefit of Child 1 is referred to herein as Trust 1. The trusts created for the benefit of Child 2 and Child 3 are not at issue in this letter ruling.

Clause 4, paragraph (b) provides that the trustee shall pay the income from each child's trust in reasonable installments to the child for whom it is set apart. Upon each child's death, the income of the deceased child's trust shall be paid to his or her spouse to whom he or she was married at the time of Decedent's death, and after the death of such spouse, to such deceased child's then living issue, per stirpes. If any child shall die leaving no spouse or surviving issue, the trust estate set apart for such child shall be divided equally between the trust estates for Decedent's other surviving children, and if thereafter a second child should die leaving no surviving spouse or issue, the entire property of the two trust estates shall be held as one trust estate for the benefit of the last survivor of Decedent's children.

Clause 4, paragraph (c) provides that upon the death of the last survivor of Child 1, Child 2, Child 3, and their spouses, all of the trusts created for Decedent's children shall terminate and the property in each child's respective trust will be distributed to such child's then living issue, per stirpes.

All of Decedent's children are now deceased. Pursuant to the terms of Decedent's will, Trust 1 will terminate upon the death of Wife, the surviving spouse of Child 2. Child 1 died in Year 1 and the income from her trust became payable in equal shares to her two children, Grandchild 1 and Grandchild 2. Grandchild 1 is still living. Grandchild 2 died in Year 2 survived by three children, Great-Grandchild 1, Great-Grandchild 2, and Great-Grandchild 3. Accordingly, the income from Trust 1 is currently payable as follows: one-half to Grandchild 1, and one-half, in equal shares, to Great-Grandchild 1, Great-Grandchild 2, and Great-Grandchild 3.

Great-Grandchild 1, Great-Grandchild 2, and Great-Grandchild 3 intend to petition the appropriate state court for entry of an order that would partition Trust 1 into two separate, equal trusts, known as Trust 1-A and Trust 1-B. The partition of Trust 1 into Trust 1-A and Trust 1-B would be made on a pro rata basis. Trust 1-A would be held for the benefit of Grandchild 1 and Trust 1-B would be held for the benefit of Great-Grandchild 1, Great-Grandchild 2, and Great-Grandchild 3. Both trusts would be administered pursuant to the terms of Decedent's will, except that: (i) Grandchild 1 and any descendant of his shall be treated as deceased for purposes of Trust 1-B while any descendant of Grandchild 2 is living; and (ii) the descendants of Grandchild 2 shall be treated as deceased for purposes of Trust 1-A while Grandchild 1 or any descendant of his is living.

Although Grandchild 1 does not wish to be named as a petitioner in the state court proceeding to partition Trust 1, he has no objection to the partition of the trust and will consent to the entry of an order partitioning Trust 1 into Trust 1-A and Trust 1-B.

It has been represented that no additions have been made to Trust 1 since Decedent's death. You now request the following rulings:

1. The proposed partition of Trust 1 into Trust 1-A and Trust 1-B will not subject the partitioned trusts to the federal GST tax.

2. The proposed partition of Trust 1 into Trust 1-A and Trust 1-B will not result in any taxable gift for federal gift tax purposes.

3. The proposed partition of Trust 1 into Trust 1-A and Trust 1-B will not result in the recognition of gain or loss for federal income tax purposes to Trust 1, Trust 1-A, Trust 1-B, or any of the beneficiaries, and the basis of the assets as well as the holding periods will remain the same after the partition as before the partition.

Ruling 1

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

Section 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 provide that the GST 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 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) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii) (B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from the application of chapter 13 by § 1433(b)(2)(A) of the 1986 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.

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 GST 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 GST 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 capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraphs (b)(4)(i)(A), (B), or (C) of this subsection) 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, but only if -- (1) 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 (2) 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.

In this case, Trust 1 is considered irrevocable because neither § 2038 nor § 2042 apply. Also, it is represented that no additions were made to Trust 1 after September 25, 1985. Consequently, Trust 1 is currently exempt from the GST tax.

The proposed partition of Trust 1 into Trust 1-A and Trust 1-B will not shift any beneficial interest in Trust 1 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 partition. In addition, the proposed partition will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trusts.

Thus, the proposed partition of Trust 1 into Trust 1-A and Trust 1-B will not result in a loss of exempt status from the GST tax for Trust 1, Trust 1-A, or Trust 1-B.

Ruling 2

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 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 a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. Section 2512(b) provides that where property is transferred for less than an adequate 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 a gift.

In this case, the dispositive provisions of Trust 1-A and Trust 1-B will be identical to those of Trust 1, except that Trust 1-A and Trust 1-B will be established for the benefit of a single family line. Based on the facts submitted and the representations made, and provided the State A court approves the petition for partition, we conclude that the partition of Trust 1 into Trust 1-A and Trust 1-B will not result in a transfer by any of the beneficiaries that is subject to federal gift tax under § 2501.

Ruling 3

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 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) 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 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 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 of the United States in Cottage Savings, 499 U.S. at 560-61, 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 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. 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. Cottage Savings, 499 U.S. at 566.

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 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 by the amount of gain or decreased by the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. In addition, the principles in § 1.1015-1(b) concerning the uniform basis are applicable in determining the basis of property where more than one person acquires an interest in property by transfer in trust. Section 1.1015-1(b)

provides that property acquired by gift has a single 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.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included in the period for which such property was held by any other person, if the property has the same basis in the taxpayer's hands as it would have in the hands of that other person.

Provided that the State A court approves the petition for partition, it is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of Trust 1-A and Trust 1-B will not differ materially from their interests in Trust 1. In the proposed partition transaction, Trust 1 will be divided on a pro rata basis. Except for the changes described above, all other provisions of Trust 1 will remain unchanged. Accordingly, the proposed transaction will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries, and no gain or loss is recognized by the beneficiaries or the trusts on the partition for purposes of § 1001.

Because § 1001 does not apply to the partition of Trust 1, under § 1015 the basis of the assets will be the same after the partition as the basis of those assets before the partition. Furthermore, pursuant to § 1223(2) the holding periods of the assets in the hands of Trust 1-A and Trust 1-B will include the holding periods of the assets in the hands of Trust 1.

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.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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.

Sincerely,

James F. Hogan

James F. Hogan
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Office of Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosure
Copy for 6110 purposes