Internal Revenue Service **Department of the Treasury**

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:7:PLR-110897-98
Date:
April 16, 1999

Re:

EIN:

Legend: Trust:

EIN:

Date 1:
Grantor:
Beneficiary:
Daughter:
Bank:
Date 2:
Son:
Statute:

Court:

Dear Sir:

This letter is in response to the, request by the authorized representative of Trust, Daughter and Son (Taxpayers) for rulings concerning the income, estate, gift, and generation-skipping transfer (GST) tax consequences of a proposed division of a Trust.

Taxpayers represent the facts to be as follows. On Date 1, Grantor created a trust ("Trust") for the benefit of Grantor's daughter ("Beneficiary"). The Trustees of Trust are Daughter and Bank.

Article First of Trust provides that the net income from Trust is to be paid to Beneficiary during her lifetime.

Article Second of Trust provides that, at Beneficiary's death, if she is survived by Son, the net income is to be paid to Beneficiary's children, and the issue of deceased children of Beneficiary, during Son's lifetime, in equal shares, per stirpes and not per capita, the issue of a deceased child to receive the same share, collectively, which the parent would have received if living. Article Second of Trust further provides that on Son's death, if he shall survive Beneficiary, otherwise on the death of Beneficiary, the Trustees shall pay over the principal of the Trust estate to the surviving children and the issue of deceased children of Beneficiary, in equal shares, per stirpes and not per capita, the issue of a deceased child to receive the same share, collectively, which the parent would have received if living.

Taxpayers represent that Trust currently holds a diversified portfolio of publicly traded securities, cash, and cash equivalents, and that no additions, actual or constructive, have been made to Trust since September 25, 1985.

Taxpayers represent that Son and Daughter are the only children of Beneficiary, who died on Date 2. In order to pursue differing investment strategies for Son and his issue ("Son's family") and Daughter and her issue ("Daughter's family"), the parties propose to divide the trust into two separate trusts, each to hold one-half of the principal of Trust. It is represented that, to the extent practicable, the trustees will distribute to each split trust a pro-rata share of each of the assets of Trust. Further, to the extent such pro rata distribution cannot be made, the distribution to each split trust will be of equal value based on the fair market value of the assets of Trust on the date of distribution, which may result in small differences in adjusted basis. It is represented that Statute authorizes the trustees of a trust to distribute assets on a non-pro rata basis.

A proceeding was commenced in Court for an order directing the division. After the division, the Trustees for Daughter's Trust will be Daughter and Bank, and the Trustees for Son's Trust will be Son and Bank.

In furtherance of the proposed division, Taxpayers propose to amend Article Second of Trust to add the following paragraphs:

> During the continuation of the trust after the death of Beneficiary, upon direction of the court having jurisdiction over the trust the Trustees shall divide the principal of the trust into two equal shares and shall hold each such share in a separate trust as follows:
>
> (i) To collect the income from one such share and pay the net amount thereof to Son. On the death of Son, the Trustees shall pay over the principal of the said share to the issue of Son, or if none, to the issue then living of Beneficiary, in equal shares, per stirpes, and not per capita, the issue of a deceased

child to receive the same share, collectively, which the parent would have received if living.

(ii) To collect the income from one such share and pay the net amount to Daughter, and if she does not survive Son, then after her death, to her issue in equal shares, per stirpes and not per capita, the issue of a deceased child to receive the same share, collectively, which the parent would have received if living. If Daughter predeceases Son without leaving issue, the principal of such share shall, upon her death, be added to the share for the benefit of Son. On the death of Son, the Trustees shall pay over the principal of the said share unto Daughter, or, if she does not survive Son, to her issue then living, or, if none, to the issue then living of Beneficiary, in equal shares, per stirpes and not per capita, the issue of a deceased child to receive the same share, collectively, which the parent would have received if living.

Taxpayer represents that the terms of each trust will be identical to the terms of Trust.

Ruling Request 1:

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST) made after October 22, 1986.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act) and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations 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 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)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from Chapter 13 (Tax on Certain Generation-Skipping Transfers) by section 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.

In the present case, it has been represented that no additions have been made to the Trust after September 25, 1985.

A modification of a generation-skipping trust that is otherwise exempt under the Act will generally result in a loss of its exempt or “grandfathered” 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.

The proposed partition of Trust will follow the terms of Trust. Provided that the split trusts are funded as described above, and the assets transferred to each properly reflect the fair market value of the assets on the date of distribution, and provided further that there are no future additions to either split trust, we conclude that any generation-skipping transfers from or with respect to the split trusts will remain exempt from generation-skipping transfer tax under section 2601.

Ruling Request 2:

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

Section 1001 of the Code 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 section 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 1.1001-1(a) of the Income Tax Regulations provides that "[e]xcept 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 extent, is treated as income or as loss sustained."

A pro rata 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. See Rev. Rul. 56-437, 1956-2 C.B. 507. Thus, to the extent assets of the Trust are distributed to the Split Trusts on a pro rata basis, the division of the Trusts's assets does not result in the realization of gain or loss to the Trust or the Split Trusts.

Rev. Rul. 69-486, 1969-2 C.B. 159, holds that a non-pro rata distribution of trust corpus in kind by mutual agreement of the beneficiaries is subject to gain or loss treatment under section 1001. The trust instrument cited in the ruling did not contain a provision allowing the trustee to make a non-pro rata distribution and local law did not convey authority on the trustee to make a non-pro rata distribution of property in kind. Where neither the trust instrument nor local law convey authority on the trustee to make a non-pro rata distribution, the beneficiaries are viewed as having an absolute right to a ratable in kind distribution. Accord Rev. Rul. 83-61, 1983-1 C.B. 78 (distinguishing Rev. Rul. 69-486 by stating that that ruling was based on a finding that the trustee was not authorized by the trust or local law to make an in-kind property distribution). Accordingly, the distribution was equivalent to a ratable distribution to the beneficiaries followed by an exchange between the beneficiaries that was subject to section 1001.

The present case is distinguishable from Rev. Rul. 69-486, because applicable state law authorizes the trustees to make a non-pro rata distribution of property based on fair market value and the Trust is silent on the issue. Also, to the extent practicable, the trustees in the present case will either distribute to each Split Trust a pro rata share of each of the Trust assets and those assets' respective bases or make distributions to each Split Trust based on fair market value, taking into account those assets' tax attributes.

In Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), the Supreme Court addressed the issue of when a sale or exchange has taken place that results in realization of gain or loss under section 1001. Under the facts of that case, 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 institutions. The Supreme Court concluded that section 1.1001-1 of the regulations reasonably interprets section 1001(a) and stated that an exchange of property gives rise to a realization event under section 1001(a) if the properties exchanged are "materially different." Id. at 560-561.

In defining what constitutes a "material difference" for purposes of section 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 entitlement that are different in kind or extent. Id. at 564-565. 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 the loans.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the proposed distribution of the Trust assets to the Split Trusts will not differ materially from the distribution of the Trust assets under the terms of the Trust. Therefore, the interests of the beneficiaries in the Split Trusts will not differ materially from their interests in the Trust. Accordingly, the proposed distribution of assets does not give rise to a realization event under section 1001(a).

Ruling Request 3:

Section 1015(a) of the Code provides that if property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss, the basis shall be such fair market value.

Section 1015(b) provides that if property was 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 7701(a)(43) of the Code provides that the term "transferred basis property" means property having a basis determined under any provision of subtitle A (or under any corresponding provision of prior income tax law) providing that the basis shall be determined in whole or in part by reference to the basis in the hands of the donor, grantor, or other transferor.

Based upon the information submitted and representations made, we conclude that because section 1001 will not apply to the proposed partition of Trust, under section 1015(b), the basis of the assets in Trust and the split trusts after the partition will be the same as the basis of those assets prior to the partition. Therefore, we conclude that the partition of Trust will not alter the status of the assets held in Trust prior to the proposed partition as transferred basis property under sections 1015 and 7701(a)(43).

Ruling Request 4:

Section 1223(2) of the Code provides that, in determining the period for which a taxpayer has held property, there shall be included in the period for which the property was held by any other person, if the 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 hands of the taxpayer as it would have in the hands of the other person.

As noted above, the basis of the assets in Trust before and after the proposed partition will be the same as the basis of those assets prior to the partition. Accordingly, based upon the information submitted and representations made, we conclude that under section 1223(2), the holding period of the assets in the trusts after the partition will include the holding periods of the same assets in Trust.

Ruling Request 5, 6, and 8:

Section 2033 of the Code provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death. In the present case, after the proposed division of Trust, the beneficiary or beneficiaries of each trust will be entitled to distributions of income only from their respective trusts. On the death of Son, his descendants and Daughter, if she is then living, or her descendants if she is not then living, will be entitled to the principal of their respective trusts. Upon the death of a beneficiary before Son's death, or in the case of Son, upon his death, such person's interest in the split trust will cease. Accordingly, we conclude that the proposed division of Trust will not cause the interest

of Son or Daughter, as beneficiaries of the Trust or the split trusts to be includible in such beneficiary's gross estate under section 2033.

Section 2036(a) of the Code provides that the value of the gross estate includes the value of any property of which the decedent has made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) in which the decedent has retained for his life the possession or enjoyment of, or the right to the income from the property, or the right to designate the persons who shall possess or enjoy the property or the income from the property.

Section 2037 of the Code provides that the value of the gross estate includes the value of any interest therein of which the decedent has at any time after September 17, 1916, made a transfer (except in the 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 then property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a) of the Code provides that the value of the gross estate includes the value of all property of which the decedent has at any time made a transfer (except where there has been a bona fide sale for adequate and full consideration in money or money's worth) by trust or otherwise where the enjoyment thereof was subject at the date of death to any change through the exercise of a power by the decedent to alter, amend, revoke, or terminate the interest in the property or where the decedent relinquished this power within the three year period ending on the date of the decedent's death.

In order for sections 2036 through 2038 to apply, the decedent must have, at any time, made a transfer of property or any interest therein (except in the case of a bona fide sale for an 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, each beneficiary of Trust has the right to the income from the property. Upon the proposed partition of Trust, each beneficiary will have the same right to income as the beneficiary had under Trust.

Accordingly, this transaction will not cause Son or Daughter, as beneficiaries of Trust, to be considered to have made a transfer within the meaning of sections 2036 through 2038. In the absence of a transfer within the meanings of section 2036 through 2038, the proposed transaction will not cause any portion of Trust or of any successor trust, to be includible in such beneficiary's (including any beneficiary serving as trustee) gross estate under sections 2036 through 2038.

Section 2041 of the Code provides that the gross estate includes any property with respect to which the decedent has, at the time of his death, a general power of appointment or with respect to which the decedent has at any time released or exercised such power of appointment by a disposition which, had the property been owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 through 2038, inclusive. A general power of appointment is a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, except where the decedent's power is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent.

Section 2514(b) of the Code provides that the exercise or release of a general power of appointment created after October 21, 1942, will be deemed a transfer of property by the individual possessing the power.

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides that a power of appointment is not a general power if by its terms it is either (1) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of the decedent's estate. A power of appointment exercisable for the purpose of discharging a legal obligation of the decedent or for his pecuniary benefit is considered a power of appointment exercisable in favor of the decedent or his creditors.

Section 20.2041-1(b) provides that the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment.

In the present case, the trustees propose to petition Court to designate Son and Bank as co-trustee's of Son's Trust, and to designate Daughter and Bank as co-trustees of Daughter's Trust. Further, Trust provides and each split trust will provide solely for non-discretionary distributions of income during the lifetime of the measuring life. No beneficiary or trustee has or will have the power to pay principal to himself or to any other person prior to the termination of Trust, at which time the principal will be distributed in accordance with the terms of Trust.

Accordingly, we conclude that the proposed partition of Trust will not cause the interest of Son or Daughter, as beneficiaries of the Trusts, including any beneficiary serving as co-trustee, to be includible in such beneficiary's gross estate under section 2033 or sections 2036 through 2038. In addition, we conclude that Son or Daughter, as beneficiaries of each trust, will not be treated as holding a general power of appointment within the meaning of section 2041 or 2514, and therefore, the property

in each split trust will not be includible in the gross estate of the beneficiary of that trust under section 2041.

Ruling Request 7:

Section 2501 of the Code imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident. Section 2511 of the Code 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. Upon division of Trust into the split trusts, each beneficiary will have the same right to income as the beneficiary had under Trust. Because the beneficial interests, rights, and expectancies of the beneficiaries of Trust 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 proposed division. Accordingly, we conclude that the proposed transaction will not cause Son or Daughter, as beneficiaries of Trust or of any successor trust, including any beneficiary serving as trustee, to have made a taxable gift for purposes of the gift tax.

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

Sincerely,

James C. Gibbons

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James C. Gibbons
Assistant to the Chief, Branch 7
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures:
Copy for § 6110 purposes