

Internal Revenue Service

Department of the Treasury

Index Numbers: 2601.00-00; 1001.00-00
1015.02-00

Washington, DC 20224

Number: **199933027**
Release Date: 8/20/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4/PLR 112701-98
Date:
May 24, 1999

Re:

Legend

- Settlor A =
- Settlor B =
- Trust A =
- Trust B =
- Trust C =
- Trustee =
- Son =
- Spouse =
- Grandchild A =
- Grandchild B =
- Date 1 =
- Date 2 =
- Date 3 =

This is in response to your letter dated April 1, 1999, and prior correspondence submitted by your authorized representatives, in which you requested several ruling concerning the partition of three trusts.

Settlor A and Settlor B created Trust A, an irrevocable trust, on Date 1.

Trust B was created under Article Five of Settlor A's revocable trust agreement dated Date 2. Trust B became irrevocable on Date 3 when the Settlor A waived his right to modify Trust B.

Trust C was created under Article Five of Settlor B's revocable trust agreement dated Date 2. Trust B became irrevocable on Date 3 when the Settlor B waived her right to

modify Trust B. The terms of Trust C are identical to those of Trust B, except for the name of the settlor.

Each trust was established for the benefit of Son and his children (Grandchild A and Grandchild B), and their respective children and other issue. Son is deceased. Son's wife, Spouse, is also deceased. Both Grandchild A and Grandchild B are now living and each has issue now living.

Trust A provides that on the death of Son, and during the joint lives of Grandchild A and Grandchild B, the trustee is to pay one-fourth of the trust income to Grandchild A; one-fourth to the living issue of Grandchild A, by representation; one-fourth to Grandchild B; and one-fourth to the living issue of Grandchild B, by representation. Upon the death of Grandchild A, if survived by Grandchild B, the one-fourth share of income payable to Grandchild A is to be paid to his living issue, by representation. Upon the death of the last surviving issue of Grandchild A, if Grandchild A is living, the share of income that would have been payable to the issue of Grandchild A if living is to be paid to Grandchild A. If Grandchild A is not living, then the income is to be paid to Grandchild B. Similar dispositive provisions apply to the income payable to Grandchild B and Grandchild B's issue.

Upon the death of the survivor of Grandchild A and Grandchild B, one-half of the income is to be paid to the living issue of Grandchild A, by representation, and one-half is to be paid to the living issue of Grandchild B, by representation. In the event that all of the issue of Grandchild A die during the trust term, then the income payable to the issue of Grandchild A is to be paid to the living issue of Grandchild B, by representation. Similar provisions apply with respect to the one-half share of income payable to the issue of Grandchild B.

Upon the termination of Trust A, the corpus is to be divided into two halves with one half to be distributed to the living issue of Grandchild A, by representation, and one half to be distributed to the living issue of Grandchild B, by representation. At termination, if Grandchild A dies without surviving issue, then the entire corpus is to be distributed to the living issue of Grandchild B, by representation. Similar provisions apply with respect to the one-half share of corpus payable to the issue of Grandchild B.

Trust A terminates upon the death of the survivor of Son, Grandchild A, Grandchild B, and six named great-grandchildren; provided, however, that after the death of the survivor of Son, Grandchild A, and Grandchild B, Trust A will terminate on the day that the youngest of the six named great-grandchildren attains

age 45, or earlier if the five oldest attain age 45 and the youngest does not survive. All six of the named great-grandchildren have already attained the age of 45.

Under the terms of Trust A, the trustee also has the discretion to distribute corpus if the trustee deems it necessary and proper for the maintenance, support or education of an income beneficiary. Any distribution of corpus is to be charged against the share of principal which may thereafter be distributed to such income beneficiary. It is represented that no such distributions have been made to any living beneficiary of Trust A.

The dispositive provisions of Trust B and Trust C with respect to periods after the death of Settlor A, Settlor B, Son, and Spouse are substantially similar to the dispositive provisions of Trust A. In addition, no discretionary distributions of corpus have been made to any living beneficiaries of Trust B or C.

Trust A, Trust B, and Trust C each own marketable securities and undivided interests in timberland. The Trustee proposes to petition state court to partition Trust A, Trust B, and Trust C each into two separate trusts (Trust A into Trust A-1 and Trust A-2; Trust B into Trust B-1 and Trust B-2; Trust C into Trust C-1 and Trust C-2). Trust A-1, Trust B-1, and Trust C-1 will be held primarily for the benefit of Grandchild A and his issue. Trust A-2, Trust B-2, and Trust C-2 will be held primarily for the benefit of Grandchild B and her issue. Each trust will receive one-half of the fair market value of the marketable securities (with a cash adjustment for fractional shares) and one-half of the fair market value of the undivided interest in timberland. After partition, each partitioned trust will have the same terms as the original trust, except where necessary to reflect the fact that an original trust now has two partitioned trusts. Consistent with the terms of Trusts A, B, and C, in certain cases, Grandchild A and his issue will have contingent rights with respect to Trust A-2, Trust B-2, and Trust C-2, and in certain cases, Grandchild B and her issue will have contingent rights with respect to Trust A-1, Trust B-1, and Trust C-1.

Specifically, Trust A-1 will provide that during the joint lives of Grandchild A and Grandchild B and during the life of the survivor of them, the trustee will pay one-half of the trust income to Grandchild A and one-half to the living issue of Grandchild A, by representation.

Trust A-1 will provide that if Grandchild A dies before Grandchild B, the issue of Grandchild A will take his share of the trust income by right of representation. If all issue of

Grandchild A die before the survivor of Grandchild A and Grandchild B, then from and after the death of the survivor of such issue, any income which such issue would have taken if living will be paid to Grandchild A if living, or if not to Grandchild B. Upon the death of the survivor of Grandchild A and Grandchild B, the net income of the trust estate will be paid over in equal shares to the issue of Grandchild A, by right of representation. In the case that all of the issue of Grandchild A shall die during the trust term, the share which they would have taken if living will be paid over to the issue of Grandchild B, by right of representation.

Upon termination of Trust A-1, the principal of the trust estate will be transferred to the issue of Grandchild A who shall be then living, by right of representation, or if none of them are then living, to the issue of Grandchild B who are then living, by right of representation.

If the trustee makes a payment out of principal to Grandchild A or his issue, the payment will be made equally out of the principal of Trust A-1 and Trust A-2. Any payment of principal so made will be charged against the share of principal which is thereafter given to such beneficiary or the issue of such beneficiary, and one-half thereof will be restored to Trust A-2.

Trust A-1 terminates upon the death of the survivor of Son, Grandchild A, Grandchild B, and three named children of Grandchild A (who are among the six great-grandchildren named in the termination provision of Trust A); provided, however, that after the death of the survivor of Son, Grandchild A, and Grandchild B, Trust A-1 will terminate on the day that the youngest of the three named children attains age 45, or earlier if the two oldest attain age 45 and the youngest does not survive.

Trust A-2 will contain terms identical to Trust A-1 except for differences resulting from the fact that Grandchild B and the issue of Grandchild B will be the primary beneficiaries of Trust A-2 and Grandchild A and the issue of Grandchild A will be the contingent beneficiaries of Trust A-1.

The dispositive provisions of Trust B-1 and Trust C-1 are substantially similar to the dispositive provisions of Trust A-1 and the dispositive provisions of Trust B-2 and Trust C-2 are substantially similar to the dispositive provisions of Trust A-2.

Section 16246 of the California Probate Code provides that a "trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting

differences in valuation. A distribution in kind may be made pro rata or non-pro rata." Section 11953 provides that "the court shall partition, allot or otherwise divide the property so that each party receives property with a value proportionate to the value of the party's interest in the whole."

It is represented that no additions have been made to the trusts after September 25, 1985.

The following rulings have been requested:

1. The proposed partition of the trusts, as described above, will not cause any distribution from, or any termination of any interest in, the original trusts or the partitioned trusts thereto to be subject to the generation-skipping transfer (GST) imposed under § 2601.

2. The proposed partition of the trusts, as described above, will not cause the original trusts, the partitioned trusts or any beneficiary to recognize any gain or loss from a sale or other disposition of property under §§ 61 and 1001 of the Internal Revenue Code.

3. Under § 1015, the basis of each partitioned trust in each asset received from the corresponding original trust, as a result of the proposed partition, will be the same as such original trust's basis in the asset.

4. Pursuant to § 1223(2) of the Code, the holding period of each partitioned trust for each asset received from its corresponding original trust, as a result of the proposed partition of the trusts along family lines, will include such original trust's holding period for that asset.

Ruling Request 1

Section 2601 of the Code 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 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 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 are subject to the provisions of Chapter 13.

In general, any modification of an irrevocable trust that results in a change in the quality, value, or timing of any interest in the trust will cause the trust to lose exempt status.

In the present case, it has been represented that no additions have been made to Trusts A, B, or C after September 25, 1985. Further, the proposed division of Trusts A, B, and C as described will not affect the quality, value, or timing of any beneficial interest under the original trust. In this regard, we noted that the great-grandchildren designated in the provisions providing for the termination date of Trust A, Trust B and Trust C have all attained age 45. Thus, Trusts A-1, A-2, B-1, B-2, C-1, and C-2 will all terminate at the same time as provided in Trusts A, B, and C. Provided that the resulting trusts are funded as described above, and provided further that no additions are made to the Trusts, we conclude the proposed partition of the Trusts will not cause any distribution from, or any termination of any interest in, the trusts or the resulting trusts thereto to be subject to the generation-skipping transfer tax imposed under § 2601.

Ruling Request 2:

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

Section 1001(a) 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 § 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 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.

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 of the Code.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that California law authorizes the trustee to make a non-pro rata distribution of property in kind without any agreement by the beneficiaries. Thus, the new trusts to be created are not required to receive pro rata distributions for each asset of the three original trusts. 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), concerns the issue of when a sale or exchange has taken place that results in realization of gain or loss under § 1001 of the Code. 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.

Since all six of the great-grandchildren named in the provisions providing for the termination of Trusts A, B, and C have attained the age of 45, Trusts A-1, A-2, B-1, B-2, C-1, and C-2 will terminate at same time as the original trusts.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of Trusts A-1, A-2, B-1, B-2, C-1, and C-2 will not differ materially from their interests in Trusts A, B, and C. 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, since the original trusts are to be partitioned, but all other provisions of the trusts will remain unchanged, other than changes described above which are necessary to ensure that the beneficiaries of the original trusts will be entitled to the same benefits under the partitioned trusts. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

Therefore, the beneficiaries of Trusts A, B, and C and of the six partitioned trusts will not realize gain or loss under § 1001 of the Code as a result of the proposed transaction. For the same reasons, the three original trusts and the six partitioned trusts also will not realize gain or loss under § 1001.

Ruling Requests 3 & 4:

Section 1015(b) provides that if property is acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by gift, bequest, or devise), the basis 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 is made.

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 that taxpayer has held property however acquired, there is included the period for which the property was held by any other person, if under chapter 1 of the Code, the property has, for the purposes of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of the other person.

Because the partition of Trust A, B, and C will not constitute a sale or other disposition for purposes of § 1001, pursuant to § 1.1001-1, no gain or loss will result. Accordingly, we conclude that the bases of the assets in the partitioned trusts, Trusts A-1, A-2, B-1, B-2, C-1, and C-2, will be same as the bases of those assets in the original trusts before the partition. In addition, we conclude that the holding period of each partitioned trust for each asset received from its corresponding original trust, as a result of the proposed partition of the original trusts along family lines, will include such original trust's holding period for that asset.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code.

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

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
Geroge L. Masnik
Chief, Branch 4

Enclosure
Copy for 6110 purposes