

Internal Revenue Service

Department of the Treasury

Number: **200226042**
Release Date: 6/28/2002
Index Number: 1001.00-00, 2601.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04-PLR-163315-01

Date:

March 29, 2002

In Re:

LEGEND:

Grantor =
Wife =
Child 1 =
Child 2 =
Trust =
Trust A =

Trustee =
Date 1 =
Date 2 =
Decedent =
Grandchild 1 =
Grandchild 2 =

Dear :

This letter is in reply to your letter of October 31, 2001, requesting rulings regarding the proposed division of a trust that, because it was irrevocable as of September 25, 1985, is not subject to generation-skipping transfer (GST) tax. Specifically, you requested the following rulings:

1. After the proposed division of Trust A into Trust 1 and Trust 2, Trust 1 and Trust 2 will be treated as trusts that were irrevocable on September 25, 1985.
2. The proposed division will not constitute an addition to Trust 1 or Trust 2 that will cause them to lose their exempt status under section 1433(b)(2)(A) of the Tax Reform Act of 1986.
3. The proposed division of Trust A into Trust 1 and Trust 2 will not cause any future distribution from the trusts to be subject to the generation-skipping transfer tax under section 2601 of the Internal Revenue Code.
4. The proposed transaction will not cause any beneficiary of Trust A, Trust 1, or

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Trust 2 to be considered as having made a taxable gift and will not constitute a taxable gift to those beneficiaries under section 2501.

5. Neither the division of Trust A nor the distributions of the assets to Trust 1 and Trust 2 on a fractional share basis will require the recognition of gain or loss for federal income tax purposes.

FACTS:

On Date 1, Grantor created Trust for the benefit of his wife and their three children. Trust was to exist and continue during the lifetime of the survivor of each child and issue of such child living on the creation of Trust.

ARTICLE TWO of Trust provides that Trustee agrees to receive, hold, and manage all of the property transferred or hereafter transferred to it in trust, to sell, exchange or transfer all or any part thereof, except only as hereinafter provided, to invest and reinvest the same, to collect, receive and recover the income and profits thereof, and to pay, distribute and apply the income and principal thereof in the manner and upon the terms and conditions as are provided herein.

ARTICLE THREE provides that during the lifetime of my beloved wife [Wife], the Trustee is authorized to pay out, distribute and apply the net income of this Trust as follows:

Section 1. Trustee may at such time as it may determine pay to or for the benefit of my wife [Wife], so much of such net income as it in its uncontrolled discretion deems advisable for her care, comfort, support and maintenance in the standard of living to which she is now accustomed, giving due consideration to income available to her from all other sources.

Section 2. If in any fiscal year of the Trust, there is any net income which is not distributed to my wife under Section 1 of this Article, Trustee may pay and distribute so much thereof as it may, in its uncontrolled discretion, determine in equal shares to such of my three (3) children [Decedent, Child 1 and Child 2], as are living at the time of such distribution, provided that then living issue of any such child then deceased shall receive per stirpes the share of such deceased child.

Section 3. Any net income of any fiscal year of the Trust which is not distributed pursuant to Section 1 or Section 2 of this Article during or within ninety (90) days after the end of such fiscal year, shall be added to and become a part of the principal of the Trust.

ARTICLE FOUR provides that upon the death of my wife [Wife], Trustee shall divide the then remaining principal and undistributed income into as many equal shares as there are children of mine then living or deceased with issue then living. Trustee

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shall allocate one such equal share to each such child then living and one such share to the living issue of each such child then deceased and shall hold the same in a separate trust in accordance with the terms and provisions hereof.

Section 1. Each such Trust shall be known as the Grantor Trust for the family of such child.

Section 2. During the existence of such Trust, Trustee may pay to or for the benefit of any one or more of the group consisting of said such child, said child's spouse, and said child's issue, so much of the net income or principal of such Trust as Trustee in its uncontrolled discretion may determine. Any net income of any fiscal year of the Trust which is not so distributed during or within ninety (90) days after the close of such fiscal year shall be added to and become a part of the principal of such Trust.

Section 3. This Trust shall exist and continue during the lifetime of the survivor of such child and the issue of such child now living.

Section 4. Upon the termination of this Trust, Trustee shall pay over and distribute all of the principal and accumulated income of the Trust to the issue of such child per stirpes.

Section 5. If any of the separate trusts herein created shall at any time fail for want of a beneficiary, the then remaining principal and undistributed income thereof shall be reapportioned in equal parts among the other trusts herein created, including any such trust theretofore distributed, and one such equal part shall be added to the undistributed trust to which it is so reapportioned and thereafter shall follow the fortunes thereof, and one such equal part so reapportioned to a theretofore distributed trust shall be paid over by Trustee to the person or persons who would be entitled to the assets of such theretofore distributed trust had the same then become distributable.

Section 6. Anything herein to the contrary notwithstanding, any such trust herein created shall terminate if it has not previously terminated twenty-one (21) years after the death of the survivor of the following persons living at the date this Agreement is executed, to-wit: Wife, Decedent, Child 1, Child 2, Grandchild 1, Grandchild 2, and five other beneficiaries.

Upon the death of Grantor's wife, Wife, and pursuant to the terms of Trust, Trust was divided into three (3) separate trusts, one (1) trust for each of Grantor's three children. Trust A was established for Decedent, Grantor's oldest child. Decedent and his wife are both deceased. Decedent died on Date 2, survived by Grandchild 1 and Grandchild 2. On Date 2, Grandchild 1 and Grandchild 2 became the primary beneficiaries of Trust A.

Each beneficiary of Trust A has different investment objectives and are geographically spread out. A division of Trust A along family branches will provide for

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more efficient administration of each trust. Trustee proposes to divide Trust A into two separate trusts, Trust 1, to benefit Grandchild 1 and his issue, and Trust 2, to benefit Grandchild 2 and her issue. The assets of Trust A will be divided equally between Trust 1 and Trust 2. Trust 1 and Trust 2 will each have terms identical to those of Trust A. Trustee has petitioned the local court to approve the division of Trust A into Trust 1 and Trust 2, with identical terms and provisions, subject to the receipt of a favorable ruling from the Internal Revenue Service. Trust was irrevocable on September 25, 1985, and no additions, actual or constructive, have been made to Trust since that date.

LAW AND ANALYSIS:

Rulings 1, 2, and 3

Section 2601 imposes tax on every generation-skipping (GST) transfer, which is defined under section 2611 as a taxable distribution, a taxable termination, or a direct skip. Under section 1433(a) of the Tax reform Act of 1986 (the Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax does not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in section 26.2601-1(b)(1)(ii)(B) or (C), any trust (as defined in 2652(b)) in existence on September 25, 1985, is considered an irrevocable trust. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(4)(i) 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 will not cause the trust to lose its exempt status. Section 26.2601-1(b)(4)(i)(D) 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 section 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. 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.

In this case, Trust was irrevocable on September 25, 1985, and no additions, constructive or actual, have been made to Trust or Trust A after that date. The parties propose to divide Trust A into equal and separate trusts, Trust 1, to benefit Grandchild 1 and his issue and Trust 2, to benefit Grandchild 2 and her issue. Trust 1 and Trust 2 will each have provisions identical to those of Trust A. The proposed division of Trust A

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into Trust 1 and Trust 2 will not shift a beneficial interest in the trusts to any beneficiary who occupies a lower generation than the persons who held the beneficial interest prior to the division. The proposed division will not extend the time for vesting of any beneficial interest in the trusts beyond the time provided for in Trust. Accordingly, based on the facts submitted and the representations made, and provided that there are no further additions to the trusts after September 25, 1985, we conclude that after the division, Trust 1 and Trust 2 will be treated as trusts that were irrevocable on September 25, 1985, and Trust 1 and Trust 2 will be exempt from the GST tax imposed under section 2601. Further, the proposed division will not constitute an addition to Trust 1 or Trust 2. Accordingly, future distributions from Trust 1 and Trust 2 will be exempt from GST tax.

Ruling 4

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

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

In this case, upon the division of Trust A into Trust 1 and Trust 2, each beneficiary of the trusts will have the same beneficial interest as he or she had under Trust A. 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 proposed division of Trust A into Trust 1 and Trust 2 will not cause any beneficiary of these trusts to have made a transfer subject to gift tax under section 2501.

Ruling 5

Section 61(a)(3) provides that gross income includes gains derived from dealings in property. On the sale or other disposition of property, section 1001 provides for the computation of gain or loss, the amount realized, and the recognition of gain or loss.

Section 1.1001-1(a) of the Income Tax Regulations provides, in part, that the exchange of property for other property differing materially in either kind or in extent is treated as income or as loss sustained.

Based on the information submitted and the representations made, the proposed partition of Trust A would merely divide the assets of Trust A into two trusts, Trust 1 and Trust 2, with the same terms as Trust A. The interests of the beneficiaries of Trust A in the trust assets would not be changed by the proposed transaction. Accordingly, the partition of Trust A into the two successor trusts, Trust 1 and Trust 2, will not constitute a taxable event under section 1001.

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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(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any tax return to which it is relevant. 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,
Lorraine E. Gardner
Assistant to the Branch Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure (1)
Copy for § 6110 purposes