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Department of the Treasury
Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:04

PLR-125213-14

Date:

December 22, 2014

Re:

LEGEND

Settlor =
Trust =

Child A =
Child B =
Child C =
Child D =
Child E =
Spouse =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Corporate Trustee =
Grandchild 1 Trust =

Grandchild 2 Trust =

Grandchild 3 Trust =

Grandchild 4 Trust =

Date 1 =

Date 2 =
State =
State Court =

Cite 1 =
Cite 2 =

Dear :

This responds to your authorized representative's letter dated June 26, 2014, requesting rulings on the income, gift, estate, and generation-skipping (GST) tax consequences of a proposed division and modification of a trust.

FACTS

On Date 1 (a date before September 25, 1985), Settlor executed a trust agreement (Trust Agreement) under which he irrevocably created and funded five trusts, one such trust for each of his children.

Article First(A) of the Trust Agreement provides that the principal shall be divided into five equal shares, respectively, by the names of Settlor's children, Child A, Child B, Child C, Child D, and Child E.

Article First(B) of the Trust Agreement provides that each share shall constitute and be administered as a separate trust and be disposed of as follows:

Article First(B)(1) provides that the trust shall terminate upon the death of the settlor's child whose name identifies the trust, except that if that child is survived by a spouse, the trust shall continue and terminate on the death of the spouse.

Article First(B)(2) provides that, during the term of the trust, the trustees shall pay as much income and principal of the trust, at any time or from time to time, to any one or more persons within a group consisting of the settlor's child whose name identifies the trust, that child's spouse, and the child's children, grandchildren, and their spouses, giving from time to time as the trustees shall determine in their discretion. The trustees shall accumulate and add to principal income not paid to the beneficiaries.

Article First(B)(3) provides that, upon termination of the trust, the trustees shall distribute whatever principal then remains in the trust to the then living issue, per stirpes, of the child of the settlor whose name identifies the trust, or in default of such issue, to the settlor's then living issue, per stirpes.

Article First(B)(5) provides that principal that becomes distributable upon termination of the trust to a beneficiary who has not then attained the age of 30 years shall not be distributed to that beneficiary. Until the beneficiary attains the age of 30 years, the trustees shall pay to him or her as much trust income and principal as the trustees shall determine in their discretion. When the beneficiary attains the age of 25 years, the trustee shall distribute to him or her one-half of whatever principal then remains in the trust, or one-half of the original principal of the trust, as the case may be. When the beneficiary attains the age of 30 years, the trustees shall distribute to him or her whatever principal then remains in the trust. If the beneficiary dies before attaining the age of 30 years, the trustees shall distribute whatever principal remains in the trust at the beneficiary's death to the beneficiary's then living children in equal shares, or in default of such children, to the then living issue, per stirpes, of the beneficiary's parent who was an issue of the settlor.

Child A Trust was created pursuant to Article First(A) of the Trust Agreement and is administered in accordance with its provisions. Corporate Trustee is the current trustee. The governing law for the administration of Child A Trust is State. It is represented that no additions have been made to Child A Trust after September 25, 1985.

Currently, Child A is married to Spouse. Child A has four living children, Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4.

Under State law, on the application of a trustee, a court at any time may modify the terms of a trust if, because of circumstances not anticipated by the settlor, compliance with the terms of the trust would impair the accomplishment of a material purpose of the trust. Cite 1. In modifying the trust, a court may amend or change the terms of the trust and terminate the trust in whole or in part. Cite 2.

Division and Modification

Due to the differences in the objectives and needs relating to Child A's four children, Corporate Trustee filed a complaint in State Court for a judicial modification of Child A Trust. On Date 2, State Court issued an order authorizing Corporate Trustee to divide Child A Trust into four separate trusts, Grandchild 1 Trust, Grandchild 2 Trust, Grandchild 3 Trust, and Grandchild 4 Trust (collectively, the Grandchild Trusts).

Upon the division of Child A Trust, each asset of Child A Trust will be allocated equally (one-fourth) to each of the four Grandchild Trusts. Corporate Trustee will be the trustee of each Grandchild Trust.

Each such Grandchild Trust will be governed by the following terms, in addition to the other terms of the Trust Agreement that will continue to apply to each Grandchild Trust.

- (i) The respective Grandchild Trust shall terminate on the death of Child A, except that if Child A is survived by a spouse, that Grandchild Trust shall continue and terminate on the death of the spouse.
- (ii) During the term of a Grandchild Trust, the trustees shall pay as much income and principal of the trust to any one or more persons within a group consisting of Child A, Child A's spouse, the respective Grandchild, that Grandchild's children, and the spouses of that Grandchild and that Grandchild's children living from time to time as the trustees shall determine in their discretion.
- (iii) Upon termination of a Grandchild Trust, the trustees shall distribute whatever principal then remains in that Grandchild Trust to that respective Grandchild, or if that Grandchild is not living, to that Grandchild's then living issue, per stirpes, or if none, to Child A's then living issue per stirpes, or if none, to Settlor's then living issue per stirpes.

You have asked us to rule that the division and modification of Child A Trust, as described above:

- (1) Will not cause Child A Trust or the resulting four Grandchild Trusts to lose their exempt status and will not cause a distribution from or termination of any interest in Child A Trust or the resulting four Grandchild Trusts to be subject to GST tax under § 2601 of the Internal Revenue Code.
- (2) Will not result in the realization by Child A Trust, a Grandchild Trust, or a beneficiary of such trusts of income, gain or loss under § 61, 661 or 1001.
- (3) Will result in each Grandchild Trust being treated as a separate trust under § 643(f).
- (4) Will result in each Grandchild Trust holding its share of Child A Trust property with the same basis as when owned by Child A Trust at the time of the division under § 1015, and with a holding period for such property that includes Child A Trust's holding period under § 1223.
- (5) Will not cause any portion of the assets of Child A Trust or a Grandchild Trust to be includible in the gross estate of any beneficiary of Child A Trust or a Grandchild Trust under §§ 2036 through 2038.
- (6) Will not be a transfer by any beneficiary of Child A Trust or a Grandchild Trust subject to gift tax under § 2501.

LAW AND ANALYSIS

Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition 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 generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains exempt status for generation-skipping transfer tax purposes. 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 § 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)(E) Example 5, describes a situation where, in 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, 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 for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be

distributed equally to A's issue, *per stirpes*. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, *per stirpes*. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The example concludes that 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.

In this case, Child A Trust was irrevocable on September 25, 1985. It is represented that there have been no actual or constructive additions to Child A Trust after September 25, 1985.

The dispositive terms of each resulting Grandchild Trust will be identical to the dispositive terms of Child A Trust and to each other, except that the beneficiaries authorized to receive distributions during the term of a respective Grandchild Trust, other than Child A and Child A's spouse, if any, will be limited to the respective Grandchild, that Grandchild's children, and the spouses of the Grandchild and that Grandchild's children.

Based on the facts submitted and the representations made, the division and modification of Child A Trust, as described above, will not result in a shift of any beneficial interest in Child A Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division. Further, the division and modification will not extend the time for vesting of any beneficial interest in the Grandchild Trusts beyond the period provided for under Child A Trust.

We conclude that the division and modification of Child A Trust, with the resulting Grandchild 1 Trust, Grandchild 2 Trust, Grandchild 3 Trust and Grandchild 4 Trust, will not cause Child A Trust or any of the four divided trusts to lose exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986. Accordingly, Child A Trust and the four divided trusts will not be subject to the provisions of Chapter 13.

Ruling 2

Section 61(a)(3) and (15) provide that gross income includes gains derived from dealings in property and income from an interest in a trust.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the 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.

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 662(a) provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

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 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 (conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature and the partition of a joint tenancy in stock are not sales or exchanges).

Similarly, divisions of trusts are also not sales or exchanges of trust interests where each asset is divided pro rata among the new trusts. See Rev. Rul. 69-486 1969-2 C.B. 159 (pro rata distribution of trust assets not a sale or exchange).

Here, the division of Child A Trust and the equal allocation of all of its assets into the four resulting trusts, Grandchild 1 Trust, Grandchild 2 Trust, Grandchild 3 Trust, with the same terms as Child A Trust will not result in any shift in beneficial interest in the assets of Child A Trust. Accordingly, the division of Child A Trust, as described, will not result in the realization of gain or loss under §§ 61 and 1001. In addition, because the division of Child A Trust is not a taxable event under § 1001, the holding period of the assets that the Grandchild Trusts receive from Child A Trust will include the period that Child A Trust held those assets.

Based on the facts submitted and representations made, we conclude that the division of Child A Trust to create Grandchild 1 Trust, Grandchild 2 Trust, Grandchild 3 Trust, and Grandchild 4 Trust is not a distribution under § 661 or § 1.661(a)-2(f). Accordingly, the proposed division will not result in the realization by Child A Trust, a Grandchild Trust, or any beneficiary of Child A Trust or a Grandchild Trust of any income, gain, or loss under § 662 or § 1.661(a)-2(f).

Ruling 3

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 that was irrevocable on March 1, 1984, it shall apply only to that portion of the trust that is attributable to contributions of corpus after March 1, 1984.

The trustee represents that upon division each resulting Grandchild Trust will have different beneficiaries. Based on the facts submitted and representations made, we conclude that as long as each Grandchild Trust created by the division of Child A Trust is separately managed and administered, the trusts will be treated as separate trusts for federal income tax purposes.

Ruling 4

Section 1015(a) provides that if the property was acquired by gift, 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 the basis (adjusted for the period before the date of the gift as provided in § 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 the fair market value.

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 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 by 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 a 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 a 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.

Based on the facts submitted and representations made, we conclude that because § 1001 does not apply to the division of the trust assets, under § 1015 the basis of the trust assets will be the same after the modifications and division of Child A Trust as the basis of those assets before the modifications and division.

Ruling 5

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2036(a) provides 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 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 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 after September 7, 1916, 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 (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), 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 that the value of the decedent's 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 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 three-year period on the date of the decedent's death.

In order for §§ 2036 through 2038 to apply, a decedent must have 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 this case, no person made a transfer to Child A Trust or the four resulting trusts other than Settlor on Date 1. Accordingly, we conclude that neither the amendment to Child A Trust nor the trustees' division of that trust into Grandchild 1 Trust, Grandchild 2 Trust, Grandchild 3 Trust and Grandchild 4 Trust will constitute a transfer by the beneficiaries of Child A Trust or any Grandchild Trust within the meaning of §§ 2036 through 2038. For this reason, neither the division nor the amendment will cause the property of those trusts to be includible in the gross estate of any beneficiary by reason of §§ 2036 through 2038.

Ruling 6

Section 2501 provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual resident or nonresident. Section 2511 provides that the tax imposed by § 2501 will apply 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 25.2511-1(c) of the Gift Tax Regulations provides 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.

The division of Child A Trust into Grandchild 1 Trust, Grandchild 2 Trust, Grandchild 3 Trust and Grandchild 4 Trust, as described above, will not result in any change in the beneficial interests of any of the trust beneficiaries. Accordingly, based on the facts submitted and representations made, neither the amendment to Child A Trust nor the division of that trust into the Grandchild Trusts will cause the beneficiaries of Child A Trust or any Grandchild Trust to have made a taxable gift for federal gift tax purposes.

Except as expressly provided herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

These rulings are directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code 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 your authorized representatives.

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,

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:

Copy of letter for section 6110 purposes