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Person To Contact:
, ID No.
Telephone Number:

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February 06, 2004

Legend

Grantor =
Trust 1 =

Trust 2 =

Date 1 =
Spouse =
Child 1 =
Date 2 =
Child 2 =
Child 3 =
Child 4 =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
State =
Trust A =

Trust B =
Trust C =
Trust D =
Date 3 =
Court =
Date 4 =
Trust E =

Trust F =

Trust G =

y =
z =
Trust H =

Trust J =

Trust K =

Dear Sir:

This letter responds to your letter, dated June 13, 2003, requesting rulings under §§ 61, 661, 1001, 1015, 1223, 2036, 2037, 2038, 2501, and 2601 of the Internal Revenue Code.

Grantor created Trust 1 and Trust 2 on Date 1. Trust 1 was created for the benefit of Spouse and the issue of Grantor and Spouse. Trust 2 was created for the benefit of Child 1 and the issue of Child 1. Spouse died on Date 2. Grantor and Spouse had four children: Child 1, Child 2, Child 3, and Child 4. Child 1 has four children: Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4.

Trust 1

Article Two(a) of the Trust 1 agreement provides that the trustees may, in their discretion, accumulate the income of Trust 1 and add it to principal or, at any time or from time to time, distribute any part or all of the income and principal of Trust 1 to or among Grantor's lineal descendants and their spouses, and Spouse.

Article Two(b) provides that the distributions authorized under Article Two(a) may be outright or in further trust for any one or more of the classes among which the trustees may distribute. However, any distribution to a new trust shall be made so that no part of the income or principal of such new trust will at any time be distributed to any person to whom a distribution could not have been made under Trust 1.

Article Two(c) provides that if not otherwise terminated sooner, Trust 1 shall terminate twenty years and eleven months after the death of the last survivor of Spouse and all of Grantor's lineal descendants living at the time of creation of Trust 1. Upon termination, the trustees shall distribute all property remaining in Trust 1, including all principal and undistributed income, per stirpes, to Grantor's lineal descendants to whom the trustees were authorized to make distributions from such trust immediately before such termination.

Article Two(d) provides that if not otherwise terminated sooner, Trust 1 shall terminate upon the death of the last survivor of Spouse and Grantor's lineal descendants, whenever born. Upon such termination, the trustees may distribute the remaining Trust 1 property to any one or more of any surviving spouse of Grantor's lineal descendants. The trustees shall also distribute the rest of the property, if any, to and among the persons who would have been entitled to Grantor's personal property, and in such proportions as they would have been entitled to, immediately following the death of the last survivor of Spouse and Grantor's lineal descendants if Grantor died intestate, domiciled in State. No distribution under this paragraph may be made after the time for termination of Trust 1 under Article Two(c).

Article Four(a) provides, in relevant part, that the trustees have the power and discretion to act as they deem proper in any recapitalization, merger, reorganization, consolidation, partition or other transaction affecting any of the property held by them.

In order to better serve beneficiaries with differing needs, the trustees of Trust 1 split Trust 1 into four trusts: Trust A, Trust B, Trust C, and Trust D (one each for the benefit of each of the Grantor's children, that child's issue, that child's spouse, and the spouse of any of the child's issue). The Service issued a favorable private letter ruling regarding the federal income, gift, estate, and generation-skipping transfer tax consequences of this transaction on Date 3. Trust A is the trust created for the benefit of Child 1 and his family line. The dispositive terms of Trust A are identical to the terms of Trust 1, except that the discretionary distributions of income and principal in Trust A are limited to the members of Child 1's family line.

<u>Trust 2</u>

Article Two(a) of the Trust 2 agreement provides that the trustees may, in their discretion, accumulate the income of Trust 2 and add it to principal or, at any time or from time to time, distribute any part or all of the income and principal of Trust 2 to or among Child 1, Child 1's spouse, Child 1's lineal descendants, and the spouses of any of Child 1's lineal descendants.

Article Two(b) provides that the distributions authorized under Article Two(a) may be outright or in further trust for any one or more of the classes among which the trustees may distribute. However, any distribution to a new trust shall be made so that no part of the income or principal of such new trust will at any time be distributed to any person to whom a distribution could not have been made under Trust 2.

Article Two(c) provides that if not otherwise terminated sooner, Trust 2 shall terminate twenty years and eleven months after the death of the last survivor of all of Grantor's lineal descendants living at the time of creation of Trust 2. Upon termination, the trustees shall distribute all property remaining in Trust 2, including all principal and undistributed income, per stirpes, to Grantor's lineal descendants to whom the trustees were authorized to make distributions from such trust immediately before such termination.

Article Two(d) provides that if not otherwise terminated sooner, Trust 2 shall terminate upon the death of the last survivor of Grantor's lineal descendants, whenever born. Upon such termination, the trustees may distribute the remaining Trust 2 property to any one or more of any surviving spouse of Grantor's lineal descendants. The trustees shall also distribute the rest of the property, if any, to and among the persons who would have been entitled to Grantor's personal property, and in such proportions as they would have been entitled to, immediately following the death of the last survivor of Grantor's lineal descendants if Grantor died intestate, domiciled in State. No distribution under this paragraph may be made after the time for termination of Trust 2 under Article Two(c).

Article Four(a) provides, in relevant part, that the trustees have the power and discretion to act as they deem proper in any recapitalization, merger, reorganization, consolidation, partition or other transaction affecting any of the property held by them.

Proposed Transaction

The current beneficiaries of Trust A and Trust 2 are identical and the operative provisions of the trust agreements are identical. The beneficiaries have differing personal and financial situations and as a result, they have differing financial needs concerning distributions of principal and income. The trustees recommended splitting the trusts pursuant to the authority granted them in the Trust Agreement. The beneficiaries, however, disagreed as to the appropriate methodology for splitting the trusts and ultimately challenged the trustee's decision in Court. Court entered an order on Date 4, providing that effective upon receipt of a favorable ruling by the Internal Revenue Service, Trust A and Trust 2 would each be divided into three trusts. The resulting trusts with the same beneficiaries would then be merged together.

According to the Date 4 Court order, Trust A shall be divided into Trust E, Trust F, and Trust G (collectively referred to as the "Trust A Resulting Trusts"). Trust E will be for the benefit of Child 1, Child 1's spouse, Child 1's lineal descendants other than Grandchild 1 and Grandchild 2, and the spouses of Child 1's lineal descendants other than Grandchild 1 and Grandchild 2 (collectively referred to as "Child 1's limited family line"). Trust F will be for the benefit of Grandchild 1, Grandchild 1's spouse, the lineal descendants of Grandchild 1, and the spouses of the lineal descendants of Grandchild 1 (collectively referred to as "Grandchild 1's family line"). Trust G will be for the benefit of Grandchild 2, Grandchild 2's spouse, the lineal descendants of Grandchild 2, and the spouses of the lineal descendants of Grandchild 2 (collectively referred to as "Grandchild 2's family line").

Trust A will be divided so that y% of the assets of Trust A, determined at the time of division, will be allocated to Trust E, z% will be allocated to Trust F, and z% will be allocated to Trust G. The funding of the Trust A Resulting Trusts will generally be on a fractional basis; however, each asset need not be distributed strictly pro rata provided that the assets selected for each Trust A Resulting Trust from each asset class must be fairly representative of the appreciation, depreciation and tax basis of the assets available for distribution from such class. Any loans which have been made by Trust A to any beneficiary shall be among the assets distributed to the Trust A Resulting Trust of which the borrower is a beneficiary.

Following the proposed division, the dispositive terms of each of the Trust A Resulting Trusts will be identical to the dispositive terms of Trust A, except that the discretionary distributions of income and principal of each Trust A Resulting Trust would be limited to the members of Child 1's limited family line, Grandchild 1's family line, or Grandchild 2's family line. Upon the death of the last survivor of Grandchild 1, Grandchild 2's family line will be first-tier contingent remainder beneficiaries of the trust for the benefit of Grandchild 1's family line unless that trust is terminated sooner. Upon the death of the last survivor of Grandchild 2, Grandchild 1's family line will be first-tier contingent remainder beneficiaries of the trust for the benefit of Grandchild 2's family line unless that trust is terminated sooner. Upon the death of the last survivor of Grandchild 1 and Grandchild 2, the trust for the benefit of Child 1's limited family line will be first-tier contingent remainder beneficiaries of the trusts for the benefit of Grandchild 1 and Grandchild 2's family lines unless those trusts are terminated sooner. Upon the death of the last survivor of Child 1 other than Grandchild 1 and Grandchild 2, the trusts for the benefit of Grandchild 1's family line and Grandchild 2's family line will be first-tier contingent remainder beneficiaries of the trust for the benefit of Child 1's limited family line unless that trust is terminated sooner. All of the resulting trusts will terminate no later than twenty years and eleven months after the death of the last survivor of Spouse and all of Grantor's lineal descendants living on Date 1.

Furthermore, Trust 2 shall be divided into Trust H, Trust J, and Trust K (collectively referred to as the "Trust 2 Resulting Trusts"). Trust H will be for the benefit of Child 1's limited family line. Trust J will be for the benefit of Grandchild 1's family line. Trust K will be for the benefit of Grandchild 2's family line.

Trust 2 will be divided so that y% of the assets of Trust 2, determined at the time of division, will be allocated to Trust H, z% will be allocated to Trust J, and z% will be allocated to Trust K. The funding of the Trust 2 Resulting Trusts will generally be on a fractional basis; however, each asset need not be distributed strictly pro rata provided that the assets selected for each Trust 2 Resulting Trust from each asset class must be fairly representative of the appreciation, depreciation and tax basis of the assets available for distribution from such class. Any loans which have been made by Trust 2 to any beneficiary shall be among the assets distributed to the Trust 2 Resulting Trust of which the borrower is a beneficiary.

Following the proposed division, the dispositive terms of each of the Trust 2 Resulting Trusts will be identical to the dispositive terms of Trust 2, except that the discretionary distributions of income and principal of each Trust 2 Resulting Trust would be limited to the members of Child 1's limited family line, Grandchild 1's family line, or Grandchild 2's family line. Upon the death of the last survivor of Grandchild 1, Grandchild 2's family line will be first-tier contingent remainder beneficiaries of the trust for the benefit of Grandchild 1's family line unless that trust is terminated sooner. Upon the death of the last survivor of Grandchild 2, Grandchild 1's family line will be first-tier contingent remainder beneficiaries of the trust for the benefit of Grandchild 2's family line unless that trust is terminated sooner. Upon the death of the last survivor of Grandchild 1 and Grandchild 2, the trust for the benefit of Child 1's limited family line will be first-tier contingent remainder beneficiaries of the trusts for the benefit of Grandchild 1 and Grandchild 2's family lines unless those trusts are terminated sooner. Upon the death of the last survivor of Child 1 other than Grandchild 1 and Grandchild 2, the trusts for the benefit of Grandchild 1's family line and Grandchild 2's family line will be first-tier contingent remainder beneficiaries of the trust for the benefit of Child 1's limited family line unless that trust is terminated sooner. All of the resulting trusts will terminate no later than twenty years and eleven months after the death of the last survivor of Spouse and all of Grantor's lineal descendants living on Date 1.

After the divisions of Trust A and Trust 2, Trust E and Trust H will be merged together; Trust F and Trust J will be merged together; and Trust G and Trust K will be merged together.

Rulings Requested

The trustees have requested the following rulings relating to the proposed division and merger of these trusts: (1) The proposed division of Trust A and Trust 2 and the proposed allocation of each existing asset among the resulting trusts will not cause Trust A, Trust 2, or the resulting trusts to lose their status as grandfathered trusts that are exempt from the generation-skipping transfer tax and will not cause a distribution from, or termination of any interests in Trust A, Trust 2, or any of the resulting trusts to be subject to the generation-skipping transfer tax; (2) the merger of the resulting trusts into trusts with identical terms will not cause the resulting trusts to lose their status as grandfathered trusts that are exempt from the generation-skipping transfer tax and will not cause a distribution from, or termination of any interests in any of the resulting trusts to be subject to the generation-skipping transfer tax; (3) the resulting trusts will be treated as separate taxpayers under § 643(f); (4) the proposed division and merger will not result in the realization by Trust A, Trust 2, or the resulting trusts, or a beneficiary of Trust A, Trust 2, or the resulting trusts of any income, gain, or loss under § 661; (5) the proposed division and merger will not result in the realization of any income, gain, or loss under § 61 or § 1001 by Trust A, Trust 2, the resulting trusts, or a beneficiary of Trust A, Trust 2, or the resulting trusts; (6) the proposed division and merger will result in resulting trusts with assets that have the same basis as they had at the time of the allocation under § 1015; (7) the holding periods for all the assets allocated to each resulting trust will include Trust A or Trust 2's holding period, respectively, under § 1223; (8) the proposed division and merger will not cause any portion of the assets of Trust A, Trust 2, or any of the resulting trusts to be includible in the gross estate of any beneficiary of Trust A, Trust 2, or the resulting trusts under §§ 2036 through 2038; and (9) the proposed division and merger will not constitute a transfer by any beneficiary of Trust A, Trust 2, or the resulting trusts that will be subject to the gift tax under § 2501.

Rulings 1 and 2

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

Section 2611(a) defines the term "generation-skipping transfer" to include a taxable distribution, taxable termination, and a direct skip.

Under § 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, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) 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) of the Generation-Skipping Transfer Tax Regulations provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, Trust A and Trust 2 are considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

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 generation-skipping transfer 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. 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 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)(1) 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) of this section) 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 in the original trust. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), Example 1, provides that in 1980, Grantor established an irrevocable trust (Trust) for the benefit of Grantor's child, A, A's spouse, and A's issue. At the time Trust was established A had two children, B and C. A corporate fiduciary was designated as trustee. Under the terms of Trust, the trustee has the discretion to distribute all or part of the trust income to one or more of the group consisting of A, A's spouse, or A's issue. The trustee is also authorized to distribute all or part of the trust principal to one or more trusts for the benefit of A, A's spouse, or A's issue under terms specified by the trustee in the trustee's discretion. Any trust established under Trust, however, must terminate twenty-one years after the death of the last child of A to die who was alive at the time Trust was executed. Trust will terminate on the death of A, at which time the remaining principal will be distributed to A's issue, per stirpes. In 2002, the trustee distributes part of Trust's principal to a new trust for the benefit of B and C and their issue. The new trust will terminate 21 years after the death of the survivor of B and C, at which time the trust principal will be distributed to the issue of B and C, per stirpes. The terms of the governing instrument of Trust authorize the trustee to make the distribution to a new trust without the consent or approval of any beneficiary or court. In addition, the terms of the governing instrument of the new trust do not extend the time for vesting of any beneficial interest in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of Trust, extending beyond any life in being at the date of creation of Trust plus a period of twenty-one years, plus if necessary, a reasonable period of gestation. Therefore, neither Trust nor the new trust will be subject to the provisions of chapter.

Section 26.2601-1(b)(4)(i)(E), Example 6, provides that in 1980, Grantor established an irrevocable trust for Grantor's child and the child's issue. In 1983, Grantor's spouse also established a separate irrevocable trust for the benefit of the same child and issue. The terms of the spouse's trust and Grantor's trust are identical. In 2002, the appropriate local court approved the merger of the two trusts into one trust to save administrative costs and enhance the management of the investments. The merger of the 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 merger. In addition, the merger 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 trust that resulted from the merger will not be subject to the provisions of chapter 13.

In this case, Trust A and Trust 2 are generation-skipping transfer trusts because they provide for distributions to more than one generation of beneficiaries below the grantor's generation. Date 1 is prior to September 25, 1985, and Trust A and Trust 2 were irrevocable on September 25, 1985. Trust A and Trust 2, therefore, are exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i).

The division of Trust A and Trust 2 proposed by the trustees is within the authority granted to them in the original trust agreements. The beneficiaries challenged the trustees' methodology for computing the fractional shares of Child 1's limited family line, Grandchild 1's family line and Grandchild 2's family line. Court ultimately issued an order authorizing the division and merger of the trusts. Because the terms of the resulting trusts will be the same as the terms of the original trusts, the proposed division and merger of the trusts does not shift a beneficial interest 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. In addition, the proposed transactions do not extend the time for vesting of any beneficial interest in either trust beyond the period provided in the original trust. Based on the facts submitted and the representations made, we conclude that the proposed division of Trust A and Trust 2 and the subsequent mergers of the various resulting trusts will not affect Trust A or Trust 2's status as exempt from the generation-skipping transfer tax. As a result, the proposed divisions and mergers will not cause distributions from or terminations of any interests in Trust A, Trust 2 or any of the resulting trusts to be subject to the generation-skipping transfer tax.

Ruling 3

Section 643(f) provides that, for purposes of subchapter J, 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 the trusts is the avoidance of the tax imposed by chapter 1.

While the Trust A Resulting Trusts have the same grantor, they have different beneficiaries. Therefore, we conclude that each of the Trust A Resulting Trusts will be treated as separate trusts for federal income tax purposes under § 643(f). Similarly, the Trust 2 Resulting Trusts have the same grantor but different beneficiaries. Therefore, we conclude that each of the Trust 2 Resulting Trusts will be treated as separate trusts for federal income tax purposes under § 643(f).

Ruling 4

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)(1) of the Income Tax Regulations provides that if property is paid, credited, or required to be distributed in kind, no gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of the distribution, unless the distribution is in satisfaction of a right to receive a distribution in a specific dollar amount or in specific property other than that distributed.

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.

Based solely on the facts submitted and the representations made, we conclude that the division of Trust A into the Trust A Resulting Trusts is not a distribution under § 661 or § 1.661(a)-2(f)(1). Similarly, the division of Trust 2 into the Trust 2 Resulting Trusts is not a distribution under § 661 or § 1.661(a)-2(f)(1).

Rulings 5, 6 and 7

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 such section for determining loss over the amount realized.

Section 1.1001-1(a) provides that except as otherwise provided in subtitle A, 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.

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.

Section 1223(2) provides that, in determining the period for which a taxpayer has held property however acquired, there shall be included the period for which such property was held by any other person, if under chapter 1 of subtitle A 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 his hands as it would have in the hands of such other person. See also § 1.1223-1(b).

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.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that the assets of the trusts will be allocated accordingly to their respective interests evenly among the three resulting trusts. The assets of the original trusts will be divided fractionally and distributed to the resulting trusts in accordance with the respective fractional interest of each of the resulting trusts. Each asset may not be distributed strictly pro rata, but the assets selected for each trust will be fairly representative of the appreciation, depreciation, and tax bases of the assets available for distribution. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets among the beneficiaries of the 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. 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 than an exchange of property gives rise to a realization event under § 1001 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" 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.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that the interests of the beneficiaries of the three resultant trusts will not differ materially from their interests in the original trusts. 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 divided, but all other provisions of the trusts will remain substantially identical. Thus, the proposed transaction will not result in a material difference in the kind or extent of the legal entitlements enjoyed by the beneficiaries.

Based upon the facts submitted and the representations made, we conclude that the division of Trust A and Trust 2, with the division of the assets of the trusts among the three separate trusts, and the subsequent merger of each of the three resultant trusts into its corresponding trust will not constitute a sale or other taxable disposition of the assets of the trusts under § 1001. 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 partition as the basis of those assets before the partition. Furthermore, pursuant to § 1223, the holding periods of the assets in the hands of the new trusts will include the holding periods of the assets in the original trusts.

Ruling 8

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 an 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(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 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 the property, 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 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, either by the decedent alone or in conjunction with any person, to alter, amend, revoke, or terminate, or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

In order for §§ 2036-2038 to apply, the 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 the present case, the proposed division and merger of trusts does not constitute a transfer within the meaning of §§ 2036-2038. The beneficiaries of the resulting trusts will have the same interest after the division and merger as they had as beneficiaries before. We therefore conclude that the proposed division and merger will not cause the interest of any beneficiary of the original trust or the resulting trusts to be includible in the beneficiary's gross estate under §§ 2036-2038.

Ruling 9

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual, resident or nonresident.

Section 2511(a) 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 the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate and full 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 to be a gift, and is included in computing the amount of gifts made during the calendar year.

In this case, the beneficiaries of the resulting trusts will have the same interests after the proposed division and merger that they had as beneficiaries under the original trust so there is no direct transfer of assets. Because the beneficial interests, rights, and expectancies of the beneficiaries are substantially similar, 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 division of the original trusts and the allocation of assets among the resulting trusts as proposed is not a transfer, direct or indirect, of property that will be subject to the gift tax imposed by § 2501.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

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.

Sincerely,

James F. Hogan
Acting Branch Chief
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure
Copy of Letter for § 6110 purposes

cc: