

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

May 1, 2000

Legend:

Date 1:
Decedent:
Date 2:
Date 3:
Date 4:
Date 5:
Trust:

Daughter:
Grandson:
Granddaughter 1:
Granddaughter 2:
Individual:
Trust 2:

Trustee:
Court:

State:
Date 6:

Dear

We received the March 22, 1999, letter and later submissions requesting rulings concerning the income, gift, and generation-skipping transfer (GST) tax consequences of the proposed division of a trust. This letter responds to that request.

The facts and representations submitted are as follows: On Date 1, Decedent executed his will, which was amended by Codicil on Date 2, by Second Codicil on Date 3, and by Third Codicil on Date 4. Decedent died on Date 5, which was before January 1, 1987.

Trust was created for the benefit of Daughter and her family under Decedent's will. Article FOURTH, Section K of the will, as amended, contains the dispositive provisions of Trust.

Article FOURTH, Section K of the will, as amended, provides that in the event Daughter, Grandson, Granddaughter 1, and Granddaughter 2, and any other issue of Daughter now born or hereafter to be born, and Individual [now deceased], or any of them, survive Decedent, the residue and remainder of Decedent's estate is to be transferred in trust.

Article FOURTH, Section K, paragraph 1 of the will, as amended, provides that the trustee is to pay such amounts as requested by Decedent's executor for the satisfaction and payment of estate and inheritance taxes, debts and administration expenses as may be required by Decedent's executor.

Article FOURTH, Section K, paragraph 4 of the will, as amended, provides that in the event Daughter survives Decedent and should become widowed or divorced at any time, the trustee shall pay to her or for her benefit so long as she is widowed or divorced so much of the residue of the net income and/or corpus as may be necessary to take care of her expenses if she be in need because of accident, illness, infirmity, or other misfortune, and such payment shall be strictly limited to necessities such as medical bills, food and clothing, and only after the trustee has taken into consideration her income and other means of support from all other sources known to the trustee and further, that such payments shall be made only after the satisfaction by the trustee of the administrative expenses of the trust and the payments of the expenses to be made under paragraphs 1 and 2 of Section K of Article FOURTH.

Article FOURTH, Section K, paragraph 5(a) of the will, as amended, provides that the trustee is to pay for the benefit of Grandson, Granddaughter 1, Granddaughter 2, and any other issue of Daughter to be born, while said issue are under the age of twenty-one years of age, the educational expenses of tuition, lodging, board, books and laundry, while said grandchildren are attending boarding school or college, including graduate institutions, but said expenses shall be paid directly by the trustee to the school, college, or particular institution which bills same; and the trustee is further authorized to pay for the benefit of said Grandchildren other expenses if they be in need because of accident, illness, or other misfortune; however, the trustee shall only make these additional payments after taking into consideration the grandchild's income and other means of support from all sources known to the trustee, and the trustee is to pay such expenses directly.

Article FOURTH, Section K, paragraph 5(b) of the will, as amended, provides that as each grandchild reaches the age of twenty-one, he or she shall start receiving his per stirpes share of the current income from the trust, but such payments shall be made only after the satisfaction of the trustee of the administrative expenses of the trust, and the payments and expenses to be made under subparagraphs 1, 2, 4, and 5(a) of Section K of Article FOURTH of the will. Article FOURTH, Section K, paragraph 5(b) of the will further provides that should there be any other

issue born to Daughter subsequent to Decedent's death, the per stirpes shares for the grandchildren shall be adjusted accordingly.

Article FOURTH, Section K, paragraph 5(c) of the will, as amended, provides that the trustee is to add any income of the trust which is not currently distributable to the trust corpus as principal.

Article FOURTH, Section K, paragraph 6 of the will, as amended, provides that when Individual and Daughter have died and the oldest of the grandchildren then living has attained the age of thirty-five years old, the remaining assets of the trust shall be divided, per stirpes, one share for each child then living and one share for each grandchild then deceased with surviving issue; provided, however, that notwithstanding the equal division of the trust assets, the trustee is directed to value the assets that are in Trust 2 (which was established prior to Granddaughter 2's birth for the benefit of Grandson and Granddaughter 1), if said trust is still in existence, and if said trust has terminated, then the trustee shall determine the value of assets at the time said trust terminated, and the trustee shall increase the share of Granddaughter 2 and any other issue born to Daughter to equal the amount of trust assets which passed or are passing to Grandson and Granddaughter 1 from Trust 2. Article FOURTH, Section K, paragraph 6 of the will further provides that prior to final distribution and prior to any grandchild attaining the age of twenty-one years, the trustee shall also pay to or apply for the benefit of each living grandchild so much of the income and principal of his or her respective share as the trustee deems appropriate for his or her support, maintenance, education (including college) and medical care. At such time as each grandchild attains the age of twenty-one years, he or she shall then receive all of the income each year and so much of the principal of his or her respective share as the trustee deems appropriate for his or her support, maintenance, and education (including college) and medical care.

Article FOURTH, Section K, paragraph 7 of the will, as amended, provides that the share of any grandchild who is not living at the time of per stirpes division of Trust, or who is living at the time of division but dies before receiving his or her entire share outright and free from trust, shall go to his or her surviving issue, or if there be no surviving issue, then such deceased grandchild's share shall be added to the shares for the benefit of his or her brothers and sisters or their issue, per stirpes. The share going to the issue of any deceased grandchild may, in the discretion of the trustee, if such issue has not attained the age of twenty-one years, continue to be held in trust. The Trustee shall pay to or for the benefit of any such minor issue so much of the income and principal as the trustee deems appropriate for his or her support, maintenance, education (including college) and medical care, and distribute the then remaining assets to him or her upon attaining the age of twenty-one years, or to the estate of such issue if he or she should die prior to attaining the age of twenty-one years.

Article FOURTH, Section K, paragraph 8 of the will, as amended, provides that notwithstanding any other provision of the will, if any assets are held in trust on the date that is twenty-one years after the date of the last to die of Decedent's descendants living at my death,

such assets shall immediately vest in and be distributed outright to the beneficiary or beneficiaries to whom the income from the trust is then distributable.

Article FOURTH, Section K, paragraph 9 of the will, as amended, provides that in the event Decedent's grandchildren die leaving no issue surviving them, and Daughter and Individual have died, then upon the death of the last of the aforesaid, the trustee shall make prompt distribution in equal shares, per stirpes, to the children of Decedent's sister.

Article FOURTH, Section L of the will, as amended, provides that the interest of any beneficiary of Trust in the principal or income shall not be subject to assignment, alienation, pledge, attachment, or the claims of their creditors.

Article SEVENTH of the will, as amended, provides that any reference in the will to children or grandchildren or issue shall include children or grandchildren born at the time of execution of the will, or born afterwards, but shall not include adopted children.

It is represented that, to date, no payments have been made to Daughter pursuant to Article FOURTH, Section K, paragraph 4 of the will, as amended. It is further represented that the will was in existence on October 21, 1986, and was not amended at any time after October 21, 1986.

At the time Decedent created Trust 2, Decedent had only two grandchildren. After the birth of Decedent's third grandchild, Decedent executed the second codicil to his will, which contains the equalization provisions mentioned above.

The parties ascertained that the language of Article FOURTH, Section K, subparagraph 6 of the will, as amended by the second codicil, creates an ambiguity in the interpretation of the will with respect to the timing concept to be used for such equalization.

The Trustee filed a petition in Court to construe the will. The petition requested that Court:

(1) Decree that the ambiguity in the will should be interpreted to mean that the assets of Trust should have been divided among Decedent's grandchildren on the date Decedent's oldest grandchild attained the age of twenty-one;

(2) Modify the terms of Trust, contingent upon a favorable ruling from the Internal Revenue Service, dividing Trust into four separate trusts, each to be held upon a separate trust to be administered in accordance with the terms of Trust until the termination date; and,

(3) Decree that any invasion of net income and/or principal for the benefit of Daughter pursuant to the terms of Article FOURTH, Section K of the will be made equally from each of the four separate trusts.

The following rulings are requested:

(1) The division of Trust into four separate trusts and the division of its assets among the four new trusts on a pro rata basis will not constitute a taxable disposition of the trust assets for purposes of § 1001;

(2) The division of Trust into four separate trusts and the division of its assets among the four new trusts on a pro rata basis will not result in a transfer that is subject to the gift tax under § 2501; and,

(3) The division of Trust into four separate trusts and the division of its assets among the four new trusts on a pro rata basis will not cause the trusts to lose their grandfathered exempt status for purposes of the generation-skipping transfer tax under § 2601.

Ruling Request 1:

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 the assets of Trust will be divided on a pro rata basis. Also, the purpose of the division will be to resolve ambiguities in the trust agreement. Accordingly, the proposed transaction will not be treated as a pro rata distribution followed by an exchange of assets.

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.

In Cottage Savings, 499 U.S. at 560-61, the Supreme Court 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.

As the Trustee asserts, Trust does appear to be ambiguous. The first paragraph of subparagraph 6 of Section K (as amended by the 1983 codicil) provides that at such time as each grandchild attains the age of twenty-one, he or she shall then receive all of the income each year and so much of the principal of his or her "respective share" as the Trustee deems appropriate for his or her support, maintenance, education (including college) and medical care. Also, prior to reaching age 21, beneficiaries are entitled to payments from the income or principal of their "respective share" for certain specified expenses. Nevertheless, the Trust does not provide for the dividing of the Trust into shares and the only way to pay a grandchild out of his or her respective share would be to divide the Trust into shares and pay a beneficiary only the income or principal from his or her respective share. The same subparagraph discusses an increase in the share of Granddaughter 2 at the time of termination to equalize her share with the assets that passed or are passing to Grandson and Granddaughter 1 from Trust 2. Trust is ambiguous about whether the respective share for purposes of income distributions is the same as the respective share for termination.

The Trustee has indicated that the Supreme Court of State recognizes an equitable remedy of construction of a will in order to ascertain the intent of the testator. It is further represented that a reasonable interpretation of the ambiguous language in the will, in accord with decisions of the Supreme Court of State, would require that the assets of Trust be divided into four separate trusts. If Court determines that Trust is ambiguous, and Court orders the division of Trust into four separate trusts on a pro-rata basis, as described above, in order to resolve the

ambiguity in a way that effectuates the testator's intentions, the proposed division of the trust will not result in a disposition event for purposes of § 1001 of the Code. The division will merely be carrying out the terms of Trust rather than resulting in a disposition. Therefore, it is consistent with § 1001 to conclude that the division of Trust into four separate trusts and the division of the assets among the four new trusts on a pro-rata basis will not constitute a disposition under § 1001 of the Internal Revenue Code.

Ruling Request 2:

Section 2511(a) of the Internal Revenue Code provides that the tax imposed by § 2501 shall 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 2512(a) provides that, if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

Section 2512(b) provides that, if 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 shall be deemed a gift.

State law follows the general rule that the intention of the testator, if not inconsistent with some established rule of law, must control. In ascertaining that intention, the courts must seek to determine what the testator meant by examining the whole of the will, including a codicil thereto, the apparent purpose sought to be accomplished by the testator, and the means used to that end, as well as any other circumstances disclosed by the will which aid in determining such intention.

State law specifically authorizes the trustees of a trust to petition the local court to divide the trust into two or more separate trusts. State Code provides in part, that upon petition by a trustee, the court may, for good cause shown, reform a trust in any manner, including, without limitation, dividing a trust into two or more separate trusts if such action will neither (1) materially impair the accomplishment of the trust purposes nor (2) adversely affect the interests of any beneficiary.

On Date 6, Court issued an order in which it construed the ambiguity created under the will, in light of the testator's intent, and the purpose to be accomplished under the will to mean that the assets of Trust should be immediately divided into four separate trusts as set forth in the petition. In the present case, the intent of the Decedent when Trust was created was that there would be an equalization of assets among the Decedent's grandchildren. Accordingly, we conclude that the judicial construction that follows the petition in this particular case, determining the timing of that division, will not be a transfer by gift under § 2511.

Ruling Request 3:

Section 2601 imposes a tax on every generation skipping transfer made by the "transferor" to a "skip person."

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that the tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii) 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.

Section 26.2601-1(b)(2)(i) provides that the provisions of chapter 13 do not apply to any generation-skipping transfer under a will or revocable trust executed before October 22, 1986, provided that - -

(A) The document in existence on October 21, 1986, is not amended at any time after October 21, 1986, in any respect that results in the creation of, or an increase in the amount of, a generation-skipping transfer;

(B) In the case of a revocable trust, no addition is made to the revocable trust after October 21, 1986, that results in the creation of, or an increase in the amount of, a generation-skipping transfer; and,

(C) The decedent dies before January 1, 1987.

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 26.2611-1 provides that a generation-skipping transfer is an event that is either a direct skip, a taxable distribution, or a taxable termination. The determination as to whether an event is a generation-skipping transfer is made by reference to the most recent transfer subject to the estate or gift tax.

Section 2612(c)(1) defines the term "direct skip" to mean a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613(a) defines the term "skip person" to mean - -

(1) a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor, or

(2) a trust - -

- (i) if all interests in such trust are held by skip persons, and
- (ii) at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Because Decedent's will was in existence on October 21, 1986 (without any modifications thereafter) and because Decedent died prior to January 1, 1987, Trust has been exempt from the GST tax.

An amendment to an exempt trust that modifies or otherwise changes the quality, value, or timing of any of the powers, or beneficial interests, rights, or expectancies originally provided for under the terms of the trust will cause the trust to lose its exemption from the GST.

Based on the facts presented and representations made, we conclude that the proposed division of Trust into four trusts reflects the relative merit of the claims asserted by the parties to the litigation, and the proposed division does not alter the intended quality, value, or timing of any beneficial interests Decedent created in Trust. Accordingly, we conclude that the proposed division will not cause Trust or any of the four trusts created under the proposed division to lose their exempt status for purposes of the GST tax under § 2601.

Except as specifically ruled under the cited provisions of the Code, we express or imply no opinion about the tax consequences of the proposed division under those provisions or under any other provisions of the Code. In particular, we are not ruling on the validity of the specific methodology that will be used to divide the trust assets into shares.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions in this ruling take effect, the ruling will have no force or effect.

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

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

Enclosures:

Copy for § 6110 purposes