Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:P&SI:7-PLR-120315-98
Date:
September 29, 2000

In Re:

Legend:

H:
W:

Trust A:
Trust B:
Trust C:

Child 1:
Child 2:
Child 3:

State:

Applicable State Statute:

x:
y:

Dear

You requested rulings concerning the income, estate, gift, and generation-skipping transfer (GST) tax consequences of a proposed division of each of three trusts into three separate trusts. This letter is in response to your request.

The taxpayers have represented the following facts:

H and W (also referred to collectively as grantors) were husband and wife. H and W are deceased. They were survived by their three children, Child 1, Child 2, and Child 3. At the time of this ruling, there is one surviving child and one surviving spouse of a child of H and W.

Trust A was established under the Will of H, who died in x. Under the terms of Trust A, net income of Trust A is to be distributed per stirpes among H's issue living at the time of the distribution and W. W was to take the same share she would if she were a child of H. After the death of W, net income is to distributed per stirpes among H's issue living at the time of each distribution. Trust A will terminate on the death of the last to die of Child 1, Child 2, and Child 3. On termination, trust property is to be distributed in fee simple among H's issue then living, per stirpes.

The terms of Trust A allow for encroachment of principal for the proper support, maintenance, and education of anyone entitled to income from Trust A. No powers of appointment are conferred by the terms of Trust A.

By deed of gift dated y, W transferred interests in certain real property, including timberland to Child 1, Child 2, and Child 3 and their spouses for their lifetime and then for the lifetime benefit of the descendants of Child 1, Child 2, and Child 3, per stirpes. The terms of the deed of gift do not allow for encroachment of principal. Further, no powers of appointment are conferred by the terms of the deed of gift. Under State law, the terms of the deed of gift establish legal life estates and remainder interests and impose on the life tenants or their successors the fiduciary duties of trustees to manage the property and to hold and administer the proceeds from any sale of the property. The legal estates and equitable interests created by this deed of gift have been administered since the original conveyance as Trust B.

Under the terms of the deed of gift administered as Trust B, Trust B will terminate on the death of the last to die of Child 1, Child 2, and Child 3 and their spouses. On termination of Trust B, trust property is to be distributed in fee simple among the lineal descendants of Child 1, Child 2, and Child 3 then living, per stirpes.

By a separate deed of gift dated y, H transferred interests in certain real property, including timberland for the lifetime benefit of Child 1, Child 2, and Child 3 and then for the lifetime benefit of the descendants of Child 1, Child 2, and Child 3, per stirpes. The terms of the deed of gift do not allow for encroachment of principal. Further, no powers of appointment are conferred by the terms of the deed of gift. Under State law, the terms of the deed of gift establish legal life estates and remainder interests and impose on the life tenants or their successors the fiduciary duties of trustees to manage the property and to hold and administer the proceeds from any sale of the property. The legal estates and equitable interests created by this deed of gift have been administered since the original conveyance as Trust C.

Under the terms of the deed of gift administered as Trust C, Trust C will terminate on the death of the last to die of Child 1, Child 2, and Child 3. On termination of Trust C, trust property is to be distributed in fee simple among the lineal descendants of Child 1, Child 2, and Child 3 then living, per stirpes.

Each of the branches of the family[1] has its own philosophy about the management of the assets of the trusts. There are differences of opinion among the branches of the family concerning the timber management contracts of the trusts and the investment policy of the trusts. As a result, a division of the trusts is desirable to enable the trustees to administer the trusts in the best interests of the beneficiaries.

The interested parties propose to institute a proceeding in State court concerning the division of three trusts and the partition of timberland by life tenants and remaindermen in order to divide each of three family trusts (Trusts A, B, and C) into three separate trusts (for a total of nine trusts), each for the benefit of one of the three branches of the family.

Trust A will be partitioned into Trusts A1, A2, and A3. The terms of Trusts A1, A2, and A3, with respect to income and principal distributions and with respect to termination of the trusts, will be identical to the terms of Trust A, except that each such separate trust after division will be for the sole benefit of one of the three branches of the family. Notwithstanding such division, any encroachment on principal for a beneficiary of a separate trust (A1, A2, or A3) resulting from the division of Trust A will be made pro rata from all of the separate trusts resulting from the division of Trust A (A1, A2, and A3).

The timberland held in Trusts B and C will be legally partitioned into three separate parts. It is represented that the rights of the life tenants and remaindermen with respect to present and future interests in this property and with respect to ultimate vesting in possession of this property will be identical to the rights set forth in the original deeds, except that each separate share after partition will be owned solely by the children and further descendants in one of the three branches of the family.

Trust B, with respect to its remaining assets, will be partitioned into Trusts B1, B2, and B3. The terms of Trusts B1, B2, and B3, with respect to income and principal distributions and with respect to termination of the trusts, will be identical to the terms of Trust B, except that each such separate trust after division will be for the sole benefit of one of the three branches of the family.

Trust C, with respect to its remaining assets, will be partitioned into Trusts C1, C2, and C3. The terms of Trusts C1, C2, and C3, with respect to income and principal distributions and with respect to termination of the trusts, will be identical to the terms of Trust C, except that each such separate trust after division will be for the sole benefit of one of the three branches of the family.

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[1] For purposes of this ruling each child of H and W and that child's lineal descendants represent a branch of the family.

The nine resulting trusts will be allocated to the three branches of the family as follows: (1) A1, B1, and C1; (2) A2, B2, and C2; and (3) A3, B3, and C3. Each branch of the family will thus be the beneficiaries of one-third of the partitioned timberland and one-third of the remaining assets in each of the three original trusts.

The trustees have requested the following rulings:

1. The proposed transaction will not cause any distribution from, or termination of any interests in, Trusts A, B, or C or any successor trust resulting from the division transaction to be subject to the generation-skipping transfer tax under § 2601 of the Internal Revenue Code. The separate trusts resulting from the division will be treated as having been established before, and being irrevocable on, September 25, 1985.

2. The proposed transaction will not cause Trusts A, B, or C, any successor trust resulting from the partition transaction, or any beneficiary to recognize any gain or loss from a sale or other disposition of property under §§ 61 or 1001.

3. The proposed transaction will not cause any beneficiary to be considered as having made a taxable gift and will not constitute a taxable gift to any beneficiary under § 2501.

RULING REQUEST 1

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 section 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 section 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust.

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 --

(A) if all interests in such trust are held by skip persons, or

(B) if --

(i) there is no person holding an interest in the trust, 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.

Trusts A, B, and C are generation-skipping trusts because they provide for distributions to more than one generation of beneficiaries below H and W's generation. Trusts A, B, and C, however, have been exempt from the GST tax pursuant to section 26.2601-1(b)(1)(i) because they were irrevocable on September 25, 1985, and there have been no additions to them since that date. You have requested a ruling that the partition of Trusts A, B, and C into separate trusts will not cause the resulting sub-trusts to be subject to 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 under the terms of the trust will cause the trust to lose its exemption from the GST tax. A trust's exemption from the GST tax is not affected, however, by amendments relating to the administration of a trust.

You have represented that Trusts A, B, and C were irrevocable on September 25, 1985, and no additions have been made to Trusts A, B, or C after that date.

Based on the information submitted and the representations made, the interests of the income beneficiaries under the partition of Trusts A, B, and C will remain the same and the timing of the termination of the trusts will remain the same. Consequently, the value of the income and corpus interests of each income beneficiary will not change materially as a result of the partition of Trusts A, B, and C. Therefore, the partition of Trusts A, B, and C will not change the quality, value, or timing of any powers, beneficial interests, rights, or expectancies originally provided for under the terms of Trusts A, B, and C. Accordingly, the division transaction will not cause any distribution from, or termination of any interests in, Trusts A, B, or C or any successor

trust resulting from the division transaction to be subject to the generation-skipping transfer tax under § 2601 of the Internal Revenue Code. Further, the separate trusts resulting from the division will be treated as having been established before, and being irrevocable on, September 25, 1985, provided that no additions to the trusts are made after September 25, 1985.

RULING REQUEST 2

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 over the amount realized. Section 1001(b) provides 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. Section 1001(c) provides that, 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) of the Income Tax Regulations provides that, generally, the gain or loss realized from a conversion of property into cash, or from an exchange of property for other property differing materially either in kind or extent, is treated as income or as loss sustained.

For purposes of § 1001, in an exchange of property, each party to the exchange gives up a property interest in return for a new or additional property interest. Such an exchange is a disposition under § 1001(a). See § 1.1001-1 of the Regulations.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). There is a material difference when the exchanged properties embody legal entitlements "different in kind or extent" or if they confer "different rights and powers." 499 U.S. at 565.

Rev. Rul. 69-486, 1969-2 C.B. 159, holds that a non-pro rata distribution of trust corpus in kind by mutual agreement of the beneficiaries is subject to gain or loss recognition under § 1001. In the revenue ruling, there was no provision in the trust instrument allowing the trustee to make non-pro rata distributions, and local law did not authorize the trustee to make a non-pro rata distribution of property in kind. Because neither the trust instrument nor local law authorized the trustee to make a non-pro rata distribution, the beneficiaries were viewed as having an absolute right to a ratable in kind distribution. Accordingly, the revenue ruling holds that the distribution was

equivalent to a ratable distribution to the beneficiaries followed by an exchange of property between the beneficiaries that was subject to § 1001.

Rev. Rul. 56-437, 1956-2 C.B. 507 holds that the severance of a joint tenancy in stock under a partition action provided for by state law to compel issuance of separate stock certificates is not a sale or exchange. Under applicable state law the right of the owners of the property to pursue such a result is an inherent ownership right each had in the property involved.

Trusts A, B, and C assets to be divided under the proposal here consist primarily of timberland and other real estate, cash and cash equivalents, and marketable securities.

The shares of each issue of marketable securities held by the three existing trusts will be divided equally among the respective resulting trusts. Certain real estate assets of the three trusts will be divided into undivided interests among the appropriate resulting trusts. The proposed division of the marketable securities, the real estate assets, and the cash are represented to be pro rata and, therefore, unlike the situation in Rev. Rul. 69-486, would not be equivalent to a pro-rata distribution followed by an exchange subject to § 1001.

The division of timberland under the proposal, however, will not be strictly pro rata. The taxpayers represent that the timberland will be partitioned among the separate resulting trusts so that the separate trusts are not left as undivided owners of timberland. The bulk of the timberland will be distributed such that each separate resulting trust will receive the same value in timberland acreage as each other separate trust.

The taxpayers represent that their proposed division of the timberland is appropriate under Applicable State Statute, which states that, where an undivided interest in real estate has been or may be granted or devised to a person for his lifetime with remainder or reversion to others, such life tenant may compel a partition provided the property is capable of fair and equitable partition, as well as under applicable State case law, which holds that a tenant in common has a statutory right to compel partition of the subject property and that joint owners of land are entitled to have partition in kind, each to have his share allotted to him in severalty.

With respect to whether there has been a sale or exchange of property that results in the recognition of loss or gain, the essential questions are whether or not, upon the partition of the timberland, there has been a sale or exchange, and whether, upon the division of each of the three original trusts into three trusts, the beneficiaries will have materially different rights to trust income and principal than they currently have.

In this case, the division of Trusts A, B, and C and the partition of the timberland will not constitute a sale or other disposition for purposes of § 1001. Under the rationale of Rev. Rul. 56-437, the partition of the timberland does not result in a sale or exchange. The division of Trusts A, B, and C does not result in a § 1001 transaction because the exchanged properties are not materially different since they do not embody legal entitlements that are different in kind or confer different rights and powers from those entitlements and rights the beneficiaries had prior to the proposed division.

We conclude that the proposed transaction will not cause Trusts A, B, or C, any successor trust resulting from the transaction, or any beneficiary, to recognize any gain or loss from a sale or other disposition of property under §§ 61 or 1001.

RULING REQUEST 3

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 a gift, and is included in computing the amount of gifts made during the calendar year.

In this case, the interest of each beneficiary will remain the same after the proposed division except as specifically contemplated in the instruments establishing Trusts A, B, and C. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division will not cause any beneficiary to be considered as making a taxable gift under § 2501.

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

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

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,
Paul F. Kugler
Associate Chief Counsel
By: Joseph H. Makurath
Senior Technician Reviewer

Enclosure (1)