

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

September 30, 1999

LEGEND:

Decedent =

Trust =

a =

b =

Spouse =

c =

Son =

Grandson 1 =

Grandson 2 =

Grandson 3 =

d =

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e =f =g =h =i =j =k =

Court 1 =

m =n =o =

State =

p =

Court 2 =

q =r =

Dear Sir or Madam:

In a letter, dated April 27, 1999, you requested rulings under §§ 2501 and 2601 of the Internal Revenue Code. This letter responds to your request.

The information submitted and the representations made are summarized as follows: Decedent created the Trust on a. Pursuant to Article IX, Paragraph (4) of the Trust, on the death of Decedent in b, all the net income from the trust was distributed to Spouse until Spouse's death on c

Article IX, Paragraph (4) of the Trust further provides that after the death of

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Spouse, or on her remarriage, the trustee is to pay over and expend all of the net income from the Trust to or for the benefit of Son and his children from time to time living (that is to say, his children in being Grandson 1, Grandson 2, and Grandson 3, together with such other child or children who shall be born to or lawfully adopted by Son and Spouse during Son's lifetime, or within the period of gestation after his death), together with, in the discretion of the trustee, whatever amount or amounts of the corpus of the Trust may be necessary for their comfortable care, maintenance, support, and education in accordance with the liberal standard of living to which persons in their station of life are entitled and can afford, such as, by way of example, travel and entertainment. For these purposes, the trustee is not bound to observe any precept of equality of distribution between Son and his children and the final discretion of the trustee is to be binding and conclusive upon all parties concerned, except that in making any distributions of corpus or income from the Trust to Son's children, Son, if he is living, is to be consulted as to the advisability thereof in relation to his judgment of the welfare, protection, and best interest of his children, but the final discretion with respect to the necessity for, adequacy and amount of the distribution is to be vested in the trustee alone.

Article IX, Paragraph (5) of the Trust provides that, after the death of Son, and subsequent to the death of Decedent, and Spouse, whenever the youngest of Son's children, from time to time living, has reached d years of age, the entire residue of the Trust, including both corpus and undistributed income, is to be divided into as many equal shares as there may be children of Son then living or children of Son then deceased leaving lineal descendants then surviving, so that there is one equal share for each of the children of Son then living and one equal share for the then surviving lineal descendants, collectively of each of the children of Son then deceased *per stirpes* (any child of Son who is then deceased and survived by no then living lineal descendants to be excluded), and the share or shares are to continue to be held, managed, and distributed by the trustee as separate parts of a single trust.

Article IX, Paragraph(5)(a) of the Trust provides that the income and corpus of each share set aside for the surviving lineal descendants collectively of a deceased child of Son is to be paid over to the lineal descendants *per stirpes* outright and freed from terms of the Trust, subject to the provisions relating to minors set forth in Article X.

Article IX, Paragraph (5)(b) of the Trust provides that the income and corpus of each share set aside for a child of Son then living is to be paid over to the child for the uses and purposes set forth in Paragraph (4) of Article IX until the child reaches d years of age, whereupon e of the share then held in trust for him, including both corpus and undistributed income, is to be paid over to him outright and freed of the terms of the Trust. When the child reaches f years of age, an additional g of the entire then remaining part of the share then held in trust for him, including corpus and undistributed income is to be paid over to him outright and freed of the terms and conditions of the Trust. When the child reaches h years of age, the entire remaining part of the share

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then held in trust for him is to be paid over to him outright and freed of the terms and conditions of the Trust.

On i, Son and Grandson 1, Grandson 2, and Grandson 3 (collectively, Grandchildren) entered into a "Disclaimer and Modification of Trust Agreement" (Agreement). Under the terms of the Agreement, Son disclaimed his interest in the Trust. In addition, the Trust was modified to provide that the Trust income is to be accumulated and no principal is to be distributed until the later of the date of Son's death or the date the oldest grandchild attains age j. When the first Grandchild attains age j, the Trust corpus is to be divided into equal shares and each Grandchild is to receive his share free of Trust. The estate of a deceased Grandchild is to receive the deceased Grandchild's share. In the event a Grandchild becomes disabled, the trustee is directed to use Trust income and principal for the benefit of that Grandchild. On k, the Court entered an order (k Order) approving and affirming the Agreement.

On m, an action was brought to set aside the k Order and restore the Trust to its original terms. On n, Court 1 ruled (n Order) that the distribution scheme put into effect through the Agreement presented contradictory direction that would likely cause confusion and hinder the orderly administration of the Trust. Court 1 stated that the changes directed by the k Order were inconsistent with Decedent's intent. Court 1 rescinded all of the k Order except that portion relating to Son's disclaimer and restored the original distribution scheme of the Trust.

On o, Court 1 vacated both its k Order and its n Order for lack of jurisdiction. Under State law, the Probate Courts have exclusive jurisdiction over matters involving trusts. Therefore, jurisdiction did not vest with Court 1 when it issued the k Order and the n Order.

On p, Son filed a complaint in Court 2 seeking a declaratory judgment that his q disclaimer of his interest as a beneficiary of the Trust was valid. On r, Court 2 ruled that Son's disclaimer was valid and should be treated in the same manner as if Son were deceased for the purposes of the Trust. Court 2 further held that because each of the beneficiaries of the Trust is now h years of age the corpus of the Trust should be distributed in accordance with Article, IX Paragraph 5 of the Trust and State's statutory and common law.

You have requested the following rulings:

(1) Son's disclaimer of his right to receive distributions of income and corpus from the Trust solely within the discretion of the independent corporate trustee will not constitute a taxable gift to the other Trust beneficiaries.

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(2) The distribution of the Trust assets and the termination of the Trust will not subject the Trust to the generation-skipping transfer (GST) tax.

Ruling 1:

Section 2046 provides that for estate tax purposes, disclaimers of property interests passing upon death are treated as provided in § 2518.

Section 2518(a) provides that if a person makes a qualified disclaimer of any interest in property, the interest is treated as if it had never been transferred to the person making the disclaimer.

Section 2518(b) defines the term "qualified disclaimer" to mean an irrevocable and unqualified refusal by a person to accept an interest in property but only if:

- (1) the refusal is in writing,
- (2) the writing is received by the transferor of the interest, his or her legal representative, or the holder of the legal title to the property to which the interest relates not later than nine months after the later of the date on which the transfer creating the interest in the person making the disclaimer is made or the date on which that person attains age 21,
- (3) the person making the disclaimer has not accepted the interest or any of its benefits, and
- (4) as a result of the disclaimer, the interest passes without any direction on the part of the person making the disclaimer and passes either to the spouse of the decedent, or to a person other than the person making the disclaimer.

Section 25.2518-1(b) of the Gift Tax Regulations provides that if a person makes a qualified disclaimer for purposes of the federal estate, gift, and GST tax provisions, the disclaimed interest in property is treated as if it had never been transferred to the person making the qualified disclaimer. Instead, it is considered as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer. Accordingly, a person making a qualified disclaimer is not treated as making a gift. Similarly, the value of a decedent's gross estate for purposes of the federal estate tax does not include the value of the property with respect to which the decedent, or the decedent's executor or administrator, has made a qualified disclaimer. If the disclaimer is not a qualified disclaimer, for purposes of the federal estate, gift, and GST tax provisions, the disclaimer is disregarded and the person making the disclaimer is treated as having received the interest.

Section 25.2518-2(c)(3) provides that the 9-month period for making a disclaimer

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generally is determined with reference to the transfer creating the interest in the person making the disclaimer. With respect to inter vivos transfers, a transfer creating an interest occurs when there is a completed gift for federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift.

Section 2501(a) imposes a tax on the transfer of property by gift during the calendar year.

Section 2511(a) provides that the tax imposed by § 2501(a) 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 25.2511-1(c)(1) provides that the gift tax also applies to gifts indirectly made. Thus, 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. However, in the case of a transfer creating an interest in property made after December 31, 1976, this paragraph (c)(1) does not apply to the donee if, as a result of a qualified disclaimer by the donee, the property passes to a different donee. Nor does it apply to a donor, if as a result of a qualified disclaimer by the donee, a completed transfer of an interest in property is not effected.

You have requested a ruling that Son's disclaimer of his right to receive distributions of income and corpus from the trust solely within the discretion of the independent corporate trustee does not constitute a taxable gift to the other trust beneficiaries.

Under § 2518, a person making a qualified disclaimer is not treated as making a gift for federal gift tax purposes. To be a "qualified disclaimer" for purposes of § 2518, a disclaimer must be made not later than nine months after the later of the date on which the transfer creating the interest in the person making the disclaimer is made or the date on which that person attains age 21.

Based on the information submitted and the representations made, we conclude that Son's disclaimer of his interest in the Trust was not made within nine months of the date of Decedent's death. Therefore, Son's disclaimer does not constitute a qualified disclaimer for purposes of §§ 2046 and 2518. Accordingly, Son will be treated as having made a completed transfer of the value of Son's interest in the Trust and the transfer of Son's interest in the trust is subject to gift tax.

We express or imply no opinion as to the value of Son's interest in the trust that is subject to gift tax. Resolution of this and all other factual matters would be under the jurisdiction of the District Director on audit of the return.

Ruling 2:

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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)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from chapter 13 by reason of § 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to chapter 13 (the non-chapter 13 portion) and a portion subject to chapter 13 (the chapter 13 portion), each with a separate inclusion ratio (as defined in § 2642(a)). The non-chapter 13 portion represents the value of the assets of the trust as it existed on September 25, 1985. The applicable fraction (as defined in § 2642(a)(2)) for the non-chapter 13 portion is deemed to be 1 and the inclusion ratio for such portion is 0. The chapter 13 portion represents the value of all additions made to the trust after September 25, 1985. The inclusion ratio for the chapter 13 portion is determined under § 2642. This paragraph (b)(1)(iv) requires separate portions of one trust only for purposes of determining inclusion ratios.

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

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(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.

You have requested a ruling that the termination of the Trust and the distribution of the Trust assets will not subject the Trust to the GST tax. An amendment to a trust that was irrevocable on September 25, 1985, 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.

In this case, on o, Court 1 vacated both its k Order and its n Order for lack of jurisdiction. Thus, any amendments to the Trust under the k Order and the n Order were nullified and the terms of the Trust remained as originally provided. Therefore, there has been no modification of or change in the quality, value, or timing of any of the powers, or beneficial interests, rights, or expectancies originally provided under the terms of the Trust.

Because Son's disclaimer of his interest in the Trust does not constitute a qualified disclaimer for purposes of § 2518, and is, therefore, subject to gift tax, the value of the interest disclaimed by Son is treated as an addition to the Trust after September 25, 1985. Accordingly, pursuant to § 26.2601-1(b)(1)(iv), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the Trust will be subject to the provisions of chapter 13.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code. In particular, we express or imply no opinion concerning the value of Son's addition to the Trust or what portion of subsequent distributions from (and terminations of interests in property held in) the Trust will be subject to the provisions of chapter 13.

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

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In accordance with the power of attorney on file with this office, we are sending a copy of this letter to Taxpayer.

Sincerely yours,

Christine E. Ellison

Christine E. Ellison
Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)