

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:4

PLR-136875-04

Date: JULY 12, 2005

DO: Date of Death:

Legend:

| | |
|--------------------|---|
| Decedent | = |
| Spouse | = |
| Daughter | = |
| Son | = |
| Grandson | = |
| Granddaughter 1 | = |
| Granddaughter 2 | = |
| Great-grandchild 1 | = |
| State | = |
| Acting Trustee | = |
| County | = |
| Court 1 | = |
| Court 2 | = |
| Date 1 | = |
| Date 2 | = |
| Date 3 | = |
| Date 4 | = |
| Date 5 | = |
| Date 6 | = |
| Date 7 | = |
| Date 8 | = |
| Date 9 | = |
| Date 10 | = |
| Date 11 | = |
| Trust | = |
| X% | = |
| Y% | = |
| \$Z | = |

Dear _____ :

This is in response to your authorized representative's submission dated July 1, 2004, and subsequent correspondence in which rulings were requested concerning the effect of orders issued by Court 1 and Court 2 with regard to Trust.

According to the facts submitted, Decedent executed his Last Will and Testament and the Decedent Revocable Trust Agreement (Trust) on Date 1. Trust was amended on Date 2 and Date 3. Decedent died a resident of County, State on Date 4.

Under Item III of Decedent's will, Decedent directs that the residue of Decedent's estate is to be given, bequeathed, devised and appointed to the trustee of Trust.

Article III, Paragraph 3.1 of Trust provides that if Decedent's wife (Spouse) survives Decedent, then upon Decedent's death, after the distribution of a specific bequest to each of Son and Daughter, Trustee is to distribute the assets of Trust to Marital Trust. Paragraph 3.2(a) provides that Trustee is to pay the entire net income from the Marital Trust to Spouse so long as she lives. As amended on Date 2, Paragraph 3.2(c) provides that, upon the death of Spouse, and if either of Decedent's children, Daughter and Son are then living, the Marital Trust is to end and its remaining balance is to be held in a Family Trust. Notwithstanding the foregoing, Spouse shall have a testamentary special power of appointment to donate and appoint at her death the remaining balance of the Marital Trust at such time to or for the benefit of such one or more of Decedent's issue, in such manner and in such proportions, whether outright, in trust or otherwise, as she may desire, ... but under no circumstances may that remaining balance be appointed to Spouse's creditors, Spouse's estate or the creditors of Spouse's estate.

Paragraph 3.3, as amended, provides that upon Spouse's death the trustee shall, except to the extent Spouse's will contains a different direction for the payment of death taxes, make available from the property belonging to the Marital Trust to the executors of Spouse's estate such amount as said executor shall determine to be equal to the excess of (1) all death taxes which shall become payable by reason of Spouse's death, over (2) the death taxes which would have become payable by reason of Spouse's death if in the computation there had not been included any part of the property belonging to the Marital Trust.

On Date 5, Acting Trustee and Spouse petitioned Court 1: (i) to divide Marital Trust into two separate trusts, the GST Exempt Marital Trust and the GST Non-Exempt Marital Trust, to be held on the same terms and conditions as those set forth in Trust, and (ii) to direct that all death taxes attributable to the GST Exempt Marital Trust and the GST Non-Exempt Marital Trust at the subsequent death of Spouse be allocated against the GST Non-Exempt Marital Trust. On Date 6, Court 1 issued its order

granting the petition. The GST Exempt Marital Trust would hold an amount of property equal to Decedent's unused GST exemption and the GST Non-Exempt Marital Trust would hold the remaining property in the Marital Trust. Court 1 ordered that the GST Non-Exempt Marital Trust would be liable for all estate and inheritance taxes on the GST Exempt Marital Trust and the GST Non-Exempt Marital Trust payable at the death of Spouse. Except as otherwise hereinabove provided, both trusts would be held pursuant to the terms of Marital Trust.

Decedent's federal estate tax return (Form 706) was filed on Date 7 (a date that is prior to December 27, 1995). An election was made on the return to treat the GST Exempt Marital Trust and GST Non-Exempt Marital Trust as qualified terminable interest property (QTIP) pursuant to section 2056(b)(7) and an estate tax marital deduction was claimed. Pursuant to section 2652(a)(3) and section 26.2652-2(c) of the Generation-Skipping Transfer Tax Regulations, a reverse QTIP election was made to treat Decedent as the transferor of the GST Exempt Marital Trust and Decedent's remaining GST exemption was allocated to the trust to cause the trust to have a zero inclusion ratio for purposes of chapter 13.

On Date 8, Spouse executed her Last Will and Testament. Spouse died on Date 9. The QTIP property for which a deduction was claimed on Decedent's estate tax return is includible in Spouse's gross estate under section 2044.

Item II of Spouse's will provides that any inheritance and estate taxes assessed by reason of Spouse's death with respect to assets that pass under her will are to be paid out of and charged generally against the principal of Spouse's residuary estate, without apportionment.

Under Item VI of Spouse's will, Spouse exercised her special testamentary power of appointment under Decedent's will and directed that any and all property remaining in the Marital Trust and, for purposes of this ruling, specifically the GST Non-Exempt Marital Trust, continue to be held in trust and divided into five (5) shares as follows: Daughter - X%, Son - X%, Granddaughter 1 - Y%, Granddaughter 2 - Y%, and Grandson - Y% (Separate Trusts). Spouse's Will incorporates by reference the terms of Trust into the Separate Trusts.

On Date 10, Acting Trustee filed a Second Amended Petition for Declaration of Rights concerning the interpretation of Item VI of Spouse's will. On Date 11, Court 2 issued its order construing the language of Item VI of Spouse's will to mean that Spouse intended to divide the GST Non-Exempt Marital Trust into Separate Trusts. Court 2 stated that if Spouse had intended the GST Non-Exempt Marital Trust to remain one trust, she would not have stated that the GST Non-Exempt Marital Trust be divided. According to Court 2, the use of the word "share" is further indication of her intent that the GST Non-Exempt Marital Trust be divided for the benefit of the five named beneficiaries. Court 2 reasoned that had Spouse intended to leave the corpus intact in the GST Non-Exempt Marital Trust, no reference to division would have been necessary

and Spouse could have simply mandated the percentage of payout in favor of each beneficiary. Consequently, Court 2 determined that it was the intent of Spouse to create the Separate Trusts.

The following rulings are requested.

1. Court 2's construction and interpretation of the language of Item VI Spouse's will regarding whether there is a single trust, the GST Non-Exempt Marital Trust, for Decedent's five named beneficiaries or five Separate Trusts, one for each of the five named beneficiaries, will be given effect by the Internal Revenue Service (Service) for purposes of chapter 13.
2. Court 1's order directing that the GST Non-Exempt Marital Trust be liable for all federal estate taxes payable by the GST Exempt Marital Trust and GST Non-Exempt Marital Trust at the death of Spouse will be given effect by the Service for purposes of federal estate taxes.

Law

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

Section 2601 imposes a tax on every generation-skipping transfer (GST). A GST is defined under section 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip, made by a transferor.

Under section 2612(a)(1), a "taxable termination" means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that for purposes of chapter 13, a "taxable distribution" means any distribution from trust to a skip person (other than a taxable termination or a direct skip).

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

Under section 2613(a), for purposes of chapter 13, a "skip person" means (1) a natural person assigned to a generation which is 2 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) -- (i) there is no person holding an interest in such trust, and (ii) at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2613(b) provides that for purposes of chapter 13, the term “non-skip person” means any person who is not a skip person.

Section 2603(a)(1) provides that in the case of a taxable distribution, the tax imposed by section 2601 shall be paid by the transferee.

Section 2603(a)(2) provides that in the case of a taxable termination or direct skip from a trust, the tax shall be paid by the trustee.

Ruling 1

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court’s characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be the state law after giving “proper regard” to the state trial court’s determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

On Date 11, Court 2 issued its order construing the language of Item VI of Spouse’s will to mean that Spouse intended to divide the GST Non-Exempt Marital Trust into five Separate Trusts. While Court 2’s order is not controlling for purposes of chapter 13, Court 2’s interpretation is a reasonable interpretation of Spouse’s will and is consistent with applicable state law. Accordingly, we conclude that Court 2’s construction and interpretation of the language of Item VI of Spouse’s will regarding whether there is a single trust, the GST Non-Exempt Marital Trust for Decedent’s five named beneficiaries, or five Separate Trusts for each named beneficiary, will be given effect by the Service for purposes of chapter 13. The division of the GST Non-Exempt Marital Trust into the three Separate Trusts for the grandchildren will result in a direct skip under section 2612(c) and the GST taxes due are payable by the trusts under section 2603(a)(2).

Ruling 2

On Date 6, Court 1 issued an order directing that the GST Non-Exempt Marital Trust be liable for all estate and inheritance taxes attributable to the GST Exempt Marital Trust and the GST Non-Exempt Marital Trust due on the death of Spouse.

This situation is analogous to the situation in Rev. Rul. 73-142, 1973-1 C.B. 405. In the ruling, a lower state court construed a trust instrument to mean that the decedent reserved the right to remove and appoint a trustee only once, and that this power did

not include the right to appoint himself, and that once having exercised that power, decedent would have exhausted his reserved powers. The decedent, subsequent to the decree, did remove the original trustee and appoint another (not himself) so that under the interpretation of the court he no longer had such a right as of the date of his death. The lower court decree was contrary to decisions of the highest court of the state. The Service considered the effect to be given the decree in determining the estate tax consequences of the trust.

In the ruling, the Service stated that while the problem in Bosch involves the fact that “federal authorities are not bound” by a determination of a state trial court, this does not mean that the parties to the state court action are not bound by the decree. The lower court had jurisdiction over the parties and over the subject matter of the proceeding. The time for the parties to appeal the lower state decree had passed. Unlike the situation in Bosch, the decree in the ruling was handed down before the time of event giving rise to the tax (that is, the date of the grantor’s death). Thus, while the decree would not be binding on the Government as to questions relating to the grantor’s power to appoint himself as trustee prior to the date of the decree, it is controlling.

In this situation, Court 1 had jurisdiction over the parties and over the subject matter of the proceeding. The time for appeal had passed. The decree was handed down before the time of the event giving rise to federal estate taxes (that is, the death of Spouse). Thus, as in Rev. Rul. 73-142, the Service will give effect to Court 1’s order directing that the GST Non-Exempt Marital Trust be liable for all federal estate taxes payable by the GST Exempt Marital Trust and the GST Non-Exempt Marital Trust at the death of Spouse, to the extent that there are sufficient assets in the GST Non-Exempt Marital Trust to pay such taxes.

The ruling contained in this letter is 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.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction or any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
(Passthroughs and Special Industries)

Enclosure

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