

## Internal Revenue Service

## Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:

**CC:PSI:9/PLR-104663-01**

Date:

**March 13, 2001**

### Legend:

Trust

Settlor

Spouse

A

B

C

D

E

F

G

H

I

J

Stock

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Company

Policy

Businesses

State

State Statute 1

State Statute 2

State Statute 3

State Statute 4

Petition

Preliminary  
Order

Court

Date 1

Date 2

Date 3

Date 4

Date 5

Date 6

Year 1

a

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b

c

Dear Sir:

We received your letter dated January 12, 2001, requesting rulings under § 2601 of the Internal Revenue Code. This letter responds to your request.

Settlor established Trust, a revocable inter vivos trust, on Date 1. Settlor amended and restated Trust in its entirety on Date 2 and further amended Trust in part on Date 3. The original trustees of Trust were Settlor, Spouse, A, and B. Trust became irrevocable at the death of Settlor on Date 4. Spouse died on Date 5. The outgoing trustees of Trust were C, D, and E. The current income beneficiaries of Trust are Settlor's two daughters, F and G, and the three children of Settlor's deceased son A, namely, E, I, and J. The current interim trustees of Trust are E, G, and H.

Article I of Trust provides in part that initially the 'Trust Property' shall consist of a shares of Stock of Company, a State corporation.

Article II of Trust provides that until the death, resignation or incapacity to serve of Settlor as a Trustee, there shall be four (4) Trustees. Thereafter, there shall be three (3) Trustees, but Trust shall not fail for want of a Trustee or any number of Trustees. Upon the death, resignation, incapacity, or failure to qualify of one or more of the Trustees (other than Settlor), from time to time, the Trustee or Trustees then serving as such shall appoint sufficient additional Trustees to bring the number up to three (3); and if there is no Trustee serving as such, the successor Trustees shall be selected by the adult beneficiaries then entitled to receive the income, if any, under Section 2 and 3 of Article III, voting in proportion to their interests in that income. As the sole exception to the foregoing, Spouse shall have power, by deed or will, to designate the person who succeeds her as Trustee upon her death, resignation or incapacity; but if she does not exercise that power then her vacancy shall be filled by the other Trustees or adult beneficiaries in the same way. The Trustees, in selecting successor Trustees, shall select persons who, at the time of selection, are top executives of Company, or one of its subsidiaries, but their determination as to that capacity shall be final.

Section 1 of Article III of Trust provides that all of the net income from the Trust Property earned during the lifetime of Settlor shall be paid to Settlor from time to time as it is earned. All other provisions in this Indenture for the payment or distribution of income or principal shall be deemed to refer solely to periods after the death of Settlor.

Section 2 of Article III of Trust provides that all of the net income from the Trust Property shall be paid to Settlor's wife, Spouse, during her lifetime. Payments shall be made on the 25<sup>th</sup> days of January, April, July and October in each year.

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Section 3 of Article III of Trust provides that all of the net income from the Trust Property after the death of Settlor's wife, Spouse, shall be paid to Settlor's descendants living from time to time as such income is earned, in equal shares *per stirpes* and not *per capita*. Payments shall be made on the 25<sup>th</sup> day of January, April, July and October in each year.

Section 4 of Article III of Trust provides that twenty-one (21) years after the death of the survivor of a class composed of Settlor's wife, Spouse, and all of Settlor's descendants living at the time of the execution of this Second Amendment to this Indenture, the Trust Property shall vest in and be distributed to Settlor's descendants living at that time, in equal shares *per stirpes* and not *per capita*, and Trust shall terminate.

Section 1 of Article IV of Trust provides that the purpose in putting into this Trust Stock of Company is to maintain the majority voting power of that corporation in experienced and responsible persons who will preserve the established Policy and integrity of the Businesses controlled by that corporation. The Trustees are directed not to sell, lease, exchange, pledge or otherwise dispose of Stock of Company or any of it, in any way. The Trustees shall have power to participate in reorganizations and recapitalizations of Company, including, without limiting the generality thereof, mergers and consolidations, but not if, as a result, the Trust Property would consist of a smaller proportion of the voting power of Company, or any corporation into which it was merged or consolidated, than its proportion of the voting power of Company at the time of the execution of this Second Amendment to this Indenture. This limitation shall last for the duration of Trust, except that if at any time after Settlor's death, the Trustees then serving unanimously determine that substantially complete loss of the value of the Trust Property is seriously threatened thereby, and obtain the written consent of two-thirds (2/3) of the adults, if any, then entitled to income under Article III, this limitation shall become void.

Section 2 of Article IV of Trust provides that it is expected that the initial Trustees will be, and future Trustees may be, directors, officers, employees, or otherwise interested in Company, and corporations in which it is interested. This is to be encouraged. No Trustee shall be disqualified because of such a relationship, or because he or she receives a salary or other emolument from any such corporation. Any Trustee shall be entitled, if a director, to vote for himself or herself as such an officer or employee; and the Trustees shall be entitled to vote stock constituting part of the Trust Property in favor of themselves as directors.

Section 6 of Article IV of Trust provides that in determining what corporate distributions are income and what corporate distributions are principal, for the purposes of determining income and principal under Article III of this Indenture, no voting stock or other security of Company, or any other corporation into which it was merged or consolidated, shall ever be considered to be income, but shall always be considered to

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be principal, and shall be distributed only pursuant to the provisions of Article III, Section 4. In the administration of Trust, no charges shall be made against principal but charges shall be made only against income, even though they are among the charges listed in the statute commonly cited as State Statute 1; it being deemed important by Settlor, in order to accomplish the purpose of Trust as set forth in Article IV, Section 1, of this Indenture, to protect the principal against any charge of any kind.

Section 9 of Article IV of Trust provides in part that the Trustees shall act, on every matter within their power and discretion, by the vote of a majority of the persons then serving as Trustees.

In Year 1, the outgoing trustees determined that a substantially complete loss of the value of the Trust Property was seriously threatened and, ultimately, concluded that in order to preserve the interests of all current and future beneficiaries as originally contemplated by Settlor, it was in Trust's and all beneficiaries' interests to sell the Company stock. All the adult income beneficiaries of Trust gave their consent. Accordingly, the Trust's restriction on the sale of the Company stock provided in Section 1 of Article IV of Trust became void and, subsequently, the Company stock was sold for approximately \$b. Because the Company shares held by Trust had a low basis, Trust now faces capital gains taxes of approximately \$c.

On Date 6, the outgoing trustees of Trust submitted Petition to Court. On the same day, Court issued Preliminary Order granting conditional approval of the proposed changes and ordering that implementation of the changes be deferred, pending the receipt of a favorable private letter ruling from the Internal Revenue Service.

Certain proposed changes that were requested by Trust and conditionally approved by Court in §§ 3, 4, 5, and 6 b. through d. of Preliminary Order are the subject of this ruling request. They are as follows:

3. The Trustees are hereby instructed that the restriction on the application of the provisions of State Statute 1 set forth in Article IV, Section 6 of Trust expired contemporaneously with the sale of the Company shares. All charges for periods beginning with the sale shall be charged against either income or principal in the manner set forth in State Statute 1.

4. The Trustees are hereby instructed that the following safe harbor investment standard in lieu of the investment direction set forth in Article IV, Section 1, shall govern the actions of the successor trustees and their successors in making future investment decisions:

The Trustees shall perform the duties required of them by State Statute 2, but the Trustees shall be relieved from liability for alleged breaches of

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duties to beneficiaries under State Statute 3 if at least fifty percent (50%) of the Trust's assets regularly remain invested in a diversified portfolio of publicly traded assets held for long term capital appreciation (with any reallocations made not less often than quarterly).

5. The Trustees are hereby authorized to partition Trust into three trusts, each to be administered pursuant to the provisions of the Trust Indenture, subject to the following modifications:

- a. Effective upon the entry of Court's Final Order approving the partition described herein, the Trustees are authorized to divide the remaining trust corpus (net of a reasonable reserve in an amount sufficient to satisfy any remaining liabilities of the predecessor trust) into three equal shares, each of which having assets with equal value and having in the aggregate, equal income tax basis. Each share shall be designated as being held for the benefit of a Family Line headed by a child of Settlor.
- b. The Trustees, as named in this Order, shall hold each share as a separate trust.
- c. For purposes of Article III of each new trust, the descendants of Settlor entitled to receive distributions of income and/or principal are limited to the members of the respective Family Line for which the new trust is created. A "Family Line," for this purpose, shall mean (A) the descendants of A, (B) F and the descendants of F, and (C) G and the descendants of G, respectively.
- d. Unless a separate trust is earlier terminated under the circumstances described in 5.e., below, each separate trust shall terminate as of the vesting and distribution date identified in Article III, Section 4 of the Trust Indenture. The separate trust shall distribute the trust property to the then living descendants of Settlor belonging to the applicable Family Line, *per stirpes*.
- e. A separate trust shall terminate prior to the final distribution date on the date of death of the last descendant of Settlor belonging to the respective Family Line, prior to the final distribution date. In such an event, the corpus and any undistributed income in such trust shall be divided equally between the remaining two trusts created under this instrument, if both such trusts are still in existence, or shall be transferred to the only remaining trust created under this instrument, if only one such trust is in existence. Except to the extent specifically set forth in this subparagraph 5.e., no

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descendant belonging to a Family Line other than the Family Line for which the separate trust is held shall have any claim to income or principal from any other separate trust.

- f. Each separate trust, at all times, shall have a trustee as provided in Paragraph 6 of this Order.
- g. Following the partition hereunder and the winding up of the affairs of the predecessor trust, unless each of the adult income, potential income and remainder beneficiaries and the guardian *ad litem* appointed to represent the minor and unborn beneficiaries of Trust has previously released the Trustees, the Trustees shall have thirty days to prepare a final accounting for the predecessor trust, and provide the accounting to each of the persons heretofore described in this sentence. The final accounting will be deemed approved, and the Trustees discharged from any liability to the beneficiaries, if no objections thereto are filed by any interested party during the thirty days thereafter.
- h. The determination of this Court relating to charges to principal and future investment standard as set forth in Paragraphs 3 and 4 of this Order shall be deemed incorporated into each of the three successor trusts.
- i. State law shall at all times continue to govern each separate trust.

6. The Trustees are hereby authorized to take the following actions regarding successor trustees:

- b. After the partition of Trust into three separate trusts (one trust for each Family Line), each separate trust, at all times, shall have one individual co-trustee and one corporate co-trustee. Pursuant to the conditional appointment letters, the initial individual co-trustee of each trust shall be as follows: (i) the initial individual co-trustee of the trust for the benefit of the A Family Line shall be E, (ii) the initial individual co-trustee of the trust for the benefit of the F Family Line shall be H, and (iii) the initial individual co-trustee of the trust for the benefit of the G Family Line shall be G.
- c. The individual co-trustee serving from time to time shall appoint a corporate co-trustee and shall be entitled to remove and replace any corporate co-trustee serving from time to time without cause, but upon reasonable notice; provided, however, that any corporate co-trustee shall be a bank or other entity authorized to administer

trusts, holding trust assets at the time of its appointment with a fair market value of at least one hundred times as large as the fair market value of the principal of the separate Trust. A corporate co-trustee appointed in accordance herewith (i) will not be liable for any acts or omissions of predecessor trustees and will not be liable for failing to institute any action against any predecessor trustee; (ii) shall be bound as a condition of acceptance of that position, that it will submit to the jurisdiction and venue of the courts based on the residence of the individual co-trustee; (iii) shall indemnify the individual co-trustee against liability for investments or other actions taken by the corporate co-trustee without the expressed knowledge and consent of the individual co-trustee; and (iv) in addition to the reports mandated by Article IV, Section 3, shall provide an annual statement of the Trust's activity to each current and potential adult beneficiary. This Paragraph 6.c. shall not be construed to limit the rights of beneficiaries to pursue an accounting against any predecessor trustee.

- d. In the event of the death, resignation or incapacity of any initial individual co-trustee, a successor individual Trustee shall be selected as follows:
  - i. Except as provided in subparagraph 6.d.ii. below, a majority in interest of the adult current income beneficiaries belonging to a Family Line (including, for this purpose, any adult income beneficiaries who become current income beneficiaries as a result of the death of a beneficiary who is also serving as trustee) will select a successor individual trustee to replace the deceased, incapacitated, or resigned individual trustee representing that Family Line. In the event no person can attain the requisite majority vote, within ninety (90) days after the creation of a vacancy, the successor individual trustee shall be named in accordance with an Instrument Appointing Successor Individual Trustee, lodged with the trust records by the deceased, incapacitated, or resigning trustee. In the event neither of the aforementioned methods results in the appointment of a successor individual trustee, the successor individual trustee shall be the oldest non-incapacitated adult income beneficiary among the descendants of Settlor belonging to the affected Family Line. If there are no non-incapacitated adult current income beneficiaries among the descendants of Settlor belonging to the affected Family Line, then the corporate co-trustee then serving at the time of the death, resignation or incapacity of



the predecessor individual trustee shall serve as the sole trustee until an eligible individual successor trustee can be appointed pursuant to this Paragraph 6.d.i.

- ii. (A) In the event of death, incapacity, or resignation of G, as a trustee, her immediate successor shall be named in accordance with the most recent Instrument Appointing Successor Individual Trustee, lodged with the trust records prior to the time of her death, incapacity, or resignation. The Instrument Appointing Successor Individual Trustee may either name her immediate successor or provide a procedure for selecting her immediate successor, in either case, from among her own children. In the event no such Instrument is found among the trust records, the provisions of Paragraph 6.d.i. shall apply.
- (B) In the event of the death, incapacity, or resignation of H, as an individual trustee, during the lifetime of F, his immediate successor shall be appointed by F, if she is then not incapacitated, or if F is then incapacitated, his immediate successor shall be named in accordance with the most recent Instrument Appointing Successor Individual Trustee, executed by F and lodged with the trust records prior to the time of his death, incapacity, or resignation. The Instrument Appointing Successor Individual Trustee may either name the immediate successor to H or provide a procedure for selecting his immediate successor, in either case, from among the children of F. In the event no such Instrument is found among the trust records, or in the event that the death, incapacity, or resignation of H occurs after the death of F, the provisions of Paragraph 6.d.i. shall apply.
- iii. Any successor individual trustee determined hereunder pursuant to Paragraph 6.d.i. or ii. shall be required to be an individual belonging to the same Family Line as the deceased, incapacitated, or resigning trustee. A "Family Line" for this purpose, shall mean (A) the descendants of A, (B) F and the descendants of F, and (C) G and the descendants of G, respectively.
- iv. "Incapacity" in the case of an individual trustee shall mean

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failure to have the capacity described in State Statute 4.

You represent that there have been no actual or constructive additions to Trust after September 25, 1985.

You have requested the following rulings:

1. Trust is exempt from the Generation-Skipping Transfer (GST) tax imposed by § 2601.
2. The implementation of Court's Final Order by the current interim trustees of Trust will not subject Trust or any of the three resulting separate trusts, or any distributions from Trust or from any of the three resulting separate trusts, to the GST tax.
3. Following the proposed division of Trust into three equal trusts, the three resulting separate trusts will be exempt from the GST tax as trusts that became irrevocable on or before September 25, 1985, and all distributions from any of the resulting separate trusts will be exempt from the GST tax.

#### Law and Analysis

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

Section 2611(a) provides that, for purposes of the GST tax, the term "generation-skipping transfer" means

- (1) a taxable distribution,
- (2) a taxable termination, and
- (3) a direct skip.

Section 2612(a)(1) provides that, for purposes of the GST tax, the term "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 the GST tax, the term "taxable

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distribution” means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Section 2612(c)(1) provides that, for purposes of the GST tax, 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.

Section 2613(a) provides that, for purposes of the GST tax, the term “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) if –
    - (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 non-skip person.

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

Section 26.2601-1(b)(1)(i) of the GST Tax Regulations provides in part that the GST 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)(A) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust (as defined in § 2652(b)) in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener’s error will not cause an exempt trust to be subject to the provisions of chapter 13, if –

- (1) The judicial action involves a bona fide issue; and

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(2) The construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(i)(D) provides that

(1) A modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph (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 for in the original trust.

(2) For purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a 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 modification. 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 to shift a beneficial interest in the trust.

Example 5 of § 26.2601-1(b)(4)(i)(E), assuming there have been no additions to any trust after September 25, 1985, provides that in 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, *per stirpes*. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, *per stirpes*. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical

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(except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, *per stirpes*. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The division of the trust into 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 division. In addition, the division 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 two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13 of the Internal Revenue Code.

Based on the information submitted and representations made, we conclude that the proposed changes conditionally approved by Court in §§ 3, 4, 5, and 6 b. through d. of Preliminary Order neither shift any beneficial interest in 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 implementation of the proposed changes nor extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original terms of Trust. Particularly, the proposed changes regarding the division of Trust are substantively analogous to the facts presented in Example 5 of § 26.2601-1(b)(4)(i)(E). Thus, we conclude as follows:

1. Trust is exempt from the Generation-Skipping Transfer (GST) tax imposed by § 2601.
2. The implementation of Court's Final Order by the current interim trustees of Trust will not subject Trust or any of the three resulting separate trusts, or any distributions from Trust or from any of the three resulting separate trusts, to the GST tax.
3. Following the proposed division of Trust into three equal trusts, the three resulting separate trusts will be exempt from the GST tax as trusts that became irrevocable on or before September 25, 1985, and all distributions from any of the resulting separate trusts will be exempt from the GST tax.

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 considered in this ruling take effect, the ruling will have no force or effect.

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

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Sincerely,  
Lorraine E. Gardner  
Assistant to Branch Chief, Branch 9  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure: Copy for § 6110 purposes