

Internal Revenue Service

Department of the Treasury

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Date:

December 22, 1999

Re:

Legend

Testator =

Wife =

Trust I =

Trust II =

Daughter A =

Daughter B =

Daughter C =

Granddaughter A =

Granddaughter B =

Grandson =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Year 7 =

Court =

Date A =

Date B =

Dear :

We received a letter dated August 19, 1999, from your authorized representative requesting rulings concerning the application of the generation-skipping transfer (GST) tax imposed by § 2601 of the Internal Revenue Code to the proposed division of a trust.

According to the facts submitted, in Year 1, Testator and Testator's Wife created an inter vivos trust, Trust I, for the benefit of Testator's daughters, Daughter A, Daughter B, and Daughter C. Paragraph 2 of the trust directs the trustee to pay the net income of the trust in equal shares to the daughters for their respective lives. Paragraph 4 authorizes the trustee to apply such amounts for any beneficiary up to and including the whole thereof, of the principal of the trust estate, or if the trust estate has been divided into shares or departments, of the principal of the respective share or department, if the trustee believes that the net income is insufficient to provide for the proper support, maintenance, comfort, and education of any beneficiary. In the discretion of the trustee, any payment of principal to a beneficiary may be treated as an advance on the share of the particular beneficiary.

Trust I terminates on the death of the last surviving daughter. Each daughter was given a testamentary limited power to appoint her share of the income and corpus for both the period prior to the termination of the trust and with respect to distributions when the trust terminates. Pursuant to this power a daughter could designate whom of her issue would receive income and corpus during the period prior to termination. However, all distributions would continue to be subject to the Trustee's discretion under the terms of the trust instrument. If a daughter died during the trust term without appointing her share of the income, at her death, her share of the income was to be paid to her issue, per stirpes. If she had no issue surviving, her share of the income was to be paid to the survivor or survivors of the daughters, or to their issue, per stirpes, for the duration of the trust term.

As noted above, Trust I was to terminate on the death of the last surviving daughter. Unless otherwise appointed by a daughter pursuant to her testamentary limited power to appoint among her issue, the trust corpus was to be distributed among the issue of the daughters, per stirpes.

Testator died testate in Year 2. His will created several trusts for different beneficiaries. Article IX of the will established another trust, Trust II, for the benefit of the three daughters. The terms of Trust II are identical to the terms of Trust I with respect to income distributions, the testamentary limited power of appointment given to each daughter, and termination at the death of the last surviving daughter. However, Article XIV of Testator's will provides, with respect to distributions of principal from Trust II and other trusts created under the will, that if at any time any beneficiary, while entitled to receive income, should be in need of funds in excess of the income then

being paid to him or her in order to provide for his or her reasonable care, maintenance, support and education, or on account of any illness, infirmity or other emergency, then the trustees, in the trustees' absolute discretion, may make advancements to such beneficiary out of the corpus of the trust from which such beneficiary is receiving income.

Daughter C died in Year 3 leaving no issue surviving her and, under the terms of both trusts, her interests vested in her sisters, Daughter A and Daughter B. Daughter B died in Year 4 having exercised her power of appointment over Trust I and Trust II (for both the period prior to termination of the trusts and with respect to distributions of the trusts on termination) in favor of her three children (Granddaughter A, Granddaughter B, and Grandson) and their issue.

In Year 5, Trust I and Trust II merged. The merger agreement was approved by Court and provided that the proportionate part of the assets received from Trust I continued to be subject to its distribution standards and the proportionate part of the assets received from Trust II continued to be subject to its distribution standards. At the time of the merger, a favorable private letter ruling was obtained from the Internal Revenue Service that the merger would not cause the generation-skipping transfer tax under § 2601 to apply to the merged trust.

In Year 6, the merged trust was divided into two trusts: one trust for Daughter A and her issue and one trust for Daughter B's issue. The division was also approved by Court and a favorable private letter ruling was again obtained.

In Year 7, Granddaughter A died survived by two children.

The beneficiaries of the trust for Daughter B's issue now propose to further divide their trust into three separate shares: one for the benefit of Granddaughter A's issue; one for the benefit of Granddaughter B and her issue; and one for the benefit of Grandson and his issue.

On Date A, all of the beneficiaries, including a guardian ad litem on behalf of the unborn issue of Daughter B, petitioned Court for approval of the division pursuant to a Plan of Administration. Under the Plan, once the three separate shares are created, the proportionate part of each share that is attributable to the original Trust I will be subject to the standard for principal distributions set forth in Trust I, and the proportionate part of each share that is attributable to the original Trust II will be subject to the standard for principal distributions set forth in Trust II.

Court held a hearing on the petition and reviewed the history of the trust and the proposed Plan of Administration. On Date B, Court issued its Findings of Fact, Conclusions of Law, and Judgment, which approved the division of the trust and the Plan of Administration.

It is represented that Trust I and Trust II were irrevocable prior to September 25, 1985, and that no additions of assets, constructive or otherwise, have been made to any of the trusts subsequent to September 25, 1985. In addition, no modifications or amendments, other than those described above for which private letter rulings were issued have been made to any of the trusts.

You have requested a ruling that the proposed division will not cause the generation-skipping transfer tax imposed by § 2601 to apply to the existing trust created for Daughter B, or to the separate shares created for Granddaughter A's issue, Granddaughter B and her issue, and Grandson and his issue, provided there are no additions to the trusts after September 25, 1985. For this purpose, appreciation in value of the corpus will not be considered to constitute an addition.

Section 2601 provides that a tax is imposed on every generation-skipping transfer. Section 2611 defines the term "generation-skipping transfer" to mean a taxable termination, a taxable distribution, or a direct skip.

Section 2612(b) defines the term "taxable distribution" to mean any distribution from a trust to a skip person (other than a taxable termination or a direct skip). Section 2613(a)(1) defines the term "skip person" as including a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor.

Trust I and Trust II in this case are generation-skipping trusts because they provide for distributions to persons that are two or more generations below the transferors' generation. Thus, unless excepted from the GST tax provisions by reason of § 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, they would be subject to the GST tax.

Section 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1) of the regulations provide that the GST tax shall not apply to any GST under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

A modification of a generation-skipping trust that is otherwise exempt under the Act and the regulations will generally result in a loss of its exempt or "grandfathered" status if the modification changes the quality, value, or timing of any powers, beneficial interest, rights, or expectancies originally provided for under the terms of the trust.

At the present time, pursuant to Daughter B's exercise of her limited power of appointment over the income and principal of her trust, the income from the trust is being paid in one-third equal shares to Grandson, Granddaughter B, and the two surviving children of Granddaughter A. After the division of the trust into three separate shares pursuant to the Plan of Administration, these same beneficiaries will continue to

receive the income from their one-third separate share until the death of Daughter A when, pursuant to the terms of Trust I and Trust II, the trust for Daughter A and the trust for Daughter B's issue will terminate. Therefore, the division of the trust into three separate shares will not change the quality, value or timing of any beneficiary's income interest in the trust.

As it is presently being administered, the trust for the benefit of Daughter B's issue consists of two parts. Distributions of principal from that part of the trust which is allocable to Trust I assets are governed by the provisions of Trust I. Distributions of principal from that part of the trust may be made to an income beneficiary any time the trustee, in its absolute discretion, deems that the net income is insufficient to provide for that beneficiary's proper support, maintenance, comfort and education. These distributions may consist of any part, "up to and including the whole thereof, of the principal of the Trust Estate, or if the Trust Estate has been divided into shares or departments, [any part, up to and including the whole thereof] of the principal of the respective share or department." The trustee of the trust for Daughter B's issue and trust beneficiaries interpret the quoted language in Trust I as evidencing the Testator's expectation that Trust I might be divided into separate shares; first, for each of his three daughters and, later, for the issue of each daughter. Court approved this interpretation in its judgment entered on Date B. We believe this is a reasonable interpretation of the language of Trust I. Following the division of the trust for Daughter B's issue into three separate shares, the distribution of principal from that part of a separate share which is allocable to Trust I assets will continue to be governed by the Trust I distribution provisions. Therefore, the division of the trust into three separate shares will not change the quality, value or timing of any beneficiary's interest in that part of the trust principal which is allocable to Trust I.

As the trust for Daughter B's issue is presently being administered, distributions of principal from that part of the trust which is allocable to Trust II assets are governed by the provisions of Trust II. Distributions of principal from that part of the trust may be made to an income beneficiary in such amounts as the trustee, in its absolute discretion, determined necessary in order to provide for that beneficiary's "reasonable care, maintenance, support and education, or on account of any illness, infirmity or other emergency." These distributions are to be treated as "advancements" of that beneficiary's share of the corpus. The trustee of the trust for Daughter B's issue and the trust beneficiaries interpret "advancement" to mean that the Testator intended each beneficiary to be entitled to only his or her proportionate share of the principal. Court approved this interpretation in its judgment entered on Date B. We believe this is a reasonable interpretation of the Testator's intent with respect to distributions of principal from Trust II. Following the division of the trust for Daughter B's issue into three separate shares, the distribution of principal from that part of a separate share which is allocable to Trust II assets will continue to be governed by the Trust II distribution provisions. Therefore, the division of the trust into three separate shares will not change the quality, value or timing of any beneficiary's interest in that part of the trust principal which is allocable to Trust II.

Based on the facts presented and representations made, we conclude that the proposed division of Daughter B's trust into three separate shares (one for the benefit of Granddaughter A's issue, one for the benefit of Granddaughter B and her issue, and one for Grandson and his issue) will not result in any change in the quality, value, or timing of any powers or beneficial interests, rights or expectancies originally provided for under the terms of Trust I or Trust II. Accordingly, Court's order dividing Daughter B's trust into the three separate shares will not affect the exempt status of the trusts for GST purposes. Therefore, provided there are no additions, constructive or otherwise, to the trusts, neither distributions from nor the termination of the trusts will be subject to the GST tax under § 2601. For this purpose, appreciation in value of the corpus is not considered an addition to a trust.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code.

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

In accordance with a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,
Assistant Chief Counsel
(Passthroughs and Special
Industries)
By Katherine A. Mellody
Senior Technician Reviewer
Branch 4

Enclosure
Copy for § 6110 purposes