

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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PLR-111898-05

Date:

December 16, 2005

### Legend:

Date 1 =

Taxpayer =

Spouse =

Trust 1 =

Trust 2 =

Trust 3 =

Date 2 =

Corporation =

A =

B =

Accounting =

Firm =

Year 1 =

C =

Year 2 =

D =

E =

State Statute =

Dear :

This is in response to your authorized representative's letter dated February 24, 2005, and subsequent correspondence, requesting a ruling that the proposed severance of certain trusts into exempt and non-exempt trusts for Generation-Skipping Transfer (GST) tax purposes will be qualified severances under § 2642(a)(3) of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: On Date 1, Taxpayer and Spouse established Trust 1, Trust 2, and Trust 3, irrevocable trusts, each with GST potential. On Date 2, Taxpayer transferred shares of stock in Corporation with a reported value of \$A to Trust 1, Trust 2, and Trust 3. Also on Date 2, Spouse transferred shares of stock in Corporation with a reported value of \$B to Trust 1, Trust 2, and Trust 3. Date 1 and Date 2 are in Year 1.

Taxpayer and Spouse retained the services of Accounting Firm to prepare a valuation of the gifts made and to prepare and file Year 1 Forms 709 United States Gift (and Generation-Skipping Transfer) Tax Return ("gift tax returns") reporting the transfers to Trust 1, Trust 2, and Trust 3. On the Year 1 gift tax returns, Taxpayer and Spouse each elected under § 2513 to treat the gifts made by them to third parties during the calendar year as made one-half by each of them. Taxpayer and Spouse each allocated \$C (one-half of the sum of \$A and \$B) of their respective GST exemptions to the Year 1 transfers.

Taxpayer's and Spouse's Year 1 gift tax returns were subsequently selected for audit by the Internal Revenue Service. In Year 2, Taxpayer, Spouse and the Service entered into a settlement agreement that increased the value of the shares of stock in Corporation transferred by Taxpayer to \$D and increased the value of the shares of stock in Corporation transferred by Spouse to \$E. As a result of the increase in the value of the shares of stock, each trust has an inclusion ratio, as defined in § 2642(a), that is greater than zero.

The trustees of Trust 1, Trust 2, and Trust 3 propose to sever each trust into two trusts, a GST exempt trust and a GST non-exempt trust. Each of the resulting trusts shall have beneficiaries and terms identical to the original trusts prior to the division. The assets of each trust will be divided on a fractional basis so that each GST exempt trust will have an inclusion ratio of zero after the severance and each GST non-exempt trust will have an inclusion ratio of one.

Taxpayer requests a ruling that the proposed severance of each of the trusts into two separate trusts will be a qualified severance under § 2642(a)(3) and that, for GST tax purposes, the GST exempt trusts will have an inclusion ratio of zero and the GST non-exempt trusts will have an inclusion ratio of one.

Section 2642(a) provides the method for determining the inclusion ratio.

Section 2642(a)(3) was enacted as part of the Taxpayer Relief Act of 2000, and provides for the qualified severance of a trust for GST tax purposes. Section 2642(a)(3) is effective in the case of severances occurring after December 31, 2000, and provides, generally, that if a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for GST tax purposes.

Section 2642(a)(3)(B)(i) provides that the term “qualified severance” means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of two or more trusts if: (1) the single trust was divided on a fractional basis, and (2) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

Section 2642(a)(3)(B)(ii) provides that if a trust has an inclusion ratio of greater than zero and less than one, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of one.

Section 2642(a)(3)(C) provides that a severance pursuant to § 2642(a)(3) may be made at any time.

State Statute provides, in part, that unless expressly prohibited by the terms of the disposing instrument, the trustee of a trust is authorized without prior court approval or the consent of the persons interested to establish two or more separate trusts in order to segregate property held in trust which is or would be excepted, excluded or exempt from or under Chapter 13 of the Internal Revenue Code from such property which is not so excepted, excluded or exempt, so that one or more of such separate trusts will have an inclusion ratio of zero.

In the present case, Trust 1, Trust 2, and Trust 3 will each be severed into two separate trusts in accordance with the provisions of State Statute. The terms of each of the two separate resulting trusts will be identical to the terms of the original trust. In addition, it is represented that the assets of Trust 1, Trust 2, and Trust 3 will each be divided on a fractional basis between the two respective resulting trusts. One resulting trust will receive a fractional share of the total value of all the trust property equal to the applicable fraction of the single trust that would be GST tax exempt immediately before the severance (GST exempt trust) and the other resulting trust will receive the remaining trust property (GST non-exempt trust).

Accordingly, based upon the facts submitted and representations made, we conclude that the proposed division of each of Trust 1, Trust 2, and Trust 3 into two resulting trusts, a GST exempt and a GST non-exempt trust, will be a “qualified severance” within the meaning of § 2642(a)(3). The GST exempt trusts will have an inclusion ratio of zero and the GST non-exempt trusts will have an inclusion ratio of one.

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 under the cited provisions or under any other provisions of the Code.

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.

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

Sincerely,

Melissa C. Liquerman  
Branch Chief, Branch 9  
(Passthroughs & Special Industries)

Enclosures

Copy for § 6110 purposes

Copy of letter