

Internal Revenue Service

Number: **200439029**

Release Date: 9/24/04

Index Number: 2601.00-00

Department of the Treasury

Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

In Re:

Refer Reply To:

CC:PSI:B04 – PLR-150937-02

Date: JUNE 03, 2004

LEGEND:

Settlor -
Spouse -
Child A -
Trust -
Trust A -

Trust B -
Trustee -
Date 1 -
Date 2 -
Date 3 -
Date 4 -
Date 5 -
Date 6 -
State X -
Citation A -

Dear :

This letter is in reply to your request for a ruling regarding the generation-skipping transfer tax consequences of the proposed severance and modification of Trust A.

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Facts:

On Date 1, Settlor created Trust, a revocable trust that Settlor subsequently amended on Date 2 and again on Date 3, all prior to October 21, 1986. Settlor died on Date 4, after October 21, 1986, but before January 1, 1987, at which time Trust became irrevocable. Settlor was survived by Spouse and five children, including Child A. Spouse died on Date 6. Trustee, an independent corporation, is the trustee of Trust and each trust created under the terms of Trust. Trust is governed by the law of State X.

Article FIFTH of Trust provides, in part:

(A) Upon the death of settlor, if the settlor's wife, [Spouse], survives him, the trustees shall hold the balance of the trust principal in further trust as follows:

(1) During the life of settlor's wife, [Spouse]:

(a) the trustees shall pay [Spouse] the income of the trust, at least quarterly;

(b) the trustees shall pay [Spouse] as much principal of the trust, even to the extent of all or none, (i) as [Spouse] may request from time to time, or (ii) as the trustees shall determine in their discretion from time to time.

Upon Spouse's death, the principal was to be distributed pursuant to the terms of Article SIXTH.

Paragraphs (A) and (B) of Article SIXTH, as amended, provide as follows:

(A) At the death of the survivor of settlor and his wife, [Spouse], the trust principal to be disposed of as directed in this Article shall be divided and set apart in equal shares for those of the settlor's children [Child A and the other four children], who are then living, except that if a child of the settlor is then deceased and leaves issue then living, the share that would have been set apart for the deceased child if he or she were then living shall be distributed to his or her then living issue, per stirpes.

(B) Each share so set apart for a child of the settlor shall constitute and be administered as a separate trust identified by that child's name and shall be disposed of as follows:

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(1) The trust shall terminate upon the death of the settlor's child whose name identifies the trust.

(2) During the term of the trust: the trustees shall pay as much income and principal of the trust, even to the extent of all or none, at any time or from time to time to any one or more persons (including persons born at any time after the date of this agreement) within a group consisting of the settlor's child whose name identifies the trust, that child's spouse, and that child's children and grandchildren and their spouses, as the trustees shall determine in their discretion. The trustees shall accumulate and add to principal income not paid to the beneficiaries.

(3) Upon termination of the trust: the trustees shall distribute the principal of the trust to the then living issue, per stirpes, of the child of the settlor whose name identifies the trust, or if no such issue is then living, to the settlor's then living issue, per stirpes, except that principal that becomes distributable to a child of the settlor or to a person for whose current benefit a trust under paragraph (C) of this Article then subsists shall not be distributed to that child or other person and shall instead be added to his or her trust.

Paragraph (C) of Article SIXTH provides generally that, notwithstanding previous dispositive provisions, principal that becomes distributable, at the death of Settlor or Spouse or at the termination of a trust established for the benefit of Settlor and Spouse's child, to a beneficiary under the age of 30 years, shall be held in trust with one-half of the principal to be distributed when the beneficiary attains age 25 and the balance payable when the beneficiary attains age 30. During this period, income will be payable to the beneficiary at the discretion of the trustee. If the beneficiary dies before attaining age 30, the principal will be distributed to, or in trust for the benefit of, the beneficiary's living issue or, if none, to the living issue of the beneficiary's nearest ancestor who was an issue of Settlor, or, if none, to the Settlor's then living issue.

Article SEVENTH, Paragraph (B), as amended on Date 3, addresses the trustees' discretionary distribution powers and provides:

(B) In exercising their discretionary power to pay principal to the settlor's wife, the trustees may consider or ignore as the trustees deem advisable other resources of the settlor's wife. In exercising their discretionary power to pay principal to any child or other issue of the settlor or the spouse of any child or issue of the settlor, the trustees shall take into account other resources of such person, but shall not pay principal to any person so long as any trust subsists under an agreement

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[Trust B], from which discretionary payments of principal may be made to such person.

On Date 5, within 9 months of Settlor's death, Spouse executed a disclaimer, renouncing her power, under Paragraph (A)(1)(b)(i) of Article FIFTH, to withdraw Trust corpus during her life. It is represented that, on the federal estate tax return filed for Settlor's estate, the estate's executor elected to treat the marital trust created under Article FIFTH as qualified terminable interest property under § 2056(b)(7) of the Code.

Upon the death of Spouse, and pursuant to the terms of Trust, Trust was divided into five separate trusts, one trust for each of Settlor's five children, including Trust A for the benefit of Child A.

Trustee proposes to reform Trust by amending Paragraph (B) of Article SIXTH, inserting a new Paragraph (C) of Article SIXTH, modifying the existing Paragraph (C) of Article SIXTH by redesignating it as Paragraph (D), and amending Paragraph (B) of Article SEVENTH.

Amended Paragraph (B) of Article SIXTH will read as follows:

(B) The share so set apart for [Child A] shall be disposed of as directed in Paragraph (C) of this Article. Each share so set apart for a child of the settlor other than [Child A] shall constitute and be administered as a separate trust identified by that child's name and shall be disposed of as follows:

(1) The trust shall terminate upon the death of the settlor's child whose name identifies the trust.

(2) During the term of the trust: the trustees shall pay as much income and principal of the trust, even to the extent of all or none, at any time or from time to time to any one or more persons (including persons born at any time after the date of this agreement) within a group consisting of the settlor's child whose name identifies the trust, that child's spouse, and that child's children and grandchildren and their spouses, as the trustees shall determine in their discretion. The trustees shall accumulate and add to principal income not paid to the beneficiaries.

(3) Upon termination of the trust: the trustees shall distribute the principal of the trust to the then living issue, per stirpes, of the child of the settlor whose name identifies the trust, or if no such issue is then living, to the settlor's then living issue, per stirpes, except that principal that becomes distributable to a child of the settlor or to a person for whose current

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benefit a trust under Paragraph (C) or Paragraph (D) of this Article then subsists shall not be distributed to that child or other person and shall instead be added to his or her trust.

New Paragraph (C) of Article SIXTH will read as follows:

(C) The share set apart for [Child A] to be disposed of as directed in this Paragraph shall be divided and set apart in equal shares for the settlor's grandchildren who are the children of [Child A], namely [the named grandchildren]. Each share so set apart for a grandchild of the settlor shall constitute and be administered as a separate trust identified by that grandchild's name and shall be disposed of as follows:

(1) The trust shall terminate upon the death of [Child A].

(2) During the term of the trust: the trustees shall pay as much income and principal of the trust, even to the extent of all or none, at any time or from time to time to any one or more persons (including persons born at any time after the date of this agreement) within a group consisting of the settlor's grandchild whose name identifies the trust, that grandchild's spouse, and that grandchild's children and their spouses, [Child A and Child A's spouse], as the trustees shall determine in their discretion. The trustees shall accumulate and add to principal income not paid to the beneficiaries.

(3) Upon termination of the trust: the trustees shall distribute the principal of the trust to the grandchild whose name identifies the trust, or if such grandchild is not then living, to the then living issue, per stirpes, of such grandchild, or if no such issue is then living, to the then living issue, per stirpes, of [Child A], or if no such issue is then living, to the settlor's then living issue, per stirpes, except that (i) principal that becomes distributable to a person for whose current benefit a trust then subsists under Paragraph (B) or Paragraph (D) of this Article or under this Paragraph shall not be distributed to that person and shall instead be added to his or her trust, and (ii) principal that becomes distributable to a beneficiary who has not then attained the age of 30 years and for whose current benefit a trust under Paragraph (D) of this Article does not then subsist shall not be distributed to that beneficiary and shall instead be held by the trustees as a separate trust for his or her benefit and administered pursuant to the terms of Paragraph (D).

Redesignated Paragraph (D) of Article SIXTH will be identical to the original Paragraph (C) of Article SIXTH in Trust, as amended, and will read as follows:

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(D) Notwithstanding the foregoing provisions: principal that becomes distributable at the death of the survivor of the settlor and his wife [Spouse], or at the termination of a trust identified by a name of a child or grandchild of the settlor, to a beneficiary who has not then attained the age of 30 years shall not be distributed to that beneficiary and shall instead be held separately in trust:

(1) Until the beneficiary attains the age of 30 years, the trustees shall pay him or her as much income and principal of the trust, even to the extent of all or none, at any time or from time to time as the trustees shall determine in their discretion. The trustees shall accumulate and add to principal income not paid to the beneficiary.

(2) When the beneficiary attains the age of 25 years, the trustees shall distribute to him or her one-half of whatever principal then remains in the trust, or if the beneficiary has already attained that age when the trust is created, the trustees shall distribute to him or her one-half of the original principal of the trust upon the creation thereof.

(3) When the beneficiary attains the age of 30 years, the trustees shall distribute to him or her whatever principal then remains in the trust.

(4) If the beneficiary dies before attaining the age of 30 years, the trustees shall distribute whatever principal remains in the trust at the beneficiary's death to the beneficiary's then living children in equal shares, or if no such child is then living, to the then living issue, per stirpes, of the beneficiary's nearest ancestor who was an issue of the settlor, or if no such issue is then living, to the settlor's then living issue, per stirpes, except that principal that becomes distributable to a child of the settlor or a person for whose current benefit a trust under this Paragraph (D) then subsists shall not be distributed to that child or other person and shall instead be added to his or her trust hereunder.

(5) Notwithstanding the foregoing provisions: if a trust is created under this Paragraph (D) for the current benefit of a person who was not alive on the date when the settlor's power to revoke this trust terminates, and if that trust does not terminate pursuant to the foregoing provisions prior to the expiration of 21 years after the death of the last to die of the settlor's children and grandchildren who were alive on that date, the trust shall terminate upon the expiration of that 21 years period and whatever principal then remains in that trust shall be distributed to the person for whose current benefit the trust was created.

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Amended Paragraph (B) of Article SEVENTH will read as follows:

(B) In exercising their discretionary power to pay principal to the settlor's wife, the trustees may consider or ignore as the trustees deem advisable other resources of the settlor's wife. In exercising their discretionary power to pay principal to any child or other issue of the settlor or the spouse of any child or other issue of the settlor, the trustees shall take into account other resources of such person, except that the trustees may but shall not be required to take into account the existence of any trust under [Trust B], from which discretionary payments of principal may be made to such person.

Thus, under the proposed division and reformation, Trust A for the benefit of Child A and her descendants would be divided into four separate subtrusts, one for the benefit of each of the children of Child A and their descendants. Each separate subtrust will also include Child A and Child A's spouse as discretionary beneficiaries. As stated above, redesignated Paragraph (D) of Article SIXTH of Trust is identical to the original Paragraph (C) of Article SIXTH. Amended Paragraph (B) of Article SEVENTH will authorize the trustees to make discretionary distributions of principal to current beneficiaries of the Trust A subtrusts, even if these beneficiaries are discretionary beneficiaries of trusts created under Trust B.

You have represented that no additions, actual or constructive, have been made to either Trust or Trust A since Date 4, the date of Settlor's death.

The law of State X, at Citation A., provides, in pertinent part, that, unless otherwise provided in the trust instrument, the trustee has the power:

To sever any trust on a fractional basis into two or more separate and identical trusts for any reason or to segregate by allocation to a separate account or trust a specific amount from, a portion of, or specific assets included in, the trust property of any trust, unless expressly provided to the contrary in the trust instrument. Income earned on a segregated amount, portion, or specific asset after the segregation is effective passes with the amount, portion, or asset segregated. Each separate trust must be held and administered upon the identical terms and conditions of the trust from which it was severed.

Specifically, you request a ruling that the proposed division and modification of Trust will not constitute a generation-skipping transfer subject to the generation-skipping transfer (GST) tax under section 2601 of the Internal Revenue Code and the proposed division will not cause the resulting trusts to be subject to the GST tax.

Law and Analysis:

Section 2601 imposes tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip. Under § 1433(a) of the Tax Reform Act of 1986 (the Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax does not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is not made out of actual or constructive additions 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.

Under § 1433(b)(2)(B) of the Act and § 26.2601-1(b)(2)(i), the GST tax does not apply to any generation-skipping transfer under a will or revocable trust executed before October 22, 1986, provided that (A) the document in existence on October 21, 1986, is not amended at any time after October 21, 1986, in any respect which results in the creation of, or increase in the amount of, a generation-skipping transfer; (B) in the case of a revocable trust, no addition is made to the revocable trust after October 21, 1986, and (C) the decedent dies before January 1, 1987.

Section 26.2601(b)(1)(v)(A) provides that, except as provided under § 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax will not cause the trust to lose its exempt status. The regulation provides that these rules only apply for generation-skipping transfer tax purposes. The rules do not apply in determining whether the transaction results in a gift subject to the gift tax, or may cause the trust to be included in the gross estate, or may result in the realization of capital gains for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the

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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. 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.

Section 26.2601-1(b)(4)(i)(E), Example 5, describes a situation where, in 1980, the grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. The trustee had the discretion to distribute income and principal to the beneficiaries. The trust would terminate upon the death of the last to die of A and B and the principal would be distributed to the living issue of A and B, per stirpes. In 2002, a court order divided the trust into two equal trusts, one for the primary benefit of A and A's issue and the other for the primary benefit of B and B's issue, with trustee discretionary distributions of income and principal along each family line. Each trust would terminate upon the death of the primary beneficiary, A or B, and the principal would be distributed to the issue, per stirpes, of each primary beneficiary. If there are no living descendants of the primary beneficiary, the principal of that trust would be added to the trust for the benefit of the other primary beneficiary and his or her issue. The example concludes that 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 than the person or persons who held the beneficial interest prior to the division. The example also concludes that 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.

In this case, Trust was revocable on October 22, 1986, and was not amended after that date. The Settlor died after October 22, 1986, but before January 1, 1987. You have represented that no additions, constructive or actual, have been made to Trust or Trust A after Date 4, the date that Trust A became irrevocable. In addition, see § 26.2601-1(b)(1)(iii) and § 26.2601-1(b)(2)(iii) regarding a special rule for trusts subject to an election under § 2056(b)(7).

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Accordingly, assuming Spouse's disclaimer was a qualified disclaimer under § 2518, Trust and the trusts created under its terms, including Trust A, are exempt from the GST tax and transfers from Trust, and the trusts created under its terms, are not subject to the generation-skipping transfer tax.

The parties propose to divide Trust A into equal and separate subtrusts, one subtrust each for the benefit of the four children of Child A and their descendants. Each resulting subtrust will have dispositive provisions identical to those of Trust A, with the exception that each trust will be established for the benefit of the named grandchild, his or her spouse and descendants, and Child A and Child A's spouse. As noted above, Paragraph B of Article SEVENTH will be modified to authorize the trustees to make discretionary principal distributions to a trust beneficiary, notwithstanding that the beneficiary is also a beneficiary of any trust created under Trust B. In this case, the beneficiaries of Trust A, and the Trust A subtrusts are also beneficiaries of Trust B. Thus, this modification may result in the acceleration of principal distributions to the Trust A beneficiaries, but will not shift a beneficial interest in Trust A to lower generation beneficiaries or delay vesting of the Trust A corpus.

We conclude that the proposed reformation and division of Trust A into separate subtrusts, as described above, will not shift a beneficial interest in the subtrusts to any beneficiary who occupies a lower generation than the persons who held the beneficial interest prior to the division. The proposed division will not extend the time for vesting of any beneficial interest in the subtrusts beyond the time provided for in Trust A. See § 26.2601-1(b)(4)(i)(e), Example 5.

Accordingly, assuming Spouse's disclaimer was a qualified disclaimer under § 2518, based on the facts submitted and the representations made, we conclude that after the reformation and division, the resulting subtrusts will be exempt from the GST tax imposed under § 2601. Further, the proposed reformation and division will not constitute an addition to Trust A or the resulting trusts. Accordingly, future distributions from the resulting subtrusts will be exempt from GST tax.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. We are not ruling on whether the transaction may result in the realization of capital gain to the beneficiaries of the subtrusts of Trust A for purposes of § 1001. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any tax return to which it is relevant. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

The rulings contained in this letter are 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.

Sincerely,

George Masnik
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure (1)
Copy for § 6110 purposes
cc