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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B09

PLR-164117-03

Date:

September 27, 2004

In Re:

Legend:

Decedent =

Spouse =

Trust =

Family Trust =

Marital Trust A =

Marital Trust B =

Son =

Daughter =

Son's Trust =

Daughter's Trust =

Son-in-Law =

Grandson =

Granddaughter =

Granddaughter's Trust =

State Statute =

Date 1 =

Date 2 =

Date 3 =

A =

B =

C =

D =

E =

F =

G =

H =

I =
J =
K =
L =

Dear :

This is in response to your letter dated October 16, 2003, and subsequent correspondence, in which you requested a ruling on the generation-skipping transfer (GST) tax consequences of severing a trust into two separate trusts pursuant to § 2642(a)(3) of the Internal Revenue Code.

The facts submitted and the representations made are as follows. On Date 1, Decedent executed a will. The will provides that the residue of his estate is to be transferred to a revocable trust (Trust) created by Decedent on Date 1, for the benefit of his spouse (Spouse) and his descendants.

Article 4 of Trust provides that, upon Decedent's death, the trust estate is to be divided into Family Trust, Marital Trust A, and Marital Trust B. Family Trust is to be funded with property equal to Decedent's unified credit. Marital Trust A is to be funded with property equal to Decedent's unused GST exemption. Marital Trust B is to be funded with the remainder of the trust estate.

Article 5 provides that Spouse is to receive all of Marital Trust A's net income at least quarter-annually. Accrued but unpaid income at the time of her death is to be paid to her estate. The trustee may distribute the principal from Marital Trust A to Spouse for her support, maintenance, and medical care. Upon Spouse's death, the balance of the trust estate of Marital Trust A is to be added to and become part of Family Trust.

Article 6 provides that Spouse is to receive all of Marital Trust B's net income at least quarter-annually. Accrued but unpaid income at the time of her death is to be paid to her estate. The trustee may distribute the principal from Marital Trust B to Spouse for her support, maintenance, and medical care. Upon Spouse's death, Marital Trust B is to be disposed of as follows. First, assets equal to Spouse's unused GST exemption are to be segregated. Second, the remaining portion of Marital Trust B, if any, is to be paid over, free of trust, as follows: two-thirds to Decedent's daughter (Daughter), if living, and if not, to Daughter's living issue, per stirpes; and one-third to the trustee of a trust for Decedent's son (Son), the terms of which are set forth in Article 9 (Son's Trust). Finally, the segregated assets (the amount equal to Spouse's GST exemption) are to be paid over to the Family Trust.

Article 7 provides that during Spouse's life, the trustee of Family Trust is to distribute net income to Spouse for her support, maintenance, and medical care. Upon Spouse's death, Family Trust's assets are to be disposed of as follows: two-thirds to the trustee of

a trust for Daughter, the terms of which are set forth in Article 8 (Daughter's Trust); and one-third to the trustee of Son's Trust.

Article 8 provides that Daughter is to receive all of the net income of her trust and trust principal to provide for her support, maintenance, and medical care. Upon Daughter's death, if she is survived by her spouse (Son-in-Law), then Son-in-Law is to receive all of the net income from Daughter's Trust for his lifetime. Upon the death of the survivor of Daughter and Son-in-Law, Daughter's Trust will terminate and the remaining principal is to be distributed as follows: one-half, free of trust, to Grandson, if living, and if not, to his then living descendants, per stirpes; and one-half to the trustee of a trust for Granddaughter, the terms of which are set forth in Article 10 (Granddaughter's Trust).

Article 9 provides that Son is to receive all of his trust's net income and principal to provide for his support, maintenance, and medical care. Upon Son's death, Son's Trust will terminate and be distributed to certain charities.

Article 10 provides that Granddaughter is to receive net income and principal from her trust to provide for her support, maintenance, medical care, and education. Income not distributed is to be added to principal. Upon Granddaughter's death, her trust will terminate and be distributed, free of trust, to her living descendants, per stirpes, if any; if none; to Grandson if he is living; if not, to Grandson's living issue, per stirpes, if any; if none, to certain charities.

Decedent died on Date 2. Spouse, Son, Daughter, Son-in-Law, Grandson, and Granddaughter survived Decedent. The executor of Decedent's estate timely filed the estate's Federal estate tax return, and on the return, the estate elected under § 2056(7) to treat the assets that passed to Marital Trust A and Marital Trust B as qualified terminable interest property (QTIP). In addition, the estate indicated that Family Trust would be funded with assets equaling \$ A, Marital Trust A would be funded with assets equaling \$ B (the amount of Decedent's remaining GST exemption), and Marital Trust B would be funded with assets equaling \$ C. The estate also made the reverse QTIP election under § 2652(a)(3) for Marital Trust A on Schedule R of the estate tax return.

Spouse died on Date 3, survived by Son, Daughter, Son-in-Law, Grandson, and Granddaughter. The executor of Spouse's estate timely filed the estate's Federal estate tax return. The return indicates that, on Date 3, the value of the assets of Marital Trust A was \$ D, and the value of the assets of Marital Trust B was \$ E. On the Schedule R of the return, the estate allocated \$ F of Spouse's available GST exemption to a trust Spouse created for Son. Spouse's remaining GST exemption (\$ G) was then allocated to Marital Trust B.

Upon Spouse's death, pursuant to Article 6 of Trust, distributions were made from Marital Trust B, free of trust, to Daughter, not a skip person, and Son's Trust, not a trust from which a GST event could occur. After these distributions, the assets remaining in Marital Trust B were equal to Spouse's remaining GST exemption (\$ G).

Also, upon Spouse's death, pursuant to the terms of Articles 5 and 6 of Trust, all of Marital Trust A's assets were contributed to Family Trust, and Marital Trust B's assets remaining after the distributions to Daughter and Son's Trust (\$ G), were contribute to Family Trust. It has been represented that, on Date 3, the value of the assets of Family Trust was \$ H. Accordingly, as of Date 3, Family Trust consisted of assets that had been valued at \$ I (\$ D plus \$ G plus \$ H equals \$ I).

Presently, Family Trust does not have a zero inclusion ratio for GST purposes. Accordingly, the trustee intends to divide Family Trust, under State Statute, into two separate trusts, GST Exempt Family Trust and GST Non-Exempt Family Trust. State Statute provides, in pertinent part, that a trustee may, without court approval, divide a trust before or after it is funded into two or more separate trusts. The trustee, however, must determine that dividing the trust is in the best interests of all persons interested in the trust and will not substantially impair the accomplishment of the purposes of the trust.

The trustee intends to divide Family Trust on a fractional bases into GST Exempt Family Trust and GST Non-Exempt Family Trust pursuant to § 2642(a)(3). The numerator of the fraction used to divide Family Trust into GST Exempt Family Trust and GST Non-Exempt Family Trust will be \$ J (\$ D plus \$ G equals \$ J) and the denominator of the fraction will be \$ I. Based upon this fraction, K percent of Family Trust's assets will be allocated to GST Exempt Family Trust and L percent (K percent minus 100 percent equals L percent) of Family Trust's assets will be allocated to GST Non-Exempt Family Trust. The terms of GST Exempt Family Trust and GST Non-Exempt Family Trust will be identical to the terms of Family Trust.

The trustee is requesting a ruling that the proposed division of Family Trust into GST Exempt Family Trust and GST Non-Exempt Family Trust will be a qualified severance under § 2642(a)(3), and that, for GST tax purposes, GST Exempt Family Trust will have an inclusion ratio of zero and GST Non-Exempt Family Trust will have an inclusion ratio of one.

Law and Analysis:

Section 2642(a)(3)(A) provides that if a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of chapter 13.

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 -- (I) the single trust was divided on a fractional basis, and (II) 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 1, 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 may be made at any time.

In this case, as of Spouse's death, pursuant to the terms of Articles 5 and 6 of Trust, Family Trust consists of the assets contributed to the trust by Decedent, assets from Marital Trust A, and assets from Marital Trust B. Based upon the facts submitted and the representations made, Family Trust does not have a zero inclusion ratio for GST tax purposes. Accordingly, the trustee of Family Trust intends to sever Family Trust into two separate trusts having the same terms as Family Trust in accordance with the provisions of State Statute. Since the terms of the two separate resulting trusts will be identical to Family Trust's terms, the terms of the two resulting trusts, in the aggregate, will provide for the same succession of interests of beneficiaries as are provided in Family Trust.

In addition, it is represented that Family Trust's assets will be divided on a pro-rata fractional basis between the two resulting trusts. One trust will receive a fractional share of the total value of all Family Trust's assets equal to the applicable fraction of the single trust that would be GST tax exempt immediately before the severance (GST Exempt Family Trust), and the other resulting trust will receive Family Trust's remaining assets (GST Non-Exempt Family Trust).

Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed division of Family Trust into two resulting trusts, the GST Exempt Family Trust and the GST Non-Exempt Family Trust, will be a qualified severance within the meaning § 2642(a)(3). The GST Exempt Family Trust will have an inclusion ratio of zero, and the GST Non-Exempt Family Trust will have an inclusion ratio of one.

The rulings contained in this letter are based upon information and representations submitted 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 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. Specifically, no opinion is expressed or implied regarding the value of the assets of Family Trust, Marital Trust A, Marital Trust B, or the value of the estates of Decedent and Spouse for Federal transfer tax purposes.

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,

James F. Hogan

James F. Hogan
Senior Technician Reviewer, Branch 9
(Passthroughs & Special Industries)

Enclosures: Copy for § 6110 purposes
One copy of this letter

cc: