

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09-PLR-132330-01

Date:

November 30, 2001

Re:

LEGEND:

Decedent =

Date 1 =

Trust =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

Caregiver =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

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| | |
|-------------------|---|
| Trust 6 | = |
| Trust 7 | = |
| Step-grandchild 1 | = |
| Step-grandchild 2 | = |
| Step-grandchild 3 | = |
| Charity | = |
| Stepdaughter | = |
| \$a | = |
| \$b | = |
| \$c | = |
| \$d | = |
| Corporation | = |

Dear :

This is in response to your letter dated June 12, 2001, requesting a ruling under § 2601 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: Decedent executed a revocable trust agreement (Trust) on Date 1, and amended it on Date 2, Date 3, Date 4, Date 5, Date 6, and Date 7. Corporation is the trustee of the Trust.

Paragraph 3 of the Trust, as amended, provides for the payment of debts and taxes upon Decedent's death. Paragraph 4 of the Trust provides that after providing for the payments contemplated in Paragraph 3, the trustee shall divide the remaining Trust property (including property to which the trustee is entitled under Decedent's will) into four separate trusts, one of which shall consist of one-half of such Trust property and shall be designated the "Charitable Trust." Each of the other three shall consist of one-sixth of Trust's property and be designated respectively by the names of Decedent's three step-grandchildren, Step-grandchild 1, Step-grandchild 2, and Step-grandchild 3. The trustee is directed to immediately distribute the principal of the Charitable Trust to Charity.

Paragraph 5 of the Trust directs that Caregiver, a non-skip person to Decedent, be paid \$a per year in monthly installments. These payments are to be made out of income and, to the extent income is insufficient, out of principal, of the respective trusts named for Decedent's step-grandchildren.

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Paragraph 6, subsection (a), of the Trust provides that, from the trusts of the step-grandchildren, the trustee shall pay to the beneficiary for whom a trust is named and his or her descendants, such part or all of the income and principal of the trust at such times as the trustee believes desirable for the best interests and welfare of the beneficiary and his or her descendants in that order and as a group, considering the desirability of supplementing their respective incomes or assets and all other circumstances and factors the trustee believes pertinent. All undistributed income is to be accumulated and from time to time added to principal.

Paragraph 6, subsection (b), of the Trust provides that, if a beneficiary for whom a trust is named dies before the complete distribution of principal from the trust, the principal and undistributed income of the trust shall be distributed to or for the benefit of his spouse and descendants or such religious, charitable, scientific or educational purposes in such proportions and subject to such trusts, powers and conditions that beneficiary may provide and appoint by will specifically referring to this power to appoint.

Paragraph 6, subsection (c), of the Trust provides that any part of a trust not effectively disposed of by any other provision shall be divided and allocated on the death of the last to die of the beneficiary for whom the trust is named and Decedent, per stirpes, among the living descendants of the beneficiary, or if none, then per stirpes, among the then living descendants of the nearest lineal ancestor of the beneficiary who was also a descendant of Stepdaughter, and of whom one or more descendants then are living, or if none, then per stirpes, among Stepdaughter's then living descendants.

Paragraph 6, subsection (d), of the Trust provides that, when a descendant of a step-grandchild for whom a trust is named reaches thirty years of age, the trustee shall distribute the remaining principal of the trust to him or her.

Paragraph 6, subsection (e), of the Trust provides that, on the day preceding the end of twenty-one years after the death of the last to die of Decedent's husband's descendants living on Date 1, and Decedent, the trustee shall distribute any property then held in a trust to the beneficiary for whom the trust is named.

Decedent died on Date 8. The trustee divided each step-grandchild's trust into three trusts; Trust A, which consisted of \$b, Trust B, which consisted of \$c, and an annuity trust, which consisted of \$d. The division and allocation were provisional because the trustee was not certain that the generation-skipping transfer (GST) tax applied to Decedent. For Step-grandchild 1, Trust A has been designated as Trust 1 and Trust B has been designated as Trust 4. For Step-grandchild 2, Trust A has been designated as Trust 2 and Trust B has been designated as Trust 5. For Step-grandchild 3, Trust A has been designated as Trust 3 and Trust B has been designated as Trust 6. The annuity trusts have been consolidated into Trust 7 and will continue to pay an annuity to Caregiver for her life. Any amount in Trust 7 at Caregiver's death will be divided and allocated among the trusts named for Decedent's step-grandchildren.

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The executor of Decedent's estate timely filed a federal estate tax return (Form 706) on Date 9. In accordance with the requirements of § 26.2601-1(b)(3)(iii) of the Generation-Skipping Transfer Tax Regulations, the executor attached to Schedule R of Form 706 a sworn statement stating Decedent was under a mental disability to change the disposition of her property from October 22, 1986, until her death, and certifications of Decedent's physicians stating that Decedent was incompetent to handle her own affairs during the period of time that each physician treated Decedent. The certifications cover the entire period of time from October 22, 1986, until Decedent's death. The Internal Revenue Service (Service) issued an estate tax closing letter for Decedent's estate on Date 10.

The trustee proposes to merge Trust A and Trust B for each step-grandchild into a single trust for the step-grandchild.

The trustee has requested a ruling under Chapter 13 of the Internal Revenue Code that, under § 1433(b)(2)(C) of the Tax Reform Act of 1986 (Act), each of the trusts created under Trust is exempt from the generation-skipping transfer (GST) tax and each Trust A and B, which are named for a step-grandchild of Decedent, may be merged into a separate trust that will be exempt from GST tax.

Section 2601 of the Code imposes a tax on every generation-skipping transfer made after October 22, 1986.

Under § 1433(b)(2)(C) of the Tax Reform Act of 1986, the tax does not apply to any generation-skipping transfer-- (i) under a trust to the extent such trust consists of property included in the gross estate of a decedent (other than property transferred by the decedent during his life after the date of the enactment of the Act), or reinvestments thereof, or (ii) that is a direct skip that occurs by reason of the death of any decedent; but only if such decedent was, on the date of the enactment of the Act, under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of death.

Section 26.2601-1(b)(3)(i) of the Generation-Skipping Transfer Tax Regulations provides, in part, that, if an individual was under a mental disability to change the disposition of his or her property continuously from October 22, 1986, until the date of his or her death, the provisions of Chapter 13 do not apply to any generation-skipping transfer-- (A) under a trust (as defined in § 2652(b)) to the extent such trust consists of property, or the proceeds of property, the value of which was included in the gross estate of the individual (other than property transferred by or on behalf of the individual during the individual's life after October 22, 1986); or (B) which is a direct skip (other than a direct skip from a trust) that occurs by reason of the death of the individual.

Section 26.2601-1(b)(3)(ii) provides that, the term "mental disability" means mental incompetence to execute an instrument governing the disposition of the individual's property, whether or not there was an adjudication of incompetence and regardless of whether there has been an appointment of a guardian, fiduciary, or other

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person charged with either the care of the individual or the care of the individual's property.

Section 26.2601-1(b)(3)(iii)(A) provides that, if there has not been a court adjudication that the decedent was mentally incompetent on or before October 22, 1986, the executor must file, with Form 706, either—

- (1) A certification from a qualified physician stating that the decedent was—
 - (i) mentally incompetent at all times on and after October 22, 1986; and
 - (ii) did not regain competence to modify or revoke the terms of the trust or will prior to his or her death; or
- (2) Sufficient other evidence demonstrating that the decedent was mentally incompetent at all times on and after October 22, 1986, as well as a statement explaining why no certification is available from a physician; and
- (3) Any judgment or decree relating to the Decedent's incompetency that was made after October 22, 1986.

Section 26.2601-1(b)(3)(iii)(B) provides that the items in § 26.2601-1(b)(3)(iii)(A), (1), (2), and (3) will be considered relevant, but not determinative, in establishing the decedent's state of competency.

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 exempt from the GST tax under §§ 26.2601-1(b)(1), 26.2601-1(b)(2), and 26.2601-1(b)(3) will not cause the trust to lose its exempt status.

Under § 26.2601-1(b)(4)(i)(D)(1) a modification will not cause a trust that was irrevocable on September 25, 1985, 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. 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 generation-skipping transfer or the creation of a new generation-skipping transfer.

According to the facts as represented, the principal of Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, and Trust 7 consists of property that was included in Decedent's gross estate, and Decedent's Form 706 included a certification regarding Decedent's mental disability from each physician who treated Decedent from October 22, 1986 until her death. Because the required statements were filed with the Form 706 on Date 9, and the Service issued an estate tax closing letter on Date 10, the Service has accepted that Decedent was under a mental disability to change the disposition of her property continuously from October 22, 1986, until her death.

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Because Decedent was under a mental disability to change the disposition of her property continuously from October 22, 1986, until her death, the provisions of § 1433(b)(2)(C) of the Tax Reform Act of 1986 apply to each of the trusts, and thus the provisions of Chapter 13 of the Internal Revenue Code will not apply to any generation-skipping transfer made from the trusts.

In addition, the trustee proposes to merge each step-grandchild's separate trusts. For Step-grandchild 1, Trust 1 will merge with Trust 4. For Step-grandchild 2, Trust 2 will merge with Trust 5. For Step-grandchild 3, Trust 3 will merge with Trust 6. In this case, the merger of the trusts will not result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. Thus, the mergers will not result in a shift in beneficial interest to a lower generation beneficiary or extend the time for vesting of any beneficial interests in the trusts for purposes of § 26.2601-1(b)(4)(i)(D)(1). Accordingly, we conclude that the merged trusts will continue to be exempt from the GST tax.

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(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,
James F. Hogan
Senior Technician Reviewer, Branch 9
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

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