

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09 / PLR-150088-01

Date:

December 18, 2001

Legend

Trust =

Date 1 =

Grantor =

Step-daughter =

Trustee 1 =

Trustee 2 =

Special Trustee 1 =

Special Trustee 2 =

Date 2 =

Court =

Trust A =

Child 1 =

Trust B =

Child 2 =

Dear

This letter responds to your letter, dated September 25, 2001, submitted on behalf of Trust, requesting rulings under § 2601 of the Internal Revenue Code.

Trust was created on Date 1, by Grantor for the benefit of the issue of

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Step-daughter. Step-daughter is currently one of the trustees of Trust.

Article I of the Trust agreement provides that the Trust instrument may not be altered, amended or revoked in whole or in part by any person.

Article II, paragraph B of the Trust agreement provides, in part, that income shall be added to and become principal, and the trustees may distribute to or for the benefit of issue living from time to time, or any one or more of them, such sums, if any, and in such proportion as may be, in the discretion of the special trustees named in Article III necessary for their respective support, health, comfort and education, until the termination of the trust pursuant to paragraph C of Article II. That paragraph provides that any payment or application of benefits pursuant to paragraph B shall be charged against the ultimate share of a beneficiary to whom or for whose benefit the distribution is made in the manner provided in subparagraph (1) of paragraph C of Article II.

Article II, paragraph C, subparagraph (1) provides that the Trust shall terminate when all the children of Step-daughter living at her death shall attain the age of sixty years or shall have died, and Step-daughter shall have died. At that time, Trust shall be distributed to all of Step-daughter's issue then living, upon the principle of representation. It is Grantor's intention that each of the beneficiaries receive an amount of the trust estate under all provisions of this instrument equal to a share of the trust estate determined under the principle of representation to the extent possible. Therefore, for the purpose of distributing the trust estate to issue upon termination of this trust, all previous distributions to Step-daughter's issue under paragraphs B and H shall be considered as part of the trust estate (valued at the date of distribution). After the trustees have computed a division of the augmented trust estate upon the principle of representation, any distributions to a beneficiary under paragraphs B and H of Article II shall be subtracted from the beneficiary's share of the augmented trust estate. If a beneficiary is deceased upon termination of Trust, all distributions to such beneficiary shall be subtracted from his issue's share of the augmented trust estate. The resulting shares shall then be distributed to issue upon the principle of representation. A share of a beneficiary shall not be reduced below zero, and no beneficiary shall be required to reimburse the trust estate if prior distributions to him exceed his share of the augmented trust estate.

Article II, paragraph E provides that unless terminated at an earlier date under the foregoing provisions of Article II, all trusts created under the Trust shall terminate one day prior to the twenty-first anniversary of the death of the last survivor of the Grantor, the Grantor's husband and his issue living on the date of the execution of the Trust. Upon termination, the principal and accumulated income of each trust shall be distributed upon the principle of representation to the persons then entitled to the income thereof or if there are none, to the persons then entitled to distributions therefrom in the discretion of the trustees.

Article II, paragraph H provides, in part, that notwithstanding the foregoing provisions of Article II, the special trustees shall have the power to accelerate

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distribution of any part of any trust or of an entire trust for any reason and shall have the power to postpone the distribution of any part of the trust or of an entire trust if they shall determined that there is a compelling reason to postpone such distribution.

Article III, paragraph A provides that, if either Trustee 1 or Trustee 2 (or any successor fiduciary designated pursuant to this paragraph A) shall be unwilling or unable to act as trustee, the remaining fiduciary shall designate a successor fiduciary other than the Grantor or the Grantor's husband to fill the vacancy.

Article III, paragraph B provides, in part, that Special Trustee 1 and Special Trustee 2 shall act as special trustees. They shall hold certain powers including those described in paragraphs B and H of Article II, and shall exercise the powers by a written instrument delivered to the trustees. If either Special Trustee 1 or Special Trustee 2 (or any successor fiduciary designated pursuant to paragraph B) shall be unwilling or unable to act as special trustee, the remaining fiduciary shall designate a fiduciary who is not the Grantor or the Grantor's husband and who is not a related or a subordinate party to the Grantor or the Grantor's husband as defined in § 672(c) of the Internal Revenue Code, to fill the vacancy.

Article V, paragraph I provides that Trust is to be governed by the laws of California. California law provides for the division of a trust on petition by a trustee or beneficiary. Cal. Prob. Code § 15412 (2001). In addition, California law provides for the modification of an irrevocable trust by all beneficiaries if the court determines that the reason for the modification outweighs the interest in accomplishing a material purpose of the trust. Cal. Prob. Code § 15403 (2001).

The trustees wished to partition Trust into two trusts, one to benefit each of Step-daughter's children, in order to manage the resulting trusts in accordance with each beneficiary's current need and tolerance for risk. In addition, the trustees intend to modify the trust to allow for the appointment of successor trustees and successor special trustees. Accordingly, the trustees petitioned Court seeking a partition and modification of trust. On Date 2, Court issued an order (1) partitioning Trust into two separate trusts: Trust A for the benefit of Child 1 and Trust B for the benefit of Child 2 under the authority of Cal. Prob. Code § 15412 and (2) modifying the provision of the Trust relating to the appointment of successor trustees and special trustees under the authority of Cal. Prob. Code § 15403. Paragraph 2 of the court order provides that the division of the existing assets of Trust shall be made equally between the two new separate trusts, after adjustment for prior distributions from Trust to each of Child 1 and Child 2, respectively, in the manner described in paragraph C, subparagraph (1) of Article II of the Trust.

Paragraph 4 of the court order provides that the provisions of these separate trusts shall be identical to the original Trust except that the new trusts are held and administered separately for their respective beneficiaries.

Paragraph 5 of the court order provides that distributions from the new, separate

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trusts shall be made in the same manner as paragraph B of Article II of the Trust, except that the distributions from each separate trust shall be made solely to or for the benefit of Child 1 and her issue or Child 2 and his issue, respectively.

Paragraph 6 of the court order provides that each new trust will terminate in the same manner and time as provided for in the original Trust, except that upon termination, each of Child 1's and Child 2's new trust shall be distributed solely to or for the benefit of Child 1 and her issue or Child 2 and his issue, respectively. Paragraph 7 of the court order provides that should Child 1 or Child 2 die without issue prior to termination, the assets of his or her new trust shall then be distributed to and augment the trust for the other child.

Paragraph 8 of the court order provides that in the event of a vacancy in the office of the trustee or special trustee where no successor has been designated by the trustee or special trustee pursuant to the terms of the Trust, a majority of the current adult beneficiaries of the separate trust, who are then entitled to receive distributions of income or principal, shall have the power to designate successor trustees or special trustees of that trust, providing however, that the beneficiaries may not designate a trustee or special trustee that is related or subordinate to the beneficiaries (within the meaning of § 672(c) of the Internal Revenue Code).

Paragraph 9 of the court order provides that in all other respects, both new, separate trusts shall be subject to and administered in accordance with the terms of the original Trust.

Special Trustee 1 has requested the following rulings: (1) the partition of Trust into two trusts for each of the two current beneficiaries and his or her respective issue, will not cause Trust to lose its status as exempt from the generation-skipping transfer tax, and (2) the modification of Trust to permit the beneficiaries to designate successor trustees and special trustees in the event of a vacancy where no successor has been designated under the terms of the Trust will not cause Trust to lose its status as a Trust exempt from the generation-skipping transfer tax.

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term "generation-skipping transfer" to include a taxable distribution, taxable termination, and a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in

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§ 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust 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 in the original trust. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

In this case, the partition will result in two trusts, one for each of the current beneficiaries and their issue. The partition does not shift a beneficial interest in the Trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification because the interests of the beneficiaries will not change as a result of the partition. In addition, the partition does not extend the time for vesting of any beneficial interest in the Trust beyond the period provided in the original Trust because the court order provides that each new trust will terminate in the same manner and time as provided for in the original Trust. Therefore, we conclude that the partition will not affect the exempt status of Trust.

Furthermore, the court order modifies Trust to allow for the appointment of successor trustees and successor special trustees. This modification is administrative in nature. Therefore, we conclude that the modification relating to these rules will not affect the exempt status of Trust. Based on the facts submitted and the representations made, the partition and modification of Trust will not affect the exempt status of Trust, Trust A, and Trust B.

Except as expressly provided herein, no opinion is expressed or implied

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concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to Special Trustee 1.

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.

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

Enclosures
Copy for § 6110 purposes