

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-113925-01

Date:

August 20, 2001

Re:

LEGEND:

Grandparent 1	=
Grandparent 2	=
Child A	=
Child B	=
Grandchild A	=
Grandchild B-1	=
Grandchild B-2	=
Grandchild B-3	=
Trust #1	=

Grandchild A Trust #1	=
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Child B Family Trust #1	=
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Trust #2	=
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Grandchild A Trust #2	=
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Child B Family Trust #2	=
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Trust #3	=
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Grandchild A Trust #3	=
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Child B Family Trust #3	=
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Date =
 Year 1 =
 Year 2 =
 Corporate Trustee =

Dear :

This is in response to the February 27, 2001 letter requesting a ruling on the generation-skipping transfer tax consequences of the judicial partition of three trusts. The facts submitted and representations are as follows.

Grandparent 1 and Grandparent 2 were husband and wife. Trust #1 and Trust #2 were created by Grandparent 1. Trust #3 was created by Grandparent 2. The trusts were irrevocable on September 25, 1985. There were no additions to the trusts made after that date. Grandparent 1 and Grandparent 2 have died. They were survived by Child A and Child B. Child A has died leaving one surviving child, Grandchild A. Child B is living. She has three living children, Grandchild B-1, Grandchild B-2, and Grandchild B-3. Corporate Trustee is the trustee of the three trusts.

Trust #1

Grandparent 1 created Trust #1 on Date. Under Article 1.1 of the trust instrument, trust income is to be paid to Child A for life. Under Article 1.2, on Child A's death, the income is to be paid in equal shares to Grandparent 1's grandchildren then surviving. If a grandchild dies leaving surviving issue, the issue will take the parent's share by representation. If an income beneficiary is a minor, the trustee may accumulate the income for the minor during the minority.

Under Article 3.8, if, in the opinion of the trustee, the income distributed to a life beneficiary, together with the beneficiary's income from other sources, is insufficient to provide for the life beneficiary or to enable him or her to afford suitable maintenance, education and support for his or her children, or if the life beneficiary needs to incur unusual expenses for education, maintenance and support, medical attention or any emergency, the trustee is authorized, in the trustee's discretion, to encroach on trust principal to the extent deemed necessary and proper. Any encroachment is to be charged against the life beneficiary for whom the encroachment is made, thus reducing the principal from which that beneficiary and his or her lineal descendants may receive income, and reducing the share distributable to the beneficiary or his or her lineal descendants.

Under Article 3.9, if a beneficiary is less than age 21, or is disabled for any reason, the trustee may accumulate the income for the beneficiary during the period of disability, or the trustee, in its discretion, may pay the income to the beneficiary or to

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such persons as the trustee may consider to be in the best interest of the beneficiary.

Under Article 2, Trust #1 will terminate on the death of the last to survive of Child A, Child B, Grandchild A, Grandchild B-1, Grandchild B-2, and Grandchild B-3. Under Article 2.1, if Grandchild A leaves surviving issue, 25% of the Trust #1 principal is to be paid to the issue, per stirpes. Under Article 2.2, the remaining principal (and if Grandchild A dies without issue, the entire principal), is to be distributed to the issue of Grandparent 1's grandchildren, per stirpes, exclusive of Grandchild A's issue.

Currently, Trust #1 income is distributable in equal shares to Grandchild A, Grandchild B-1, Grandchild B-2, and Grandchild B-3.

Trust #2

Grandparent 1 died in Year 1. Trust #2 was created under Item VI of her will. Under Item VI, paragraphs 1 and 2 of the will, 40% of the Trust #2 income is to be paid to Child A for life, and 40% of the Trust #2 income is to be paid to Child B for life.

Under Item VI, paragraph 4, on Child A's death, his 40% share of trust income is to be paid under Items VI, paragraph 3, subparagraph A, and Item VI, paragraph 3, subparagraph B, 1/8th to Grandchild A and 7/8ths equally among Child B's three children or their surviving issue per stirpes. On Child B's death, the 40% share of trust income payable to her is to be paid under Item VI, paragraph 3, subparagraph B, equally to her surviving children or their surviving issue per stirpes.

Under Item VI, paragraph 3, subparagraph A, of the remaining 20% of trust income, 1/8th is to be paid to Grandchild A for life. If a grandchild's portion of the 20% share of income, payable to him or her in accordance with Item VI, paragraph 3, subparagraph B (described below), is less than 1/8th of this 20% part, then, as long as the situation continues, the 1/8th portion payable to Grandchild A will be reduced such that the amount payable to Grandchild A will be identical to the amounts payable to the other grandchildren, as determined under Item VI, paragraph 3, subparagraph B. If Grandchild A dies with issue, the income payments will be made to the issue, per stirpes, until the trust terminates. If Grandchild A dies without issue, the portion otherwise payable to him will be distributed to the other grandchildren and their issue in accordance with Item VI, paragraph 3, subparagraph B.

Under Item VI, paragraph 3, subparagraph B, 7/8ths of remaining 20% of trust income is to be paid equally to Grandparent 1's grandchildren born to Child B and any child born to Child A after the execution of Grandparent 1's will. The income payments

will continue for a beneficiary's life or until the prior termination of Trust #2. If a beneficiary dies before Trust #2 terminates, his or her issue will take that beneficiary's share, per stirpes.

Under Item VII, paragraph 8, if, in the opinion of the trustee, the income

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distributed to a beneficiary, together with the beneficiary's income from other sources, is insufficient to provide for him or her or to enable him or her to afford suitable maintenance, education and support for his or her children, or if the beneficiary needs to incur unusual expenses for education, maintenance and support, medical attention or any emergency, the trustee may, in the trustee's discretion, encroach on trust principal to the extent deemed necessary and proper. Any encroachment is to be charged to the beneficiary for whom the encroachment is made, reducing the principal from which that beneficiary and his or her lineal descendants are entitled to receive income and reducing the share distributable to the beneficiary or his or her lineal descendants.

Under Item VII, paragraph 9, if a beneficiary is less than age 21, or is disabled for any reason, the trustee may accumulate the income for the beneficiary during the period of disability, or the trustee, in its discretion, may pay the income to the beneficiary or to such persons as the trustee may consider to be in the best interest of the beneficiary.

Under Item VI, paragraph 5, Trust #2 will terminate 21 years after the death of the last to survive of Child A, Child B, Grandchild A, Grandchild B-1, Grandchild B-2, and Grandchild B-3. Under Item VI, paragraph 5, subparagraph A, 10% of the Trust #2 principal will be distributed to Grandchild A's issue per stirpes. The remaining Trust #2 principal will be divided per capita among the children of Child B and Child A (but not Grandchild A or his issue), the issue of any deceased child taking that child's share per stirpes.

Currently, 40% of the Trust #2 income is payable to Child B. Because Child A has died, his 40% share of trust income is payable in the same manner as the remaining 20% income share. Therefore, 60% of the Trust #2 income is payable as follows: 7.5% ($1/8 \times 60\% = 7.5\%$) to Grandchild A, and 52.5% ($7/8 \times 60\% = 52.5\%$) in equal amounts to Grandchild B-1, Grandchild B-2, and Grandchild B-3.

Trust #3

Grandparent 2 died in Year 2. Trust #3 was created under Item III of his will. Under Item III, Paragraphs 2 and 3 of the will, Child A is to receive one-third of the trust income for his life, and Child B is to receive one-third of the trust income for her life. Under Item III, Paragraph 1, Grandparent 1 is to receive the remaining one-third of the trust income for her life. Because Grandparent 1 predeceased Grandparent 2, the one-third portion of Trust #3 income payable to Grandparent 1 is payable, instead, under Item III, paragraph 4. Under Item III, paragraph 4, subparagraph A, 1/8th of this one-third portion of Trust #3 income is payable to Grandchild A for life. If Grandchild A dies with issue, those payments are to be made to his issue, per stirpes, until Trust #3 terminates. If Grandchild A dies without issue, or if there is a failure of his issue, the income otherwise payable to him will be paid to the other grandchildren and their issue in accordance with Item III, paragraph 4, subparagraph B (described below). If the portion of this one-third share of income payable to a grandchild under Item III, paragraph 4, subparagraph B (described below) is less than 1/8th, then, as long as the

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situation continues, the 1/8th portion payable to Grandchild A will be reduced such that the amount payable to Grandchild A will be identical to the amounts payable to the other grandchildren as determined in Item III, paragraph 4, subparagraph B.

Under Item III, paragraph 4, subparagraph B, 7/8ths of the remaining one-third of trust income is to be distributed equally among Grandparent 2's grandchildren born to Child B and any child born to Child A after the execution of Grandparent 2's will. The income payments are to continue for a beneficiary's life or until the prior termination of Trust #3. If a beneficiary dies before the trust terminates, his or her issue will take that beneficiary's share, per stirpes.

Under Item III, paragraph 5, on Child A's death, the one-third share of income payable to him is to be paid, instead, in accordance with Item III, paragraph 4. That is, 1/8th of this one-third share of income is to be paid to Grandchild A, and 7/8ths is to be paid equally among Grandparent 2's grandchildren born to Child B and any child born to Child A after the execution of Grandparent 2's will.

On Child B's death, the one-third share of income payable to her is to be paid, instead, under Item III, paragraph 4, subparagraph B but not subparagraph A. That is, Child B's one-third share of income is to be distributed equally among Grandparent 2's grandchildren born to Child B, and any child born to Child A after the execution of Grandparent 2's will.

Under Item IV, paragraph 8, if, in the opinion of the trustee, the income being paid to a beneficiary, together with the beneficiary's income from other sources, is insufficient to provide for the beneficiary or to enable him or her to afford suitable maintenance, education and support for his or her children, or if the beneficiary needs to incur unusual expenses for education, maintenance and support, medical attention or any emergency, the trustee is authorized, in the trustee's discretion, to encroach on trust principal to the extent deemed necessary and proper. Any encroachment is to be charged against the beneficiary for whom the encroachment is made, thus reducing the principal from which that beneficiary and his or her lineal descendants are entitled to receive income and reducing the share distributable to the beneficiary or his or her lineal descendants.

Under Item IV, paragraph 9, if a beneficiary is less than age 21, or is disabled for any reason, the trustee may accumulate the income for the beneficiary during the period of disability, or the trustee, in its discretion, may pay the income to the beneficiary or to such persons as the trustee may consider to be in the best interest of the beneficiary.

Under Item III, paragraph 6, Trust #3 will terminate 21 years after the death of the last to survive of Child A, Child B, Grandchild A, Grandchild B-1, Grandchild B-2, and Grandchild B-3. Under Item III, paragraph 6, subparagraphs A and B, 10% of the Trust #3 principal will be distributed among Grandchild A's issue per stirpes. The

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remaining Trust #3 principal will be divided per capita among the children of Child B and Child A (but not Grandchild A or his issue), the issue of any deceased child taking that child's share per stirpes.

Currently, one-third of the Trust #3 income is payable to Child B. Because Child A has died, his one-third share of trust income is payable, instead, in the same manner as the remaining one-third share of trust income. Therefore, two-thirds (66.6%) of the Trust #3 income is payable as follows: 8.3% ($1/8 \times .666 = 8.3\%$) of the Trust #3 income is payable to Grandchild A, and 58.3% ($7/8 \times .666 = 58.3\%$) of the Trust #3 income is payable in equal amounts to Grandchild B-1, Grandchild B-2, and Grandchild B-3.

PROPOSED PARTITION

The parties will petition the local probate court to request a judicial division of Trust #1, Trust #2, and Trust #3 as follows.

Trust #1: Division into Grandchild A Trust #1 and Child B Family Trust #1

Twenty-five percent of the Trust #1 principal will be set aside and held in Grandchild A Trust #1, a separate trust. All of the income will be paid to Grandchild A for his life. If Grandchild A dies leaving surviving issue, the income will be paid to the issue per stirpes. If an income beneficiary is a minor, the trustee may accumulate the income for the minor during minority.

Grandchild A Trust #1 will terminate at the time designated for termination of Trust #1. If Grandchild A dies with surviving issue, the Grandchild A Trust #1 principal will be divided among the issue, per stirpes. If, at termination, there are no surviving issue of Grandchild A, the principal will be distributed among the issue of Grandparent 1's other grandchildren per stirpes. Grandchild A Trust #1 will be otherwise administered in accordance with the terms of Trust #1.

Seventy-five percent of the Trust #1 principal will be set aside and held in the Child B Family Trust #1. The income will be distributed in equal shares to Grandchild B-1, Grandchild B-2, and Grandchild B-3. If a beneficiary dies leaving surviving issue, the issue will take the parent's share by representation. If an income beneficiary is a minor, the trustee may accumulate the income for the minor during minority.

Child B Family Trust #1 will terminate at the time designated for the termination of Trust #1, and the principal will be distributed per stirpes among the issue of Grandchild B-1, Grandchild B-2, and Grandchild B-3. Child B Family Trust #1 will otherwise be administered under the terms of Trust #1.

Trust #2: Division into Grandchild A Trust #2 and Child B Family Trust #2

Seven-and-a-half percent of the Trust #2 principal will be set aside and held in Grandchild A Trust #2, a separate trust. All of the income will be paid to Grandchild A

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for his life. If Grandchild A dies leaving surviving issue, the income will be paid to the issue, per stirpes, until the trust terminates. If Grandchild A dies without surviving issue, or if there is a failure of his issue, the income will be distributed equally among Grandparent 1's other grandchildren (that is, Child B's children) for their lives or until the prior termination of the trust. If, during the trust term, a beneficiary dies leaving issue, the issue will take the parent's share of income per stirpes.

Grandchild A Trust #2 will terminate at the time designated for termination of Trust #2. On termination of Grandchild A Trust #2, the principal will be distributed to Grandchild A's issue, per stirpes. Grandchild A Trust #2 will be otherwise administered in accordance with the terms of Trust #2.

Ninety-two-and-a-half percent of the Trust #2 principal will be set aside and held in Child B Family Trust #2. Child B will receive 43.2432% of the income. Child B's right to receive 43.2432% of the Child B Family Trust #2 income is equivalent to the right to receive 40% of the entire Trust #2 income ($43.2432\% \times 92.5\% = 40\% \times 100\%$). The remaining Child B Family Trust #2 income will be distributed equally among Child B's children (Grandchild B-1, Grandchild B-2, and Grandchild B-3) for their lives or until the prior termination of the trust. If a beneficiary dies leaving issue surviving, the issue will take the parent's share per stirpes.

Child B Family Trust #2 will also terminate at the time designated for termination of Trust #2. On termination, 2.7027% of the Child B Family Trust #2 principal will be paid to Grandchild A's issue, per stirpes. The right of Grandchild A's issue to receive 2.7027% of the Child B Family Trust #2 principal, plus their right to receive the principal of Grandchild A Trust #2, is equivalent to the right to receive 10% of the entire Trust #2 principal on termination ($2.7027\% \times 92.5\% = 2.5\%$; $2.5\% \text{ of Trust \#2} + 7.5\% \text{ of Trust \#2} = 10\% \text{ of Trust \#2}$).

The remaining principal of Child B Family Trust #2 will be divided per capita among the children of Child B. The issue of a deceased child will take the parent's share per stirpes. The trust is otherwise subject to the provisions of Trust #2 as created in Grandparent's will.

Trust #3: Division into Grandchild A Trust #3 and Child B Family Trust #3

Eight-and-one-third percent of the Trust #3 principal will be set aside and held in Grandchild A Trust #3, a separate trust. All of the income will be paid to Grandchild A for his life. If Grandchild A dies leaving surviving issue, the income will be paid to the issue, per stirpes, until the trust terminates. If Grandchild A dies without surviving issue, or if there is a failure of his issue, the income will be distributed equally among Grandparent 2's other grandchildren (that is, Child B's children) for their lives or until the prior termination of the trust. If, during the trust term, a beneficiary dies leaving issue, the issue will take the parent's share per stirpes.

Grandchild A Trust #3 will terminate at the time designated for the termination of

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Trust #3. On termination, the principal will be distributed to Grandchild A's issue, per stirpes. Grandchild A Trust #3 will be otherwise administered in accordance with the terms of Trust #3.

Ninety-one-and-two-thirds of the Trust #3 principal will be set aside and held in Child B Family Trust #3. Child B will receive 36.3636% of the income. Child B's right to receive 36.3636% of the Child B Family Trust #3 income is equivalent to the right to receive one-third of the entire Trust #3 income ($36.3636\% \times 91.66\% = 33.33\% \times 100\%$). The remaining Child B Family Trust #3 income will be distributed equally among Child B's children (Grandchild B-1, Grandchild B-2, and Grandchild B-3) for their lives or until the prior termination of the trust. If a beneficiary dies leaving issue surviving, the issue will take the parent's share per stirpes.

Grandchild B Family Trust #3 will also terminate at the time designated for the termination of Trust #3. On termination, 1.8181% of the Child B Family Trust #3 principal will be distributed to Grandchild A's issue, per stirpes. The right of Grandchild A's issue to receive 1.8181% of the Child B Family Trust #3 principal, plus their right to receive the principal of Grandchild A Trust #3, is equivalent to the right to receive 10% of the entire Trust #3 principal on termination ($1.8181\% \times 91.66\% = 1.666\%$; $1.666\% + 8.3\%$ of Grandchild A Trust #3 = 10% of Trust #3).

The remaining principal of Child B Family Trust #3 will be divided per capita among the children of Child B. The issue of a deceased child will take the parent's share per stirpes. The trust is otherwise subject to the provisions of Trust #3 as created in Grandparent 2's will.

Requested ruling:

You have asked us to rule that the proposed judicial partition of each of Trust #1, Trust #2, and Trust #3 will not cause the respective partitioned trusts to become subject to the provisions of the generation-skipping transfer tax.

Discussion:

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), the generation-skipping transfer (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 tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985.

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

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is exempt from the generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains 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) provides that a modification will not cause an exempt trust to be subject to the GST tax 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 a 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.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from the GST tax authorizes the trustee to distribute income and principal, at the trustee's discretion, for the benefit of A and B and their respective issue. On the death of the last to die of A and B, the corpus is to be distributed to the issue of A and B per stirpes. Pursuant to a court order, the trust is divided equally into two trusts, one for the benefit of A and A's issue, and one for the benefit of B and B's issue. The example concludes that, under the facts presented, 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 (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division, and 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. Accordingly, the two partitioned trusts will not be subject to the provisions of chapter 13.

In this case, the division of Trust #1, Trust #2, and Trust #3 (into Grandchild A Trust #1, Child B Family Trust #1, Grandchild A Trust #2, Child B Family Trust #2, Grandchild A Trust #3, and Child B Family Trust #3 respectively) will not result in a shift of any beneficial interest in these trusts to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division. Further, the proposed division will not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for in the original Trust.

Accordingly, based on the facts submitted and the representations made, after (i) the division of Trust #1 into Grandchild A Trust #1 and Child B Family Trust #1, (ii) the division of Trust #2 into Grandchild A Trust #2 and Child B Family Trust #2, and (iii) the division of Trust #3 into Grandchild A Trust #3 and Child B Family Trust #3, the separate trusts resulting from the division will be treated as trusts that were irrevocable on September 25, 1985, for purposes of § 1433(b)(2)(A) of the Tax Reform Act of 1986,

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and each of the six separate trusts will be exempt from the generation-skipping transfer tax imposed under § 2601.

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 the appropriate party. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,
George L. Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
copy for § 6110 purposes