

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4 / PLR-106551-01

Date:

January 31, 2002

Re:

Legend:

Decedent =

Trust 1 =

Trust 2 =

Trust 3

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

A =

B =

C =

D =

E =

F =

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G =H =

Disclaimer =

Declaration =

Petition =

Court 1 =

Court 2 =

State 1 =

State 1 Statute 1 =

State 1 Statute 2 =

State 2 =

State 2 Statute 1 =

State 2 Statute 2 =

City 1 =

City 2 =

City 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

a =

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Dear _____ :

We received your letter dated August 6, 2001, and prior correspondence requesting rulings under § 2601 of the Internal Revenue Code. This letter responds to your request.

Decedent died testate on Date 1. Under Item IV of Decedent's will, Trust 1 was created for the benefit of Decedent's son, A, and Trust 2 for the benefit of Decedent's son, B. Date 1 is prior to September 25, 1985.

Pursuant to Section (4) of Item V of Decedent's will, upon A's death, without leaving either lawful descendants or a surviving spouse with whom A was living, Trust 1 is to terminate and the principal thereof and any undistributed income therefrom shall be added to and become a part of the principal of Trust 2, if then in existence.

Section B(3) of Item V of Decedent's will provides that after the death of Decedent's son B, without a surviving spouse, the entire net income from Trust 2 shall, at convenient intervals not less frequently than annually, be paid in equal shares to C, D and E, and, upon the death of C, D, or E, the share which that grandchild would have taken if living shall, during the continued existence of Trust 2, be paid per stirpes to her lawful descendants, but if she dies without lawful descendants surviving her, it shall be paid per stirpes to Decedent's other grandchildren and their lawful descendants.

The second paragraph of Section B(5) of Item V of Decedent's will provides that after the death of B, without a surviving spouse, the trustee of Trust 2 from time to time may pay or apply any part of the net income (not otherwise disposed of) or principal of Trust 2 to or for the benefit of C, D and E.

Section B(6) of Item V of Decedent's will provides that immediately following the death of the last survivor of B, C, D, E, F, G, and H, Trust 2 shall terminate and the principal thereof and any undistributed income therefrom shall be distributed absolutely per stirpes to the lawful descendants of B, then living, if any; if none, per stirpes to Decedent's lawful descendants then living, if any; if none, to those persons who would have been Decedent's heirs at law if Decedent had died at the time of the termination of Trust 2.

On Date 2, B died, survived by his three daughters, C, D, and E. B's spouse predeceased B. C has three children, F, G, and H. On Date 3, A died without leaving either lawful descendants or a surviving spouse. Because Trust 2 was in existence upon A's death on Date 3, the principal and undistributed income from Trust 1 was added to Trust 2 to be governed by the same terms in Decedent's will that govern Trust 2. Date 3 is after September 25, 1985.

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On Date 4, C disclaimed (Disclaimer) her entire interest in the GST exempt portion of A's residuary estate that was added to Trust 2. Disclaimer is in writing. C filed Disclaimer with Court 1. Disclaimer was received by the holder of the legal title of the property to which the interests relate within nine months after Date 3, the date on which the transfer creating the interests in C was made.

The effect of Disclaimer under State 1 Statute 1 is that the disclaimant is deemed to have predeceased the decedent, i.e., C is deemed to have predeceased A. As a result of Disclaimer, C's interests in the GST exempt portion of A's residuary estate passed without any direction on the part of C to F, G, and H, as provided for under Decedent's will. Section B(3) provides that upon C's death, C's share in Trust 2 income would be paid per stirpes to her descendants, namely F, G, and H. Accordingly, the GST exempt portion of A's residuary estate added to Trust 2 would remain in Trust 2 pursuant to Decedent's will until Trust 2 terminates as provided under Decedent's will. The current trustee represents that, at all times in the administration of Trust 2 since the receipt of the assets from A's residuary estate, all income attributable to the disclaimed portion of Trust 2 has been paid to F, G, and H and no income attributable to the disclaimed portion of Trust 2 has been paid or will be paid in the future to C and no amount of corpus attributable to the disclaimed portion of Trust 2 has been distributed or will be distributed in the future to C.

Under paragraph 5 of Item V of A's will, A bequeathed the remainder of his estate to Trust 2 for the uses and purposes provided for under Decedent's will. A's residuary estate exceeded in value his \$1,000,000 generation-skipping transfer (GST) tax exemption provided under chapter 13. Exercising the statutory authority granted to the trustee under State 1 Statute 1, the trustee divided Trust 2 into two separate trusts with identical provisions in order to create one trust, Trust 3, entirely exempt from the GST tax and another trust, Trust 4, entirely subject to the GST tax. Trust 2 was severed pursuant to Declaration, dated Date 5, filed in Court 1. Following this partition, Trust 3 was comprised of the assets from Trusts 1 and 2 and the GST exempt portion of A's residuary estate. It is represented that the trustee allocated a sufficient amount of A's GST exemption to fully exempt for chapter 13 purposes the GST exempt portion of A's residuary estate.

The second paragraph of Item VI of Decedent's will provides that at any time after a bank or trust company has become the trustee of Trust 2, C, D and E, or such of them as are then living and capable of acting, may from time to time by written notice signed by each of them and delivered to the trustee of Trust 2 remove the trustee and appoint as trustee any other bank or trust company which is organized under the laws of the United States, or of any state thereof, which has capital surplus and undivided profits aggregating not less than \$a and which is authorized to act as trustee under Decedent's will; and if desired the principal of Trust 2 may be removed from State 1 to the state in which the newly designated trustee has its principal place of business but said Trust and all rights therein and thereunder shall be governed by the laws of

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State 1; and any real estate in Trust 2 shall be sold if necessary in order to permit the principal of Trust 2 to be removed from State 1 as aforesaid; provided, however, that the removal of the trustee and the appointment of another trustee shall only be for the purpose of transferring the trust to a larger bank or trust company having the aforesaid financial status and qualified to act as trustee in State 1 or to such a bank or trust company not qualified to act in State 1 but having its principal place of business outside of State 1 and in the state of residence of one of Decedent's said grandchildren or in City 1, City 2 or City 3; and this right of removal may be exercised only in an attempt to secure a more competent administration of Trust 2 or for the greater convenience of Decedent's grandchildren in following the administration thereof through having it in the state of residence of at least one of them.

The provisions in Decedent's will continue to govern Trust 3. The current beneficiaries of Trust 3 are C, D, E, F, G, and H. D and E are entitled to distributions of net income and discretionary distributions of principal from the assets in Trust 3 that comprise the assets from Trusts 1 and 2 and the GST exempt portion of A's residuary estate. C is entitled to distributions of net income and discretionary principal distributions from the assets in Trust 3 that comprise the assets from Trusts 1 and 2. F, G, and H are entitled to distributions of net income and discretionary principal distributions from the assets in Trust 3 that comprise the GST exempt portion of A's residuary estate.

The current trustee of Trust 3 determined that the three family branches, namely, C family, D family, and E family, have different objectives with respect to the investment strategies and goals of Trust 3. To accommodate those different objectives of each family branch, on Date 6, the current trustee filed Petition pursuant to State 2 Statute 1 requesting Court 2 approve the partition of Trust 3 into three equal separate trusts, namely, Trust 5, Trust 6, and Trust 7. Trust 5 will benefit C and her descendants, Trust 6 will benefit D and her descendants, and Trust 7 will benefit E and her descendants. The trustee requested Court 2 appoint a Guardian Ad Litem to represent the minor living and unborn lawful descendants. Court 2 is authorized to resolve controversies among the parties to a trust under State 2 Statute 1 and to determine any questions arising in the administration and distribution of any assets in a trust under State 2 Statute 2.

Under the plan of separation proposed by the parties, Trusts 5, 6, and 7 would each receive one-third of the assets and liabilities of Trust 3. Trust 5, Trust 6, and Trust 7 will continue to be governed by the same provisions in Decedent's will that govern Trust 3, except the provisions governing the identities of the beneficiaries and the identities of the persons who have the power to appoint or remove the trustee for each trust would be modified to reflect the division of Trust 3 along family lines.

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Further, the second paragraph of Item VI of Decedent's will shall read in part as follows:

The removal of the trustee and the appointment of another trustee shall only be for the purpose of transferring the trust to a larger bank or trust company having the aforesaid financial status and qualified to act as trustee in State 1 or State 2 or to such a bank or trust company not qualified to act in State 1 and State 2 but located in the state of residence of my said granddaughter or in City 1, City 2 or City 3.

You represent that no additions have been made to Trust 3 since September 25, 1985.

You have requested the following rulings: 1) the generation-skipping transfer tax will not apply to Trust 3, Trust 5, Trust 6, and Trust 7, under the transactions contemplated, by reason of section 1433(b)(2) of the Tax Reform Act of 1986 and § 2631; and 2) any appreciation in value of the corpus of Trust 3, Trust 5, Trust 6, and Trust 7 will not be considered to constitute an addition.

Law and Analysis

Section 2518(a) provides that for purposes of this subtitle (subtitle B, estate and gift taxes), if a person makes a qualified disclaimer with respect to any interest in property, this subtitle shall apply with respect to such interest as if the interest had never been transferred to such person.

Section 2518(b) provides that for purposes of § 2518(a), the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if –

(1) such refusal is in writing,

(2) such writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date which is 9 months after the later of –

(A) the date on which the transfer creating the interest in such person is made, or

(B) the day on which such person attains age 21,

(3) such person has not accepted the interest or any of its benefits, and

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(4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either –

(A) to the spouse of the decedent, or

(B) to a person other than the person making the disclaimer.

Section 2601 imposes a tax on every generation-skipping transfer made by the transferor to a skip person. Section 2611(a) defines the term “generation-skipping transfer” to include a taxable distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of tax imposed by § 2601 is the product of the “taxable amount” (determined under §§ 2621 through 2624) and the “applicable rate.” The term “applicable rate” is defined in § 2641 to mean the product of the maximum federal estate tax rate and the “inclusion ratio” with respect to the transfer.

Section 2642(a)(1) provides that the “inclusion ratio” is the excess (if any) of 1 over the “applicable fraction.” Section 2642(a)(2) provides that the numerator of the applicable fraction with respect to a trust is the amount of the GST exemption allocated to the trust. The denominator of the applicable fraction is the value of the property transferred to the trust minus certain amounts (if any) specified in § 2642(a)(2)(B)(ii) (relating to death and estate taxes and charitable deductions).

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 2652(a)(1) provides that for purposes of chapter 13, the term “transferor” means the decedent in the case of any property subject to the tax imposed under chapter 11 and the donor in the case of any property subject to the tax imposed under chapter 12. Section 26.2652-1(a)(1) of the Generation-Skipping Transfer Tax Regulations provides that the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13.

Section 2654(b)(1) provides that for purposes of chapter 13, the portions of a trust attributable to transfers from different transferors shall be treated as separate trusts. An individual’s GST exemption is allocated to the separate trust. Section 26.2654-1(a)(4).

Under § 1433(a) of the Tax Reform Act of 1986 (Act), the generation-skipping transfer 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), the

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GST tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. This rule does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made 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.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided in § 26.2601-1(b)(1)(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)(1)(vi) provides that except to the extent that the provisions under §§ 26.2601-1(b)(1)(iv) and (v) allocate subsequent appreciation and accumulated income between the original trust and additions thereto, appreciation in the value of the trust and undistributed income added thereto are not considered an addition to the principal of a trust.

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.

Section 26.2601-1(b)(4)(i)(D) 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)) 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 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. 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 to shift a beneficial interest in the trust.

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For purposes of chapter 13, Trust 3, which has two transferors, is treated as comprised of two separate trusts: one trust holding the assets from Trusts 1 and 2 (the non-chapter 13 portion of Trust 3) and the other trust holding the GST exempt portion of A's residuary estate (the chapter 13 portion of Trust 3). Trust 3 is entirely exempt from the GST tax because the non-chapter 13 portion and the chapter 13 portion of Trust 3 are exempt from GST tax. The non-chapter 13 portion of Trust 3 is comprised of the assets from Trusts 1 and 2. Trusts 1 and 2 were irrevocable prior to September 25, 1985, and, as such, are not subject to the GST tax by reason of § 26.2601-1(b)(1)(i). The chapter 13 portion of Trust 3 is exempt from the GST tax because the executor of A's estate allocated a sufficient amount of A's GST exemption to the portion of A's residuary estate that was added to Trust 2 so that the chapter 13 portion of Trust 3 has an inclusion ratio of zero. Accordingly, the chapter 13 portion of Trust 3 is exempt from the GST tax by reason of § 2631.

C disclaimed her entire interest in the GST exempt portion of A's residuary estate on Date 4. The effect of Disclaimer under State 1 Statute 1 is that C is deemed to have predeceased A. C's Disclaimer is in writing. Disclaimer was received by the holder of the legal title of the property to which the interests relate within nine months after Date 3, the date on which the transfer creating the interests in C was made. As a result of Disclaimer, C's interests in the GST exempt portion of A's residuary estate passed without any direction on the part of C to F, G, and H, as provided for under Decedent's will. The current trustee represents that, at all times in the administration of Trust 3 since the receipt of the assets from A's residuary estate, all income attributable to the disclaimed portion of Trust 3 has been paid to F, G, and H and no income attributable to the disclaimed portion of Trust 3 has been paid or will be paid in the future to C and no amount of corpus attributable to the disclaimed portion of Trust 3 has been distributed or will be distributed in the future to C. Based upon the facts submitted and representations made, we conclude that C's Disclaimer was a qualified disclaimer for purposes of § 2518(b) and, accordingly, C's Disclaimer did not result in a constructive addition to Trust 3.

The trustee of Trust 3 petitioned Court 2 to approve the partition of Trust 3 into Trusts 5, 6, and 7. Under the plan of separation, Trust 5, Trust 6 and Trust 7 will have identical terms except the identities of the respective beneficiaries, the identities of the persons who have the power to appoint or remove the trustee for each trust, namely, C for Trust 5, D for Trust 6, and E for Trust 7, and a portion of the second paragraph of Item VI of each trust relating to trustee removal powers. Trust 3 consists of two portions, a non-chapter 13 portion and a chapter 13 portion. The partition of the non-chapter 13 portion along family lines and the administrative changes will not shift a beneficial interest in the trusts 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 modifications and the modifications do not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in Trust 3. See Example 5 and Example 10 of § 26.2601-1(b)(4)(i)(E). If Court 2 approves the partition of Trust 3

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along family lines into Trusts 5, 6, and 7, we conclude that the partition of the non-chapter 13 portion of Trust 3 into three separate portions comprising portions of Trusts 5, 6, or 7 will not subject the non-chapter portion of these trusts to the generation-skipping transfer tax.

No guidance has been issued concerning the partition of the chapter 13 portion of Trust 3 along family lines. At a minimum, a modification that does not affect the exempt status of a trust that is not subject to the GST tax because it was irrevocable on to September 25, 1985 should similarly not affect the exempt status of the chapter 13 portion of the trusts. Accordingly, based upon the facts provided and representations made, we conclude that the partition of the chapter 13 portion of Trust 3 into chapter 13 portions comprising portions of Trusts 5, 6, and 7 and the administrative changes to the trusts will not cause the chapter 13 portions of these trusts to lose their GST exempt status for purposes of chapter 13. Accordingly, we conclude that the generation-skipping transfer tax will not apply to Trust 3, Trust 5, Trust 6, and Trust 7, under the transactions contemplated, by reason of section 1433(b)(2) of the Act and § 26.2601-1(b)(1)(i) and § 2631. Further, we conclude that any appreciation in value of the corpus of Trust 3, Trust 5, Trust 6, and Trust 7 will not be considered a post-September 25, 1985 addition to those trusts.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

Except as specifically ruled herein, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or 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,
Lorraine E. Gardner
Assistant to Branch Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: Copy for § 6110 purposes

CC: