

INTERNAL REVENUE SERVICE

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-168854-01

Re:

Date: March 20, 2002

Legend:

Decedent =

Spouse =

Child 1 =

Child 2 =

Grandchild 2a =

Grandchild 2b =

Date =

Trust =

Trustee =

State =

State Code =

Charity 1 =

Charity 2 =

Charity 3 =

Charity 4 =

Beneficiary 1 =

Dear _____ :

This is in response to your letter dated December 14, 2001 in which you requested a ruling concerning the generation-skipping tax consequences resulting from the proposed division of Trust.

The facts are represented to be as follows: On Date, Decedent died testate, survived by Spouse and two children, Child 1 and Child 2.

Under Decedent's will, after providing for certain pecuniary bequests and a marital bequest for the benefit of Spouse, Section 1 of Article IV of the will provides that the residue of Decedent's estate is to pass to a residuary trust (Trust). Under the terms of Trust, specified amounts of Trust income are to be distributed quarterly to Charity 1, Charity 2, Charity 3, Charity 4 and Beneficiary 1, for the term of the trust. If any of the charities ceases to exist during the term of the trust, or if Beneficiary 1 dies during the term of the trust, the portion of the net income that would have otherwise been distributed to the beneficiary is to be added to the balance of the net income.

The balance of the Trust net income is to be divided into two equal shares. One share is to be distributed quarterly to Child 1 and one share to Child 2. If either Child 1 or Child 2 predeceases termination of the Trust, the deceased child's share is to be distributed in equal shares to the children of the deceased child then living. If any child of a deceased child of Decedent predeceases termination of the Trust, then that person's share of the net income is to be distributed in equal shares to the descendants of such deceased child then living. In the event that a child of Decedent predeceases the termination of the Trust with no children, grandchildren, or other descendants surviving, then the net income which would otherwise have been distributed to such deceased child or her children, grandchildren or descendants, etc., is to be added to the other share of the balance of the net income and is to be distributed to the other child or her children, grandchildren or other descendants, as the case may be.

Section 2 of Article IV provides that Trust shall terminate twenty-one (21) years following the death of the survivor of Decedent's children and their descendants living at Decedent's death, or if earlier, upon the death of the survivor of both of Decedent's children and their descendants. On termination, the trustees are to divide the principal of Trust into two equal parts and distribute one part outright to the descendants of Child 1, then living, per stirpes, and the other part outright to the descendants of Child 2, then living, per stirpes. If either of Decedent's children shall have no descendants then living, the share that would have otherwise been distributed to that child's descendants is to be distributed to the descendants of Decedent's other child. Finally, if there are no descendants then living of either of Decedent's children, the principal of Trust is to be distributed to those persons who would be entitled to receive the trust corpus under the intestate laws of State, as if the Decedent had died intestate.

Article VI provides that the trustees may in their discretion apply such sums of Trust principal as the trustees in their sole discretion may deem necessary or advisable for the welfare, support or education of any beneficiary of any trust created under the

terms of Trust. Further, the trustees may, with respect to the trust created under Article IV, terminate the trust at any time after the death of the survivor of Decedent's children, if, in the sole judgment of the majority of the trustees, they deem it in the best interests of the beneficiaries of the trust. If the trustees terminate the trust, the principal of the trust is to be distributed as provided in Section 2 of Article IV.

Since the inception of Trust, Spouse, Child 2 and Beneficiary 1 have died. Child 2 was survived by two children, Grandchild 2a and Grandchild 2b. Thus, currently, specified amounts of Trust income are being paid to Charity 1, Charity 2, Charity 3 and Charity 4. One half of the balance of the Trust income is being distributed to Child 1, and one half is being distributed equally to Grandchild 2a and Grandchild 2b. Trustee, a bank, is currently serving as sole trustee.

During the administration of Trust, disputes have arisen between members of Child 1's and Child 2's families concerning the administration of Trust and the investment of Trust assets. Trustee proposes to divide Trust into two separate, equal trusts, one for the benefit of Child 1 and Child 1's descendants and one for the benefit of Child 2's descendants. Following the division of Trust, Child 1 will receive all of the net income from one separate trust, and Grandchild 2a and Grandchild 2b each will receive one-half of the net income from the other trust. Each of the separate trusts will contribute one-half ($\frac{1}{2}$) of the income necessary to satisfy the specific income amounts payable to Charities 1-4 as provided in Article IV. In all other respects, the administration and distribution of the separate trusts will be governed by Decedent's will. Trustee will petition the appropriate court requesting approval of the proposed division of Trust.

State Code provides that a trustee may, without court approval, divide a trust into separate trusts, allocating to each separate trust either a fractional share of each asset and each liability held by the original trust or assets having an appropriate aggregate fair market value and fairly representing the appreciation or depreciation in the assets of the original trust as a whole. The court, for cause shown, may authorize the division of a trust into two or more separate trusts upon such terms and conditions and with such notice as the court shall direct.

Trustee requests a ruling that the proposed division of Trust into two separate trusts and the proposed equal allocation of the assets of Trust among the two separate trusts will not be a constructive addition to the trusts or otherwise cause the trusts to lose their exempt status under § 2601 of the Internal Revenue Code.

Section 2601 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.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 1, and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer was not made out of corpus added to the trust outright or pursuant to a constructive addition, after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust which is exempt from GST tax by reason of § 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the GST tax provisions.

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), will not cause the trust to lose its exempt status. The rules of § 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) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the GST tax provisions, if -- (1) 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 (2) 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, considers a situation where the Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. The appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A'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 section 2651) than the person or persons who held the beneficial interest prior to the division. In addition, 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. Therefore, the two partitioned trusts resulting from the division will not be

subject to the GST tax provisions.

In this case, Trust was irrevocable on September 25, 1985. It is represented that no additions, either outright or constructive, have been made to Trust after September 25, 1985.

Based on the facts submitted and the representations made, the division of Trust, into two trusts, one for the benefit of Child 1 and Child 1's descendants, and one for the benefit of Child 2's descendants, as described above, will not result in a shift of any beneficial interest in Trust 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 under the original Trust. Accordingly, we conclude the proposed division of Trust into two separate trusts and the proposed equal allocation of the assets of Trust among the two separate trusts will not be a constructive addition to the trusts or otherwise cause the trusts to lose their exempt status under § 2601 of the Internal Revenue Code.

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.

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 rulings are directed only to the taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

Enclosures

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