

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-162171-02

Date:

January 10, 2003

In Re:

Legend

Trust 1 =
Trustor =
Year 1 =
Court Order =

Son =
A =
B =
\$x =
C =
D =
E =
Date 1 =
Year 2 =
Trust 2 =
Court =
Date 2 =

Dear :

This is in response to your letter dated October 28, 2002, in which you requested a ruling concerning the generation-skipping transfer (GST) tax consequences of the proposed judicial construction of a trust agreement that is exempt from the application of GST tax imposed under § 2601 of the Internal Revenue Code.

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The facts and representations submitted are summarized as follows: Trust 1 was established under the provisions of Trustor's will. Trust 1 was funded in Year 1, a date prior to September 25, 1985, pursuant to Court Order. No additions have been made subsequent to that funding.

Paragraph A of Court Order provides that three-fifths of Trust 1's net income is to be distributed to Son in quarterly or other convenient installments. One-fifth of Trust 1's net income is to be held for each of Trustor's granddaughters, A and B, and is payable at the discretion of the trustee and board of advisors, for their support, maintenance, use, or benefit, provided the annual payments to each do not exceed \$x. Upon attaining the age of thirty-five years, all accumulated net income is to be paid to the granddaughters and thereafter, current net income is to be paid to them for and during the life of Son. If a granddaughter should pre-decease Son, the net income is to be paid to her lineal descendants, per stirpes, until the death of Son. If a granddaughter leaves no lineal descendants, her share of net income is payable to the other granddaughter or her lineal descendants.

Paragraph B provides that upon the death of Son, the corpus of Trust 1 is to be divided into equal shares, one share for each of Trustor's five grandchildren, A, B, C, D, and E, then living, and if not living, one equal share for that grandchild's lineal descendants.

Paragraph B, subparagraph 3, provides that the net income of a grandchild's share is payable at the discretion of the trustee and board of advisors for the grandchild's support, maintenance, use, or benefit, provided the annual payments do not exceed \$x. Upon attaining the age of thirty-five years, all accumulated net income is to be paid to the grandchild and thereafter, the grandchild is entitled to the current net income from the share set aside for his or her benefit.

Under Paragraph B, subparagraph 5, upon the death of any grandchild after the death of Son, the share of the corpus from which the grandchild is receiving income at the date of his or her death, together with any accumulated and undistributed income is to vest in and immediately be transferred equally, per stirpes, to his or her children and/or the lineal descendants of any deceased child. If there are no living lineal descendants of any deceased child, then under subparagraph 6, the grandchild's share of the corpus remains in the trust and the net income is to be accumulated until the final termination of the trust.

According to Paragraph B, subparagraph 7, Trust 1 terminates upon the death of the survivor of the five grandchildren of Trustor. In the event that a grandchild died leaving no lineal descendants, then upon termination of the trust, the share of the deceased grandchild is to be distributed equally, per capita, to the lineal descendants of Trustor.

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As a result of Son's death on Date 1, Trust 1 was divided into five equal shares, one for each of Trustor's five grandchildren. Because all five grandchildren had reached the age of 35 at that time, they each received one-fifth of the income. Two of Trustor's grandchildren, B and E, have died and their respective shares were distributed to their children. D has also died. Because he died without issue, his share has remained in Trust 1. Two grandchildren, A and C, are still living and receive their share of the net income. Trust 1 will terminate upon the death of the last to die of A or C.

Pursuant to the terms of Court Order, because D died without issue his share will be distributed per capita to the lineal descendants of Trustor upon the termination of Trust 1. The terms of Court Order, however, are not clear as to how the accumulated income earned on D's share should be distributed. Since D's death, the trustee has separately accounted for the income on D's share and since Year 2 has treated it as a separate trust, Trust 2.

The trustee petitioned Court for an interpretation of Court Order. The Court determined that under the terms of Court Order the accumulated income in Trust 2 should be added to and pass with the corpus of Trust 1 on a per capita basis to the then-living descendants of Trustor.

The trustee requests a ruling that the Court's construction of Court Order as providing for the distribution of the accumulated income on D's share of Trust 1 on a per capita basis will not affect the exempt status of Trust 1 for GST tax purposes under § 2601.

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

A generation-skipping transfer is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip. Section 2612(a) provides that the term taxable termination means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in trust where the property passes to a skip person with respect to the transferor of the property. Section 2612(b) provides that the term taxable distribution means any distribution from a trust to a skip person other than a taxable termination or a direct skip. Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person.

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 GST tax provisions do not apply to any generation-skipping transfer under a trust 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.

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Section 26.2601-1(b)(1)(iv) states that, if an addition is made after September 25, 1985, to a trust which was irrevocable on September 25, 1985, 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. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to the GST tax and a portion subject to the GST tax.

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 generation-skipping transfer tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct scrivener's error will not cause an exempt trust to lose its exempt status provided the judicial action involves a bona fide issue, and the construction is consistent with applicable state law that would be applied by the highest court of the state.

In the present case, Trust 1 was irrevocable on September 25, 1985. It has been represented that no additions have been made to the trust after that date.

The intention of the transferor as expressed in the instrument controls the legal effect of the dispositions made in the instrument. Cal. Prob. Code § 21102 (2001). The intention of the testator expressed in a testamentary instrument is always the polestar in the interpretation of a will. *Estate of Hermon v. Urteago*, 46 Cal. Rptr. 2d 577, 581, 39 Cal. App. 4th 1525, 1531 (1995). When interpreting the words of an instrument, preference is to be given to an interpretation of an instrument that will prevent intestacy, rather than one that will result in an intestacy. Cal. Prob. Code § 21120 (2001).

In this case, Court, construing Trustor's intent, interpreted the terms of Court Order to require that the accumulated income of Trust 2 be added to and pass with the corpus of Trust 1. As a result, upon the termination of Trust 1, the accumulated income on D's share will be distributed per capita to the lineal descendants of Trustor.

Based on the information submitted and representations made, we conclude that the terms of Court Order present a bona fide issue regarding the method of distribution of the accumulated income on D's share of Trust 1 upon the termination of Trust 1. We further conclude that the Court's order construing the method of distribution is consistent with applicable state law that would be applied by the highest court of the state. Accordingly, the Court's order will not affect the exempt status of Trust 1 for GST tax purposes under § 2601.

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

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

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Branch Chief, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy for section 6110 purpose