

Internal Revenue Service

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Department of the Treasury

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Person to Contact:

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Refer Reply To:
CC:PSI:4 - PLR-111908-02
Date: December 20, 2002

In re:

Legend:

Decedent =
Daughter =
Granddaughter 1 =
Granddaughter 2 =
Trust =

Year 1 =
Year 2 =
Date =
Court =

Dear :

This responds to your letter dated September 12, 2002, and prior correspondence, requesting rulings regarding the generation-skipping transfer (GST) tax consequences of the proposed division of and modifications to Trust.

FACTS

The facts submitted and representations made are as follows. Decedent died in Year 1. Article SIXTH of Decedent's will created a residuary trust for the benefit of her issue. Article SIXTH(a) directed the trustee to pay the entire net income to Decedent's daughter, Daughter, for her life. Daughter died in Year 2. As provided in Article SIXTH(b), from and after the death of Daughter, the trustee has paid income, in equal shares, to the children of Decedent's Daughter, Granddaughter 1 and Granddaughter 2. Upon the death of either Granddaughter 1 or Granddaughter 2, her share of income will be paid to her issue, per stirpes, until such time as Trust terminates.

Article SIXTH(d) controls distributions of principal and provides as follows:

The Trustee is authorized in its sole discretion with respect to any beneficiary during the time when such beneficiary is entitled to net income from a share of the trust estate, to pay any part or all of the principal of such share to meet expenses in excess of normal requirements for reasonable comfort, support, maintenance, and education of said beneficiary or his or her dependents.

To date, the cumulative amount of principal distributions to Granddaughter 1 is approximately 60% greater than similar distributions made to Granddaughter 2.

Under Article SIXTH(c), Trust will terminate twenty-one years after the death of the survivor of Granddaughter 1 and Granddaughter 2. Upon termination, principal will be payable to the then current income beneficiaries.

The parties petitioned Court to divide Trust into two separate and unequal trusts to account for the disproportionate distributions to Granddaughter 1, and to make certain other modifications to Trust. On Date, Court issued an Order to reform Trust to: (1) divide Trust into two separate trusts, one trust for the benefit of Granddaughter 1 and her descendants and the other for the benefit of Granddaughter 2 and her descendants; (2) effect an unequal division of Trust to account for prior distributions to Granddaughter 1; (3) prevent the income beneficiaries from becoming co-advisors of each other's separate trusts; and (4) allow the trustee to receive commissions in accordance with its published fee schedule. The Court's Order is conditioned on the receipt of a favorable private letter ruling from the Internal Revenue Service.

You represent that no additions, actual or constructive, have been made to any of the trusts since September 25, 1985.

We have been asked to rule as follows:

1. The proposed division of Trust into separate trusts for Granddaughter 1 and Granddaughter 2 will not subject the trusts to the GST tax under § 2601 of the Internal Revenue Code.

2. The proposed division of Trust on an unequal basis to reflect previous distributions of principal and the judicial clarification that future distributions of principal be paid only out of an income beneficiary's separate trust will not subject the trusts to the GST tax under § 2601.

3. The proposed amendment to Trust whereby each income beneficiary will serve as advisor only to her own separate trust will not subject the trusts to the GST tax under § 2601.

4. The proposed amendment to Trust whereby the trustee's compensation will be determined according to the fee schedule approved by Court will not subject the trusts to the GST tax under § 2601.

LAW AND ANALYSIS

Section 2601 imposes a tax on every generation-skipping transfer. Under § 1433(a) of the Tax Reform Act of 1986 (Act), the 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 any generation-skipping transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died 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 is exempt from the GST 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 a scrivener's error will not cause an exempt trust to be subject to the provisions of chapter 13, if (1) the judicial action involves a bona fide issue, and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(i)(D) provides that a modification 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.

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.

Section 26.2601-1(b)(4)(i)(E), Example 10, considers a situation where a trust is modified by decreasing the number of trustees. The modification pertains to the administration of the trust and 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. In addition, 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. Therefore, the modification will not subject the trust to the provisions of chapter 13.

In the present case, Trust was irrevocable on September 25, 1985, and it is represented that no additions, actual or constructive, have been made to Trust after that date. The proposed division and modifications will not result in a shift of any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the proposed division. In addition, the proposed division and modifications will not extend the time for vesting of any beneficial interest beyond the period provided for in the trust instrument. Further, the proposed division and modifications will not constitute an “addition” to Trust within the meaning of § 1433(b)(2)(A) of the Act. Based on the facts submitted and the representations made, we conclude that:

1. The proposed division of Trust into separate trusts for Granddaughter 1 and Granddaughter 2 will not subject the trusts to the GST tax under § 2601.
2. The proposed division of Trust on an unequal basis to reflect previous distributions of principal and the judicial clarification that future distributions of principal be paid only out of an income beneficiary’s separate trust will not subject the trusts to the GST tax under § 2601.
3. The proposed amendment to Trust whereby each income beneficiary will serve as advisor only to her own separate trust will not subject the trusts to the GST tax under § 2601.
4. The proposed amendment to Trust whereby the trustee’s compensation will be determined according to the fee schedule approved by Court will not subject the trusts to the GST tax under § 2601.

Accordingly, after the proposed division and modifications, the two separate trusts will continue to be exempt from the GST tax imposed under § 2601 provided there are no additions to the trusts after September 25, 1985.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

By _____
Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes