

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-121719-03
Date: SEPTEMBER 02, 2003

Re:

Legend:

Trust 1 =

Trust 2 =

Husband =

Wife =

Husband's Trust Agreement =

Wife's Trust Agreement =

Son 1 =

Son 1's Spouse =

Granddaughter =

Grandson =

Son 2 =

Daughter =

Foundation =

Date 1 =

Trust =

Granddaughter's Family Trust =

Bank =

Greatgrandchild 1 =

Greatgrandchild 2 =

Greatgrandchild 3 =

Greatgrandchild 4 =

Agreement =

Trust Indenture for Greatgrandchild 1 =

Trust Indenture for Greatgrandchild 2 =

Trust Indenture for Greatgrandchild 3 =

Trust Indenture for Greatgrandchild 4 =

State =

Dear :

This is in response to a letter dated March 21, 2003, and subsequent correspondence, requesting rulings regarding the gift and generation-skipping transfer (GST) tax consequences of the proposed division of Trust.

Facts

The facts submitted and representations made are as follows. In 1954, Husband executed an irrevocable trust agreement (Husband's Trust Agreement) creating four separate trusts: one for the benefit of Foundation, and one for each of his children, Son 1, Son 2, and Daughter, and their families. On the same date, Wife executed a substantially identical irrevocable trust agreement (Wife's Trust Agreement) creating four trusts for the benefit of the same three individuals and Foundation.

Trust 1 was established under Husband's Trust Agreement, and Trust 2 was established under Wife's Trust Agreement. Both trusts were established for the benefit

of Son 1, Son 1's Spouse, Son 1's Daughter (Granddaughter), Son 1's Son (Grandson), any afterborn children of Son 1, Son 1's grandchildren and their issue.

Husband and Wife both died before September 25, 1985. Daughter died in Year 1 (prior to September 25, 1985) with no surviving spouse or descendants. The trusts for her family were divided between the trusts for Son 1's family and the trusts for Son 2's family created under Husband's and Wife's Trust Agreements. Son 2 died in Year 2 survived by two children who now have their own children. Son 1 died in Year 3, survived by his spouse and his two children who now have children.

On Date 1, Trusts 1 and 2 were merged and immediately divided into Granddaughter's Family Trust for the benefit of Son 1's Spouse, Granddaughter, and Granddaughter's issue and Trust for the benefit of Son 1's Spouse, Grandson, and Grandson's issue. The Internal Revenue Service issued a favorable ruling regarding the merger and division.

Under the terms of Trust, the net income may be distributed to any of Son 1's Spouse, Grandson, and Grandson's issue, at any time, and in any amounts as the corporate trustee determines in its discretion, taking into account the circumstances of the beneficiaries and all other income and benefits each is receiving from all sources known to the corporate trustee. No individual trustee can participate in any decision to make these discretionary income distributions.

The corporate trustee may distribute principal from Trust for the "proper support, comfort, education, maintenance or assistance" of any beneficiary entitled to receive income from Trust or "to enable any such beneficiary to meet any accident, emergency or misfortune." No individual trustee can participate in any decision to make these discretionary principal distributions. A discretionary principal distribution to an income beneficiary will be treated as an advancement and will be charged against the share of that beneficiary or that beneficiary's descendants when Trust terminates.

Trust must terminate no later than the date twenty-one (21) years after the death of the last survivor of a group consisting of Husband, Wife, Son 1, Son 1's Spouse, Granddaughter, Grandson, Son 2, Son 2's spouse, Son 2's daughter and son, and Daughter and her spouse. Upon the termination of Trust, the assets of trust will be distributed outright to Grandson's then living descendants, per stirpes. If upon final termination of Trust, there are no then living descendants of Son 1, Son 2, and Daughter, the assets of Trust will be distributed outright to Foundation, or if it is not then a charity, to a charity selected by the trustees.

If at any time during its term, Trust has no then living beneficiaries, the assets of Trust will be distributed to Granddaughter's Family Trust, if then existing, and if not then existing, in equal parts to the trusts created by Husband and Wife for Son 2's family, if then existing. If the trusts for Son 2's family are not then existing, then until final distribution, the income of Trust will be distributed to the trusts created by Husband and

Wife for Foundation; however, instead, the trustees, in their discretion, may decide to distribute all of the assets of Trust outright to a charity they select.

Trust must have one corporate trustee, and no fewer than two and no more than four individual trustees. The initial individual trustees may appoint their own successors. Successor individual trustees must be appointed by the remaining individual trustees, or if none, by a majority of the income beneficiaries. All individual trustees may remove and replace a corporate trustee. A corporate trustee cannot be related or subordinate, within the meaning of § 672(c), to any of the beneficiaries of the trust. Any domestic corporation that is a bank or trust company with capital and surplus in excess of \$2 million is qualified to serve as a corporate trustee. Initially, the trustees of Trust were Bank, Grandson, and Grandson's spouse. However, currently, the trustees of Trust are Bank and Grandson's four adult children (Greatgrandchild 1, Greatgrandchild 2, Greatgrandchild 3, and Greatgrandchild 4).

The current beneficiaries of Trust are Son 1's Spouse, Grandson, Grandson's four adult children (Greatgrandchild 1, Greatgrandchild 2, Greatgrandchild 3, and Greatgrandchild 4) and Grandson's 10 minor grandchildren.

No additions, actual or constructive, were made to Trusts 1 and 2 after September 25, 1985, nor have any been made to Trust since its creation. It is represented that approximately twenty-five years ago, Trusts 1 and 2 made distributions of stock over several years. One-half of each distribution was paid in equal shares to the children of Son 1's Son and the other one-half of each distribution was paid to the children of Son 1's Daughter in equal shares. No other distributions have been made from Trusts 1 and 2 and none have been made from Trust since its creation.

Greatgrandchild 1, Greatgrandchild 2, Greatgrandchild 3, and Greatgrandchild 4 have different investment philosophies which has led the trustees of Trust to propose a division of Trust into four separate trusts, one for each of the great grandchildren and that great grandchild's issue.

The current trustees and all of the adult beneficiaries of Trust will execute Agreement. Agreement provides that, subject to the receipt of a favorable ruling from the Internal Revenue Service, Trust will be divided equally into four separate trusts (the New Trusts) as follows: one New Trust for the benefit of Son 1's spouse, Grandson, Greatgrandchild 1, and the issue of Greatgrandchild 1; one New Trust for the benefit of Son 1's spouse, Grandson, Greatgrandchild 2, and the issue of Greatgrandchild 2; one New Trust for the benefit of Son 1's spouse, Grandson, Greatgrandchild 3, and the issue of Greatgrandchild 3; and one New Trust for the benefit of Son 1's spouse, Grandson, Greatgrandchild 4 and the issue of Greatgrandchild 4. Agreement provides that the trustees will divide the assets of Trust pro rata among the four New Trusts. Agreement amends the provisions of Trust and provides that the New Trusts will have the same provisions as Trust, as amended under Agreement.

The current trustees of Trust and all of the adult beneficiaries of Trust will also execute Trust Indenture for GreatGrandchild 1, Trust Indenture for GreatGrandchild 2, Trust Indenture for GreatGrandchild 3, and Trust Indenture for GreatGrandchild 4. Each of these trust indentures contains provisions identical to those of Trust as amended under Agreement.

The provisions of New Trusts differ from those of Trust as follows:

If at any time during its term, a New Trust has no then living beneficiaries, the assets of that new trust will be distributed as follows: First, in equal shares to the other New Trusts then existing, and if none are then existing, to Granddaughter's Family Trust, if then existing, or in equal shares to the successors of that trust by reason of its division. If neither Granddaughter's Family Trust nor any of its successors are then existing, in equal shares to the trusts created by Husband and Wife for Son 2's family, if then existing. If the trusts for Son 2's family are not then existing, then until final distribution, the income of the New Trust will be distributed to the trusts created by Husband and Wife for Foundation; however, instead, the trustees, in their discretion, may decide to distribute all of the assets of the New Trust outright to a charity they select.

Each New Trust will provide that at its termination its assets will be distributed per stirpes to the great grandchild for whom the trust is named, if then living, or, if not then living, to the then living issue of that great grandchild, or, if none, to the then living issue of Grandson.

Bank will continue as corporate trustee of each New Trust along with designated individuals who are not identical to those currently serving as individual trustees of Trust.

Granddaughter's Family Trust will be amended to provide that if at any time during its term, Granddaughter's Family Trust has no then living beneficiaries, the assets of that trust will be distributed to Trust, if then existing, or in equal shares to the successors of Trust by reason of its division. If neither Trust nor any of its successors are then existing, the assets of Granddaughter's Family Trust will be distributed in equal shares to the trusts created by Husband and Wife for Son 2's family, if then existing. If the trusts for Son 2's family are not then existing, then until final distribution, the income of the Granddaughter's Family Trust will be distributed to the trusts created by Husband and Wife for Foundation; however, instead, the trustees, in their discretion, may decide to distribute all of the assets of Granddaughter's Family Trust outright to a charity they select.

It is represented that under State law, the trustees and adult beneficiaries of Trust may effect the division and amendment of Trust by executing Agreement in lieu of obtaining a court order.

We have been asked to rule as follows:

1. The division of Trust into the four New Trusts will not result in a transfer by any of the beneficiaries that is subject to gift tax under § 2501.
2. After the division of Trust into the four New Trusts, each of the New Trusts will be considered to have been created and to have become irrevocable before September 25, 1985, and will be exempt from generation-skipping transfer tax under Chapter 13.

Ruling Request #1:

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that, if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. Section 2512(b) provides that where property is transferred for less than an adequate consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed a gift.

In this case, the dispositive provisions of the New Trusts will be identical to those of Trust (except as noted above) except that each New Trust will be established for the benefit of a single family of one of the four great grandchildren. Based on the facts submitted and the representations made and assuming the transaction is carried out, and is effective, under State law, we conclude that the pro rata division of Trust's assets into New Trusts will not result in a transfer by any of the beneficiaries that is subject to federal gift tax under § 2501.

Ruling Request #2:

Section 2601 imposes a tax on each generation-skipping transfer made by a transferor to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986, 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 Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a 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 generation-skipping transfer tax will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph 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 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.

Example 5, contained in § 26.2601-1(b)(4)(i)(E), considers a situation where, in 1980, 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. In 2002, 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 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. 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 provisions of chapter 13.

In the present case, Trust 1, Trust 2, and Trust were irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, were made to these trusts after that date and that no distributions have been made from Trust since its creation on Date 1.

The division of Trust into the four New Trusts is substantially similar to the situation described in Example 5 of § 26.2601-1(b)(4)(i)(E). The division of Trust into the four New Trusts will not result in a shift of any beneficial interest in the trust assets to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the reorganization. New Trusts must terminate on the same date that Trust was required to terminate. Thus, division will not extend the time for vesting of any beneficial interest in the New Trusts beyond the period provided for in Trust.

The modification to New Trusts regarding the identity of the individual trustees is administrative in nature. The modifications regarding the distributions during the term of a New Trust if no beneficiaries are then living and regarding distribution at termination if the named great grandchild is not then living will not result in any shift in the beneficial interests in trust to lower generation beneficiaries.

Accordingly, based on the facts submitted and the representations made and assuming the transaction is carried out, and is effective, under State law, we rule that after the division of Trust into four New Trusts, each of the New Trusts will be considered to have been created and to have become irrevocable before September 25, 1985, and will be exempt from generation-skipping transfer tax under Chapter 13.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the modification 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.

Sincerely yours,

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

Enclosure

Copy for section 6110 purposes

cc: