Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B04 – PLR-155351-03
Date:
April 16, 2004

Re: Private Letter Ruling Request

Legend:

Settlor	-
Spouse	-
Child 1	-
Child 2	-
Child 3	-
Grandchild 1	-
Grandchild 2	-
Trustee	-
Trust A	-
Trust B	-
Trust A1	-
Trust A2	-
Trust A3	-
Trust B1	-
Trust B2	-
Trust B3	-
Date 1	-
Date 2	-
Date 3	-
Date 4	-
Date 5	-
Date 6	-
Foundation	-
State X	-
Cite 1	-

Dear :

This letter is in reply to your letter of September 17, 2003, requesting rulings regarding the generation-skipping transfer (GST) tax treatment of the proposed division and modification of two trusts.

Settlor established Trust A on Date 1 and Trust B on Date 2. Both dates were prior to September 25, 1985. Trust A and Trust B are both governed by the law of State X. Trustee, a corporate trustee, and Child 1 are the co-trustees of Trust A and Trustee is the sole trustee of Trust B. Both trusts were irrevocable and had similar terms, except as described below. You represent that no additions, constructive or otherwise, have been made to either Trust A or Trust B after September 25, 1985.

Under the terms of Trust A, income is to be distributed in the discretion of the Corporate trustee for care, education and welfare to the following beneficiaries in the following order of priorities: (1) Spouse (Settlor's spouse); (2) Child 1, Child 2, and Child 3 (Settlor's children) and, if Child 1 was not living, to his widow for her life; and (3) the children or descendants of Child 1, Child 2 and Child 3. Distributions may be made to beneficiaries at one level of priority to the exclusion of beneficiaries at a lower level of priority. Any income not distributed may be distributed as income in a subsequent year or added to corpus. Any current income or accumulated income not distributed to spouse, may be distributed or held for the benefit of Settlor's children (including the widow of Child 1, if necessary), share and share alike, or distributed or held for the benefit of the children's descendants, per stirpes. The corporate trustee may also make discretionary distributions of corpus to meet a dire or urgent need regarding the care or education of any beneficiary for which no other funds are available. Any corpus not distributed to Spouse, will be held for the benefit of Settlor's children share and share alike, or for their children or descendants, per stirpes. Any distribution to a beneficiary other than Spouse will be charged against that beneficiary's share of the corpus.

Trust A is to terminate on the first to occur of the death of all the beneficiaries described above, or the expiration of 20 years after the death of the survivor of Spouse, Child 1, Child 2, Child 3, and Grandchild 1, all of whom were living on Date 1. Upon termination, the corpus will be distributed to the then living grandchildren and/or descendants of Settlor, per stirpes. In the event there are no living grandchildren or descendants of Settlor upon termination, the corpus will be distributed to Foundation.

Article 6 of Trust A provides that, after the death of Spouse, the Trustee may divide the trust assets into three shares and administer each share as a separate trust for each of Settlor's children, if living, or such child's children or descendants, per stirpes.

Trust B has the same beneficiaries and dispositive provisions as Trust A. Trust B will terminate at the first to occur of the death of all the beneficiaries described above or

the expiration of 20 years after the death of the survivor of Spouse, Child 1, Child 2, Child 3, Grandchild 1, and Grandchild 2, all of whom were living on Date 2. As in Trust A, upon termination, the Trust B corpus will be distributed to the then living grandchildren and/or descendants of Settlor, per stirpes. If there are no living grandchildren or descendants, the trust assets will be distributed to Foundation.

As in Trust A, Article 6 of Trust B provides that, after the death of Spouse, the Trustee may divide the trust assets into three shares and administer each share as a separate trust for each of Settlor's children, if living, or such child's children or descendants, per stirpes.

Settlor died on Date 3 and Spouse died on Date 4.

You represent that Foundation was established with the intention that it qualify as a charitable entity to which contributions would be deductible under § 2055. However, you represent that Foundation, in fact, is no longer in existence.

On Date 5, the trustees of Trust A and Trust B petitioned the appropriate local court in State X to partition Trust A and Trust B into six separate subtrusts for the benefit of Settlor's children; Child 1, Child 2, and Child 3, and their respective families. The court granted the petitions on Date 6, and ordered that the trusts be partitioned contingent upon the trustees obtaining a favorable letter ruling from the Internal Revenue Service.

Pursuant to the terms of the court order, Trust A will be divided into 3 separate subtrusts: Trust A1 (for the benefit of Child 1), Trust A2 (for the benefit of Child 2), and Trust A3 (for the benefit of Child 3). In general, each separate subtrust will receive a pro rata interest in each trust asset. Trust A assets include promissory notes entered into with entities related to one or more beneficiaries of Trust A. It is anticipated that these promissory notes will be distributed to the separate subtrust of the beneficiary whose entity borrowed the funds. The distributions will be equalized by a non pro rata distribution of cash and/or securities. Trust B will also be divided into 3 separate subtrusts: Trust B1 (for the benefit of Child 1), Trust B2 (for the benefit of Child 2), and Trust B3 (for the benefit of Child 3). Each separate subtrust will receive a pro rata interest in each trust asset. The provisions of the six separate subtrusts will be identical, except that the income beneficiary of each subtrust will be the specific Settlor's child (the primary beneficiary) for whom the subtrust is established (in the case of Child 1, Child 1's widow is an alternate income beneficiary if she survives Child 1) and their children or descendants. Also, each subtrust will terminate upon the first to occur of the death of all the income beneficiaries of the respective subtrusts or 20 years after the death of the survivor of the measuring lives set forth in Trust A and Trust B, respectively, and the subtrust assets will be distributed to the living children and

descendants of the respective primary beneficiary. In the event that there are no children or descendants of the primary beneficiary living at the termination of that respective subtrust, the subtrust assets will be distributed equally to the subtrusts for the benefit of the other primary beneficiaries and their children and descendants. Foundation is no longer in existence and, thus, is not designated as a contingent remainder beneficiary.

In addition, the trustees of the six separate subtrusts will change for two of the new subtrusts. Trustee and Child 1 will remain as co-trustees of Trust A1, Trust B1, Trust A3, and Trust B3, while Trustee and Child 2 will be the co-trustees of Trust A2 and Trust B2.

Specifically, you request a ruling that the division and modification of Trust A and Trust B, as described above, and the creation of the resulting subtrusts (Trust A1, Trust A2, Trust A3, Trust B1, Trust B2, and trust B3) and any distribution from or termination of any interest in the resulting subtrusts will not subject any of the resulting subtrusts to the generation-skipping transfer tax.

LAW AND ANALYSIS:

Section 2601 imposes tax on every generation-skipping (GST) transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433(a) of the Tax reform Act of 1986 (the 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 GST tax does not apply to any generation-skipping transfer under a trust that was irrevocable on 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 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. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after 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)(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

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, 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.

The law of State X provides at Cite 1:

> Unless expressly prohibited by the terms of the governing instrument, when property is held or to be held in a trust, the trustee is authorized, but not required, to divide the trust into two (2) or more separate trusts of equal or unequal value if the trustee determines that division of the trust is in the best interests of the beneficiaries or could result in a significant decrease in current or future federal income, gift, estate, or generation-skipping transfer taxes, or any other tax.

> If a trustee divides a trust into separate trusts under this subchapter, the terms of the separate trusts need not be identical but must provide for the same succession of interests and beneficiaries as are provided in the original trust. Differing tax elections may be made for each of the separate trusts.

In this case, Trust A and Trust B were both irrevocable on September 25, 1985, and no additions, constructive or actual, have been made to either trust after that date. The parties propose to divide Trust A into three equal subtrusts, Trust A1 for the benefit of Child 1 and his spouse and issue; Trust A for the benefit of Child 2 and her issue; and Trust A3 for the benefit of Child 3 and her issue. Likewise, Trust B will be divided into three equal subtrusts, Trust B1 for the benefit of Child 1, his spouse and his issue; Trust B2 for the benefit of Child 2 and her issue; and Trust B3 for the benefit of Child 3 and her issue. The provisions in each of the resulting subtrusts regarding discretionary distributions of income and corpus by the corporate trustee are identical to those in the original trusts. The resulting subtrusts will terminate based on the same measuring lives and under the same conditions as the original trusts and final distributions will be made to the same beneficiaries as under the original trusts, except that Foundation, which no longer exists, has been eliminated. You have opined that, if on termination, there are no descendants of Settlor then living, the cy pres doctrine would apply, and the court would designate a charitable recipient for each subtrust.

Consequently, the proposed division of Trust A into Trust A1, Trust A2, and Trust A2 and the proposed division of Trust B into Trust B1, Trust B2, and Trust B3 will not shift a beneficial interest in the subtrusts to any beneficiary who occupies a lower generation than the persons who held the beneficial interest prior to the division. The proposed division will not extend the time for vesting of any beneficial interest in the subtrusts beyond the time provided for in Trust A or Trust B. See § 26.2601-1(b)(4)(i)(E), Example 5.

Accordingly, based on the facts submitted and the representations made, and provided that there are no further additions to the subtrusts after September 25, 1985, we conclude that after the division; Trust A1, Trust A2, Trust A3 and Trust B1, Trust B2, and Trust B3 will be treated as trusts that were irrevocable on September 25, 1985, and Trust A1, Trust A2, Trust A3 and Trust B1, Trust B2, Trust B3 will be exempt from the GST tax imposed under § 2601. Further, the proposed division will not constitute an addition to Trust A1, Trust A2, Trust A3, Trust B1, Trust B2, or Trust B3. Accordingly, future distributions from these resulting subtrusts will be exempt from GST tax.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any tax return to which it is relevant. In accordance with

the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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.

Sincerely,

George L. Masnik
Chief, Branch 4
Office of Associate Chief Counsel

(Passthroughs & Special Industries)

cc: