

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B04 – PLR-134141-03

Date:

November 12, 2003

In re:

Legend

Trust =

Husband =

Wife =

Child A =

Child B =

Child C =

Sister =

Father =

Foundation =

State =

Court =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Date =

Dear \_\_\_\_\_ :

This responds to a letter from your authorized representative dated May 6, 2003, and prior correspondence, requesting rulings regarding the generation-skipping transfer (GST) tax consequences of the proposed division of and modifications to Trust.

PLR-134141-03

You represent the facts to be as follows. Husband died in Year 1 survived by Wife. Article IV of Husband's Will created a marital trust over which Wife held a testamentary power of appointment. Under Article V of Husband's Will, the residue of Husband's estate was devised to Trust. Wife died in Year 2 and exercised her testamentary power of appointment over the marital trust in favor of Trust. Both Year 1 and Year 2 are prior to September 25, 1985. You represent that no additions, actual or constructive, have been made to Trust since September 25, 1985.

Article V, paragraph (A) of Trust provides as follows:

The trustees shall distribute the net income of and from the trust estate, or so much thereof as they in their sole discretion shall determine, at such intervals as they shall determine, to my wife, [Wife], and to my lineal descendants, in such proportions as they shall from time to time determine, accumulating and adding to principal any income not so distributed. In the event of a complete failure of my lineal descendants at any time following the death of my wife, the net income shall be similarly accumulated or distributed, in the discretion of the trustees, to my sister, [Sister], and her lineal descendants. Notwithstanding the discretion herein granted the trustees in regard to accumulation of income, they shall each year distribute all of that portion of the net income of or from the trust estate which is derived from rents, profits, royalties or other income from real estate or interests in real estate.

There is no provision in Trust for the distribution of principal, other than at Trust's termination. Article V, paragraph (B) provides:

This trust shall terminate on the first of the following dates:

(1) Expiration of twenty-one years following the death of the last survivor of my said wife and those lineal descendants of my father, [Father], who are living at the date of my death;

(2) any date, subsequent to the death of my wife, established by the trustees by instrument in writing signed by a majority of the trustees eligible to participate in the exercise of such discretion; or

(3) the date, subsequent to the death of my wife, upon which there occurs a complete failure of lineal descendants of [Father].

Upon such termination, the trust estate and any undistributed income therefrom shall promptly be paid over and distributed to my then living lineal descendants, per stirpes, or, if none of my lineal descendants is living on such

PLR-134141-03

date, then to the then living lineal descendants of my sister, [Sister], per stirpes; or, if none of her lineal descendants is living on such date, then to the [Foundation], a charitable corporation organized under the law of the State of [State], to be by it held, used for and applied to the charitable purposes of said corporation in the unlimited discretion of its Board of Trustees.

Child A has three children, each of whom was living at the time of Husband's death. Child B had no children until Year 3 when Child B and her husband adopted three children, each of whom was born after Husband's death. Child C has two children both of which were born after Husband's death. Child B died in Year 4.

Since the death of Wife, Trust's trustees have, in accordance with the discretionary powers set forth in Article V, made distributions of income to Child A, Child B, and Child C, but not to any of their children. Prior to Child B's adoption of three children in Year 3, the trustees chose to distribute substantially more of Trust's income to Child B than to Child A or Child C, primarily because Child B had no descendants who would benefit from the eventual distribution of Trust's assets. After Child B's death, the trustees began to accumulate all of Trust's income.

The parties petitioned Court to equalize total distributions from Trust, divide Trust into three separate shares, and obtain judicial construction regarding certain other provisions. On Date, Court issued an Order providing as follows:

1. To counteract the effect of previous distributions to Child B prior to her adoption of her children, the trustees shall distribute the entire net income of Trust to Child A and Child B and their descendants until each family line has received equivalent distributions.
2. After distributions have been equalized, the trustees will divide the assets of Trust into three equal fractional shares, one share for each of Husband's children and her descendants and each of the separate shares will thereafter be administered as a separate trust.
3. The provisions governing distributions from each of the three new trusts will be the same as those that currently apply to Trust, except that distributions from one family line's trust will be limited to persons in that family line.
4. If, at any time prior to termination of Trust, none of any child of Husband and her descendants is living, the assets of the separate trust for such persons shall be divided equally between the remaining separate trusts (or added to the sole remaining separate trust).

PLR-134141-03

5. Any decision of the disinterested trustees to terminate Trust must apply to all of the separate trusts.

6. The provisions of the governing trust instrument relating to succession of trustees shall be applied separately to the three separate trusts.

7. Upon termination of Trust, the separate trust for a child of Husband and her descendants (a) will be distributed to such child, if she is then living, or (b) if the child is not then living, will be divided into equal shares, one for each of such child's children who is then living and one for each of such child's children who has previously died leaving descendants then living. Each share for a living grandchild of Husband will be distributed to such grandchild. Each share for a deceased grandchild will be further divided among such grandchild's descendants in the same manner as is provided for division of a child's share.

You have requested the following rulings:

1. A judicial reformation of Trust dividing Trust into separate equal trusts, one for each of Child A, Child B, and Child C and their respective descendants, each of which would continue to be administered under substantially the same terms as prior to the division but with distributions restricted to the designated family line, would not cause Trust or any of the three separate trusts into which Trust is divided to fail to be a trust described in and subject to § 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act), and all distributions from, and terminations of interests in, Trust according to its terms would remain exempt from the generation-skipping transfer tax imposed under § 2601 of the Internal Revenue Code.

2. Trust would not fail to be a trust described in and subject to § 1433(b)(2)(A) of the Act if, prior to a judicial division of Trust, the trustees exercise their discretion to make distributions of income to Child A, Child C and their descendants that would be equivalent to the income distributions previously made to Child B.

3. Trust would not fail to be a trust described in and subject to § 1433(b)(2)(A) of the Act by reason of a judicial construction of the governing trust instrument under which assets of Trust would, if not previously divided, be divided upon its termination into equal shares for Husband's children, with each deceased child's share being then divided equally among her children.

## LAW AND ANALYSIS

Section 2601 imposes a tax on every generation-skipping transfer. Under § 1433(a) of the Act, the GST tax is generally applicable to generation-skipping

PLR-134141-03

transfers made after October 22, 1986. However, under § 1433(b)(2)(A) 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

PLR-134141-03

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 judicial reformation of Trust dividing Trust into separate equal trusts, one for each of Child A, Child B, and Child C and their respective descendants, each of which would continue to be administered under substantially the same terms as prior to the division but with distributions restricted to the designated family line, would not cause Trust or any of the three separate trusts into which Trust is divided to fail to be a trust described in and subject to § 1433(b)(2)(A) of the Act, and all distributions from, and terminations of interests in, Trust according to its terms would remain exempt from the generation-skipping transfer tax imposed under § 2601.

2. Trust would not fail to be a trust described in and subject to § 1433(b)(2)(A) of the Act if, prior to a judicial division of Trust, the trustees exercise their discretion to make distributions of income to Child A, Child C and their descendants that would be equivalent to the income distributions previously made to Child B.

3. Trust would not fail to be a trust described in and subject to § 1433(b)(2)(A) of the Act by reason of a judicial construction of the governing trust instrument under which assets of Trust would, if not previously divided, be divided upon its termination into equal shares for Husband's children, with each deceased child's share being then divided equally among her children.

PLR-134141-03

Accordingly, after the proposed division and modifications, the three separate trusts will continue to be exempt from the GST tax imposed under § 2601 provided there are no additions to those 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

cc: