

Internal Revenue Service

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Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:7:PLR-111789-98

Date: March 25, 1999

RE:

TIN:

LEGEND:

Decedent:

Brother:

Niece:

Date 1:

Date 2:

Date 3:

Trust A:

Trust Agreement:

executed January 26, 1992

Trust B:

State:

Dear

We received your letter, dated _____, submitted on behalf of the Co-Executors of the estate of Decedent, requesting a ruling concerning the generation-skipping transfer (GST) tax consequences of the proposed division of a trust under section 2601 of the Internal Revenue Code. This letter responds to that request.

The represented facts are as follows: Decedent, a United States citizen, died testate on Date 2, survived by her Brother and her Niece. Decedent's Last Will and Testament (Will) was executed on Date 1, and was duly admitted to probate on Date 3. After certain specific bequests, the Will provides that the residue of Decedent's estate will be distributed pursuant to the terms of the Trust Agreement. Trust A was created during Decedent's lifetime and the assets of Trust A were to be administered for the benefit of Decedent. Upon Decedent's death, Trust A was

disposed of in accordance with Article IV of the Trust Agreement. Article IV directs that after certain specific bequests, the residue of Decedent's estate will pour over into Trust B. The principal beneficiary of Trust B is Niece; the trustees are Brother and Niece who serve together with a third person to be named by Brother and Niece (collectively, the Co-Trustees).

Under Article V of the Trust Agreement, the Co-Trustees are authorized in their discretion to distribute the principal of Trust B as they deem necessary for the support, maintenance and education of Niece. The Co-Trustees are further authorized in their discretion to distribute the net income of Trust B for the support, maintenance and education of Niece until Niece reaches the age of 33 provided, however, that at least 50 percent of the net income shall be distributed to Niece at least annually. Upon reaching the age of 33, Niece may withdraw one-fifth ($1/5$) of the Trust B principal. Thereafter, and for the rest of Niece's life, the Co-Trustees are directed to distribute to Niece 80 percent of the Trust B net income. Upon reaching the age of 38, Niece may withdraw one-fourth ($1/4$) of the remaining Trust B principal (or, two-fifths ($2/5$) if one-fifth ($1/5$) was not distributed when Niece turned 33). Upon reaching the age of 43, Niece may withdraw one-half ($1/2$) of the remaining Trust B principal (or, seven-tenths ($7/10$), or 70 percent, if one-fifth ($1/5$) and one-fourth ($1/4$) were not distributed when Niece turned 33 and 38, respectively). After Niece reaches the age of 43, the remaining Trust B assets continue in trust for her benefit for the remainder of her lifetime. Upon Niece's death, the remaining assets are distributed to her descendants, if any. If there are no descendants, the remaining assets are distributed to Niece's father (*i.e.*, Decedent's Brother). If Brother is deceased, the remaining assets are distributed to various charitable beneficiaries.

At the time of Decedent's death, Niece was 37 years old. She was 38 years old at the time of the filing of this ruling request.

The Co-Trustees are prepared to file a petition in local court to request the division of Trust B into three separate trusts, Trust C, Trust D and Trust E. The Co-Trustees represent that the reformation of Trust B as requested will not materially impair the accomplishment of the Trust B purposes and will not prejudice or adversely affect the interest of any beneficiary.

In addition, the Co-Trustees represent that under the proposed reformation of Trust B:

Trust C will be funded with 70 percent of the assets of Trust B. Further, the principal of Trust C may be distributed to Niece, within the discretion of the Co-Trustees, for the support, maintenance and education of Niece. In addition, 80 percent of the net income of Trust C will be distributed to Niece at least annually. Upon the initial funding of Trust C, Niece will be able to withdraw two-sevenths ($2/7$) of the Trust C principal. Upon reaching the age of 38, Niece will be able to withdraw two-fifths ($2/5$) of the remaining Trust C principal (or, four-sevenths ($4/7$) if

two-sevenths (2/7) was not previously distributed). Upon reaching the age of 43, Niece will be able to withdraw the remaining Trust C principal, the aggregate of which represents 70 percent of the original Trust B principal.

Trust D will be funded with the lesser of: (1) the assets remaining after the funding of Trust C; or (2) a fractional share of the assets in Trust B before division into separate trusts. Generally, the numerator of such fraction will be the maximum federal GST exemption that the Co-Executors may allocate to Trust D and the denominator will be the value of the assets in Trust B before division into separate trusts. The Co-Executors anticipate that the numerator will be the entire \$1,000,000 exemption under section 2631. Further, the principal of Trust D may be distributed to Niece, within the discretion of the Co-Trustees, for the support, maintenance and education of Niece. In addition, 80 percent of the net income of Trust D will be distributed to Niece at least annually.

Trust E will be funded with the remaining Trust B assets, if any. The terms of Trust E are identical to the terms of Trust D.

Upon Niece's death, the assets remaining in Trust C, Trust D and Trust E will be distributed to her descendants, if any. If there are no descendants, the remaining assets will be distributed to Niece's father (i.e., Decedent's Brother). If Brother is deceased, the remaining assets will be distributed to various charitable beneficiaries.

Under the proposed reformation, Trust C, Trust D and Trust E will be funded based upon the fair market value of Trust B's assets as finally determined for federal estate tax purposes and the assets allocated to each trust will fairly represent the appreciation and depreciation of assets that may occur before the trusts are funded.

The Co-Executors request the following rulings:

(1) The division of Trust B into three separate trusts, Trust C, Trust D and Trust E, will be recognized for GST tax purposes as the creation of three separate trusts pursuant to section 26.2654-1(b) of the Generation-Skipping Transfer Tax Regulations; and,

(2) The decedent's GST exemption under section 2632 may be allocated solely to Trust D.

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer made by a "transferor" to a "skip person."

Section 26.2601-1(a) provides, in relevant part, that the provisions of chapter 13 will apply to any GST (as defined in section 2611) made after October 22, 1986.

Section 2611 defines the term "generation-skipping transfer" (GST) as a taxable distribution, taxable termination, or a direct skip.

Section 2612(a) provides that the term "taxable termination" means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

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).

Section 2612(c) provides that the term "direct skip" means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613(a) provides that the term "skip person" means (1) a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor, or (2) a trust if all interests in the trust are held by skip persons, or if there is no person holding an interest in such trust, and at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 2631 provides that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. An allocation, once made, shall be irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his GST exemption under section 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined without regard to exemptions), regardless of whether such a return is required to be filed.

Section 2652(a) provides that except as provided in section 2652(a) or section 2653(a), the term "transferor" means (A) in the case of any property subject to the tax imposed by chapter 11, the decedent, and (B) in the case of any property subject to tax imposed by chapter 12, the donor. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 2654(b)(2) provides that, for purposes of the GST tax, substantially separate and independent shares of different beneficiaries in a trust shall be treated as separate trusts. Except as provided in the preceding sentence, nothing in chapter 13 is to be construed as authorizing a single trust to be treated as 2 or more trusts.

Section 26.2654-1(b)(1) provides that the severance of a trust that is included in the transferor's gross estate (or created under the transferor's will) into two or more trusts is recognized for purposes of chapter 13 if (i) the trust is severed pursuant to a direction in the governing instrument providing that the trust is to be divided upon the death of the transferor; or (ii) the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or under local law; and

(A) The terms of each of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust;

(B) The severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the Federal estate tax return (including extensions actually granted) for the estate of the transferor; and

(C) Either--

(1) The new trusts are severed on a fractional basis. If severed on a fractional basis, the separate trust need not be funded with a pro rata portion of each asset held by the undivided trust. The trust may be funded on a non pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the date of death to the date of funding; or

(2) If the severance is required (by the terms of the governing instrument) to be made on the basis of a pecuniary amount, the pecuniary payment is satisfied in a manner that would meet the requirements of section 26.2654-1(a)(1)(ii) if it were paid to an individual.

Section 55-19.4 of the State Code provides, in relevant part, that upon petition by a trustee in the circuit court in which the trustee qualified, or if there is no such qualification, the circuit court for the jurisdiction in which the trustee resides, the circuit court may, for good cause shown, modify a trust in any manner, including, without limitation, dividing a trust into two or more separate trusts. Before taking any such action, however, the court must first find that such action will neither materially impair the accomplishment of the trust purposes nor adversely affect the interests of any beneficiary.

Although the trust document in this case does not require or otherwise direct severance of Trust B, State law authorizes courts to divide a trust into two or more trusts under certain circumstances. It has been represented that the Co-Trustees will petition the court to sever Trust B and that the reformation proceeding will be commenced before Decedent's federal estate tax return is required to be filed. Under the proposed reformation, the terms of each of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in

the original trust. Also under the proposed reformation, the new trusts will be funded in a manner that fairly reflects the net appreciation or depreciation in the value of the assets from the date of Decedent's death to the date of funding.

Based upon the information submitted and the representations made and provided that the State court reforms Trust B as proposed, we conclude that the severance of Trust B into three separate trusts, Trust C, Trust D and Trust E, will be recognized for GST tax purposes as the creation of three separate trusts. In addition, we conclude that Decedent's GST exemption under section 2632 may be allocated solely to Trust D.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code.

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

A copy of this letter should be sent to the Service Center where the Decedent's federal estate tax return was filed. A copy is enclosed for that purpose.

Sincerely,

Frances Schafer

Frances Schafer
Badge Number 50-06420
Counsel to the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures:

Copy of letter

Copy for section 6110 purposes