

**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-140668-01  
Date: August 17, 2001

Re:

Legend:

Settlor =  
Trust Agreement =

Trust =  
Bank =  
X =  
Date 1 =  
Y =  
Company =  
Z =  
Date 2 =  
Court =  
Corporation =  
Date 3 =  
Date 4 =

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

This is in response to a letter dated February 22, 2001, and subsequent correspondence, requesting a ruling regarding the generation-skipping transfer tax (GSTT) consequences of the severance and modification of Trust.

Facts

The facts submitted and representations made are as follows. Before September 25, 1985, Settlor executed an irrevocable Trust Agreement, creating Trust. No additions, constructive or otherwise, have been made to Trust since September 25, 1985.

Under Article 2 of Trust Agreement, the trustee has discretion to pay any part of the net income of Trust to any of Settlor's grandchildren "upon the basis of need" as determined by the trustee and to pay any part of the principal of Trust for the "emergency need" of any of Settlor's grandchildren.

Article 2 further provides:

It is the intention of the Settlor that in the exercise of its discretion, the Trustee should give preference to any of the said grandchildren attending a school, college or university, excepting any such grandchild who may have an emergency need because of illness or other disaster. It is the intention of the Settlor that until the termination of this trust the Trustee shall have the power and discretion to determine distribution of income or principal among or between the said grandchildren in the same manner and to the same extent as the Settlor might so determine if she were the sole owner of said property free from any trust.

Article 3 provides as follows:

This trust shall terminate when the youngest grandchild of the Settlor living at the time of the death of the Settlor shall attain his or her twenty-first (21<sup>st</sup>) birthday. Upon such termination the Trustee shall pay over and deliver all of the assets of the trust estate in equal shares to the grandchildren of the Settlor living at that time, provided that if any such grandchild shall have died prior to the termination of this trust leaving issue surviving, such issue shall take the share that such grandchild would have taken had he or she been living at the time of termination.

Article 4, paragraphs (a) and (b), authorize the trustee to sell any assets of Trust upon any terms and conditions and at any price the trustee deems best and to retain any assets of Trust or to dispose of them; except that common stock in Company and real estate cannot be sold during Settlor's lifetime without her written consent.

Trust Agreement states that Trust was initially funded with Y shares of common stock in Company, \$Z in cash, and a parcel of real estate. Marketable common stock in Corporation, Company's successor in interest, constitutes a large part of Trust's current assets. Trust also holds cash.

Bank is designated as trustee. Settlor is currently age X and has seven grandchildren, the youngest of whom will reach age 21 on Date 1.

On Date 2, Court construed administrative provisions of Trust.

On Date 3, the trustee filed a petition with Court to sever Trust into seven separate equal trusts, one for the benefit of each of Settlor's grandchildren, and to modify the termination provisions of Trust. The petition also sought to modify the distribution provisions of Trust so that four of the seven separate trusts would permit

distributions of income or principal for the “best interests” of a grandchild for whom the trust was created and the other three separate trusts would require the annual distribution of the greater of the net income of the separate trust and a fixed percentage of the value of the assets.

On Date 4, Court issued an order granting the trustee’s request to sever Trust and to modify the termination provisions (Order). In addition, Court construed the Trust provision to grant the trustee discretion to distribute income and principal for the best interests of each grandchild. However, the order did not require annual distribution of the greater of the net income of the separate trust and a fixed percentage of the value of the assets.

Under Order, the trustee is authorized to divide Trust into seven equal trusts, one for the benefit of each of Settlor’s living grandchildren. Each separate trust will be funded with a pro rata share of each existing Trust asset and will be permitted to pursue different investment programs, subject to Settlor’s direction and to the investment and “fiduciary” obligations applicable to Settlor or her delegate pursuant to the Court’s Date 2 order. Bank will be the trustee of each separate trust. The original terms of Trust, as modified and construed by Order, will apply to each separate trust.

If a new grandchild of Settlor is born or adopted before the termination of Trust, each existing grandchild’s trust will contribute an equal amount of assets to create a new trust for the new grandchild equal in value at its inception to the total value of all of the trusts divided by the new number of grandchildren. If the assets of any of the grandchildren’s trusts are insufficient for making the total required contribution, the remaining grandchildren’s trusts will equally contribute to make up the shortfall.

Subject to the receipt of a favorable ruling from the Internal Revenue Service and effective upon the receipt of such a ruling, the termination provisions of Trust will be modified to provide as follows:

[U]pon [Settlor’s] death (the “Termination Date”), each separate trust shall be distributed outright to the grandchild for whom the trust is named, provided that if any grandchild is deceased and leaves one or more surviving descendants, that grandchild’s trust shall be distributed outright to his or her then living descendants, per stirpes. If any grandchild is deceased and leaves no surviving descendant, that grandchild’s trust shall be added in equal shares to, and distributed as part of, the other grandchildren’s trusts.

If a grandchild dies after Trust is severed but before the Termination Date without surviving issue or the evidence of issue in gestation, the grandchild’s separate trust will be added in equal shares to the separate trusts for the then-living grandchildren. However, if such deceased grandchild is survived by issue or if the trustee receives unambiguous evidence that the grandchild left issue in gestation, the

grandchild's separate trust will be maintained until the Termination Date when the trust will be distributed outright to the deceased grandchild's then-living issue, per stirpes, or, if none, in equal shares to the other grandchildren's trusts.

Under Order, Trust is construed to grant the trustee sole and absolute discretion to distribute income and principal of Trust for the "best interests" of Settlor's grandchildren. Order further provides that this discretion will continue to apply to each separate trust after the severance of Trust except that each grandchild may then only receive distributions from the grandchild's respective trust.

Order provides that the Date 2 order applies to the separate trusts for the grandchildren, and Order construes administrative provisions of Trust.

We have been asked to rule that the proposed severance of Trust and modification of the termination provisions under Order will not subject the separate trusts to the generation-skipping transfer (GST) tax by reason of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(4)(i)(D) of the Generation-Skipping Transfer Tax Regulations.

#### Law

Section 2601 imposes a tax on each generation-skipping transfer made by a transfer 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.

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.

### Analysis

In the present case, Trust was irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, have been made to the trust after that date.

Under Order, Trust will be severed into seven separate trusts for each of Settlor's seven grandchildren who are currently beneficiaries of Trust. Each separate trust will be subject to the original terms of Trust as modified and construed under Order.

Under the original terms of Article 3, Trust terminates at the later to occur of Settlor's death and Settlor's youngest then-living grandchild reaching age 21. Under Order, all of the separate trusts will terminate at Settlor's death, even if Settlor's youngest then-living grandchild has not yet reached age 21. Thus, under Order, the separate trusts could terminate earlier than under the original terms of Trust but would not terminate any later.

Under the original terms of Article 3, when Trust terminates, the assets of Trust will be distributed in equal shares to Settlor's then-living grandchildren. However, if a grandchild dies with surviving issue before Trust terminates, "such issue shall take the share that such grandchild would have taken" if the grandchild had been alive when Trust terminates. Under Order, on the Termination Date (Settlor's date of death), each separate trust will be distributed to the grandchild for whom it is held. The trust of a grandchild who dies without issue or evidence of issue in gestation will be immediately distributed equally among the trusts of the then-living grandchild. However, if a grandchild dies after the establishment of the grandchild's separate trust but before the Termination Date leaving issue or unambiguous evidence of issue in gestation, then the deceased grandchild's separate trust will be maintained until the Termination Date when it will be distributed per stirpes among the deceased grandchild's then-living issue or, if none, in equal shares among the separate trusts of Settlor's then-living grandchildren. The provisions under Order for distribution of the assets of the separate trusts, at their termination, are substantially identical to the provisions for the distribution of the assets of Trust at its termination.

Under the original terms of Article 2, the trustee has discretion to distribute to any of Settlor's grandchildren any amount of income, on the basis of need, and any amount of principal, for emergency needs. The trustee can exercise this discretion as Settlor would if she owned Trust assets outright. Order construes Article 2 to grant the trustee discretion to distribute the income and principal of a grandchild's separate trust to the grandchild for the grandchild's "best interests." This construction does not provide a narrower standard under which the trustee may distribute income and

principal to Settlor's grandchildren from their separate trusts. Consequently, under Order, the trustee may distribute at least as much income and principal to each grandchild as the trustee could before Order was issued and may be able to distribute more.

Section 26.2601-1(b)(4)(i) discusses certain actions taken with respect to a trust which will not cause a trust to lose its exempt status. Under § 26.2601-1(b)(4)(i)(D), a modification will not cause an exempt trust to lose its exempt status, if the modification does not shift a beneficial interest in the trust to any beneficiary in a generation lower than the persons who held the beneficial interests 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 that does not cause an increase in the amount of a GST transfer or the creation of a new GST transfer will not cause the trust to lose its exempt status.

In this case, the proposed severance of Trust and modification of the termination provisions under Order will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the proposed severance and modification. Further, the proposed severance of Trust and modification of the termination provisions under Order will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in Trust Agreement. Further, the proposed severance of Trust and modification of the termination provisions under Order will not constitute an "addition" to Trust within the meaning of § 1433(b)(2)(A) of the Tax Reform Act of 1986. Accordingly, based on the facts submitted and the representations made, the proposed severance of Trust and modification of the termination provisions under Order will not subject the separate trusts to GST tax by reason of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(4)(i)(D).

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.

Sincerely yours,  
By Lorraine E. Gardner  
Acting Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

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