



Article VIII(B)(1) of Trust directs the Trustees to make such payments of principal and income of Trust as the Trustees deemed necessary to Former Spouse, for her health and maintenance. Former Spouse died on Date 3.

Article VIII(B)(2) directs the Trustees to pay the undistributed income (all of the income following Former Spouse's death) to Son, for his life. The Trustees further have the discretion to distribute corpus of Trust to Son for his health and maintenance. However, if Son is a trustee, he cannot participate in any decision to distribute corpus to himself.

Article VIII(B)(3) provides that upon the death of Son, the final income beneficiaries shall be the children and grandchildren of Son. Trustees are directed to pay all, or part, of the net income to this class of beneficiaries in the proportion as determined by the Trustees. Any income not distributed will be accumulated and added to corpus. Trustees may make discretionary distributions of corpus for the education, health, and maintenance of any member of the class of beneficiaries.

Article VIII(B)(3) also contains a paragraph providing a "statement of intent" that it is the Decedent's "hope" that following the completion of the education of each grandchild and great-grandchild of Decedent, the Trustees will refrain from making any trust distributions to such descendants until each attains the age of 30. The instrument provides that this paragraph is a "guide" to the Trustees in distributing income and is not intended in any way to limit the Trustees' exercise of sole discretion.

Article VIII(C) provides that Trust will terminate upon the death of the last to survive of Son, Former Spouse, and the children of Son living at the time of Decedent's death. Upon termination of Trust, the trust properties shall be distributed in equal shares to the grandchildren of Son, and any children of Son born after Decedent's death, per stirpes.

Trustees petitioned Court under State Statute to permit judicial modifications to Trust, conditioned upon a favorable private letter ruling from the Internal Revenue Service regarding the rulings requested.

Under the proposed modifications, upon the death of Son, the Trustees will divide Trust into as many equal separate and independent shares as there are living children of Son and living grandchildren of Son. The division of Trust will be made on a pro-rata basis. Currently, such division would create sixteen separate and independent shares of Trust.

Each separate and independent share for the benefit of each living child or grandchild of Son will be held in trust. During the life of a child or grandchild of Son, the Trustees are required to distribute all of the income as defined in section 643(b) of such beneficiary's separate and independent share to such beneficiary no less frequently

than annually, and the Trustees shall have the sole discretion to distribute principal of such beneficiary's separate and independent share for his or her health, education, support or maintenance.

Upon the death of a child of Son, such beneficiary's remaining separate and independent share shall be distributed to his or her living descendants, per stirpes. If a distribution from a child's share is to be made to a beneficiary for whom a separate and independent share of Trust is held for his or her benefit, the distribution shall be added to such beneficiary's separate and independent share.

Upon the death of a grandchild of Son, prior to the termination of Trust, such beneficiary's remaining separate and independent share shall be distributed to his or her living descendants, per stirpes. Upon termination of Trust, each separate and independent share held for the benefit of a grandchild of Son shall terminate and be distributed to the beneficiary of each separate and independent share.

In either case, if a child or grandchild of Son has no then living descendants, then such beneficiary's separate and independent share shall be distributed equally to all the remaining separate and independent shares held by Trust. Trust shall terminate upon the death of the last to survive of Son and the children of Son living at the time of Decedent's death.

Whenever the Trustees are required or permitted to make any payment or distribution of principal or income to a beneficiary who is then a minor or who is then incapacitated, the Trustees may, in their discretion, transfer and pay over the money or other property to be distributed (1) directly to such beneficiary, (2) to any person then having custody of such beneficiary, or (3) to any person or qualified corporation the Trustee may select as custodian for such beneficiary under the Uniform Transfers to Minors Act, Uniform Gifts to Minors Act, Adult Personal Custodian Law or Uniform Custodial Trust Act or other similar statute of any state, and the recipient of such beneficiary, other person or qualified corporation, as the case may be, shall constitute a full discharge and release of liability to the Trustees.

The Decedent's statement of intent contained in Article VIII(B)(3) of the Trust is retained as a guide in distributing Trust principal to Decedent's grandchildren and great-grandchildren.

State Statute provides that upon petition by a trustee, beneficiary or any party in interest, for good cause shown, a court having jurisdiction over a trust, after a hearing on notice to all parties in interest, in such manner as the court may direct, may divide a trust into two or more single trusts upon such terms and conditions as it deems appropriate, if the consolidation or division: (1) is not inconsistent with the intent of the trustor with regard to any trust to be divided; (2) would facilitate administration of the trust or trusts; and (3) would be in the best interest of all beneficiaries and not materially impair their respective interests.

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

You have requested the following rulings:

- 1) The Trust is exempt from GST tax imposed by section 2602.
- 2) The implementation of Court's order approving modification of Trust will not subject Trust to the GST tax imposed by section 2601.
- 3) The implementation of Court's order and the subsequent death of Son, resulting in separate trust shares for the children and grandchildren of Son, or any distribution from any of such resulting trust shares, will not subject Trust to the GST tax imposed by section 2601.
- 4) The implementation of Court's order and the subsequent termination of Trust resulting from the death of the last to die of Decedent's grandchildren will not subject Trust to the GST tax imposed by section 2601.
- 5) The implementation of Court's order will continue to qualify Trust to elect pursuant to section 1361 to be a QSST.
- 6) The implementation of Court's order and the subsequent death of Son will continue to qualify Trust to elect pursuant to section 1361 to be a QSST.

#### Rulings 1 - 4

Section 2601 imposes a tax on each generation-skipping transfer (GST) which includes under section 2611 a taxable distribution, a taxable termination, and a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 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. See section 26.2601-1(b)(1)(v) regarding constructive additions.

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. Unless specifically noted, these rules only apply for GST tax purposes, and do not apply, for example, in determining whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in a beneficiary's gross estate, or may result in the realization of gain for purposes of section 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial

interest in the trust to any beneficiary who occupies a lower generation (as defined in section 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 generation-skipping transfer or the creation of a new generation-skipping transfer. A modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, involves a trust that is irrevocable on or before September 25, 1985. 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 terms are identical except for the beneficiaries. 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 section 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 this case, Trust was irrevocable on September 25, 1985, and no additions, constructive or actual, have been made to Trust since that date. The parties propose to modify Trust to provide that, on Son's death, Trust will be divided into equal separate shares, one share for the benefit of each child and each grandchild of Son. All income from each separate share will be distributed to the primary beneficiary of the separate share. If upon the death of a child of Son, such beneficiary has living descendants then living, the separate and independent share allocable with respect to the deceased child of Son will be added to the separate share held for the child's living descendants, per stirpes. However, if the child's death results in the termination of Trust, the child's share will be distributed to the child's living descendants, per stirpes. If a grandchild of Son dies prior to the termination of Trust, his or her remaining separate and independent share will be distributed to his or her living descendants, per stirpes. Trust as modified, must, in all events, terminate no later than the time provided under the terms of Trust as originally executed; that is on the death of the last to die of So and Son's children living at Decedent's death. Upon the termination of Trust, each separate and independent share of a grandchild of Son shall be distributed to the beneficiary of such separate and independent share.

Based on the submitted information, we conclude that Trust is currently exempt from GST tax. The proposed division and modification of Trust as described above 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 division. Further, the proposed division and modification will not extend the time for vesting of any beneficial interest in the separate trusts beyond the period provided for in the original trust. Accordingly, we conclude that the implementation of Court's order approving the proposed modification to divide Trust, the subsequent death of Son resulting in separate and independent shares, or the distribution from any of such resulting trust shares will not cause the separate trusts to lose exempt status for GST tax purposes under section 2601. Moreover, the implementation of Court's order and the subsequent termination of Trust resulting from the death of the last to die of Decedent's grandchildren will not subject Trust to the GST tax imposed by section 2601.

### Rulings 5 and 6

Section 663(c) provides that if a single trust has more than one beneficiary, substantially separate and independent shares of different beneficiaries are treated as separate trusts for the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662. The existence of substantially separate and independent shares and the manner of treatment as separate trusts are determined in accordance with regulations.

Section 1.663(c)-3(a) of the Income Tax Regulations provides that the applicability of the separate share rule will generally depend upon whether distributions of the trust are to be made in substantially the same manner as if separate trusts had been created.

Section 1.663(c)-3(b) provides that separate share treatment will not be applied to a trust or portion of a trust subject to a power to distribute corpus to or for one or more beneficiaries within a group or class of beneficiaries, unless payment of corpus to one beneficiary cannot affect the proportionate share of corpus of any shares of the other beneficiaries, or unless substantially proper adjustment must be made (under the governing instrument) so that substantially separate and independent shares exist.

Section 1.1361-1(j)(3) provides that for purposes of section 1361(c) and (d), a substantially separate and independent share of a trust, within the meaning of section 663(c) and the regulations thereunder is treated as a separate trust. For a separate share which holds S corporation stock to qualify as a QSST, the terms of the trust applicable to that separate share must meet the QSST requirements. See also Rev. Rul. 93-31, 1993 C.B. 186, holding that a substantially separate and independent share of a trust within the meaning of section 663(c), is not a QSST if there is a remote possibility that the corpus of the trust will be distributed during the lifetime of the current income beneficiary to someone other than that beneficiary.

Section 1361(d)(3) provides that the term QSST means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall only be

1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Based on the facts and representations submitted, we conclude that the separate shares created upon the death of Son for Decedent's grandchildren and great-grandchildren will qualify as separate shares under sections 663(c) and 1.1361-1(j)(3). The ruling above is expressly contingent on the issuance of a court order and modification of Trust, as described above. No opinion is expressed or implied as to whether Company is an S corporation or whether Trust otherwise qualifies as a QSST.

No opinion is expressed or implied as to the tax consequences to Trust or any beneficiary thereof concerning the application of section 1001 of the Code with respect to the implementation of: (i) the proposed modifications of Trust; (ii) an order of Court approving any similar modifications; or (iii) an order of Court approving modifications of Trust at, or subsequent to, the death of Son.

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 taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

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

Enclosures

Copy for section 6110 purposes  
Copy of this letter

cc: