

Internal Revenue Service

Department of the Treasury

Number: **200141024**
Release Date: 10/12/2001
Index Number: 2601-00.00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:9-PLR-118614-00
Date:
July 11, 2001

LEGEND:

Addition =
Date 1 =
Grandparent =
Settlor =
Trustee =
Trust(s) =

Dear :

This is in response to your letter dated September 21, 2000, and subsequent correspondence, requesting a ruling regarding the generation-skipping transfer ("GST") tax consequences of the Trustee's proposed reconstitution of a single trust estate into three trust estates pursuant to the terms of the trust instrument.

Prior to September 25, 1985, Settlor executed a trust instrument creating three Trusts, one for each of her three great-grandchildren. Trustee represents that, approximately 35 years after the Trusts were created, when Trustee began serving as trustee of Trusts, Trustee discovered that the prior trustee of Trusts maintained only one undivided trust estate rather than three separate trust estates as required by the terms of the trust instrument.

Trustee proposes to petition a local court for permission to divide the single trust estate into three separate trust estates based upon an allocation of distributions and revenue

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beginning on Date 1. Trustee represents that Date 1 was the tax year-end of the Trusts and as of Date 1, distributions to the beneficiaries of the Trusts had been identical based upon the core value of the trust estate apportioned to each Trust. Trustee further represents that after Date 1, distributions from the Trusts were no longer equivalent amongst the beneficiaries resulting in different core values of the trust estate apportioned to each Trust. Finally, Trustee represents that it is not in possession of adequate records prior to Date 1 to trace transactions relating to the Trusts prior to that date.

Trustee has also represented that the great-grandchildren's Grandparent was the transferor of the Addition into the Trusts in 1988. Trustee represents that the Addition is exempt from GST tax because Grandparent's GST exemption under section 2631(a) of the Internal Revenue Code ("Code") was sufficient at her death for the automatic allocation rule of section 2632(c)(1)(B) to cause the inclusion ratio of Addition, and any appreciation thereto, to be zero.

Trustee has requested a ruling that the Trustee's proposed reconstitution of the single trust estate maintained by the prior trustee of the Trusts into three trust estates as required by the trust instrument: (a) will not cause the Trusts to lose their exemption from the GST tax by reason of section 1433(b)(2) of the Tax Reform Act of 1986 ("Act") and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations; (b) will not constitute additions to the Trusts under section 26.2601-1(b)(1)(iv); (c) will not cause the Trusts and the Trustee to be subject to the GST tax under section 2601; and (d) will not cause future distributions to skip persons from the Trusts to be subject to the GST tax under section 2601.

LAW and ANALYSIS:

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

Under section 1433(a) of the 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. Under section 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 sections 2038 or 2042, if the settlor had died on September 25, 1985.

Section 2631(a) 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

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the transferor.

Section 2632(c)(1) provides that any portion of an individual's GST exemption which has not been allocated within the time prescribed by section 2632(a) shall be deemed to be allocated as follows - (A) first, to property which is the subject of a direct skip occurring at such individual's death, and (B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

Section 2654(b)(1) provides that the portions of a trust attributable to transfers from different transferors shall be treated as separate trusts. Section 26.2654-1(a)(2)(i) provides that if there is more than one transferor with respect to a trust, the portions of the trust attributable to the different transferors are treated as separate trusts for the purposes of chapter 13.

Section 26.2601-1(b)(1)(iv)(A) provides that if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from chapter 13 by reason of 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to chapter 13 (the non-chapter 13 portion) and a portion subject to chapter 13 (the chapter 13 portion), each with a separate inclusion ratio (as defined in section 2642(a)). The non-chapter 13 portion represents the value of the assets of the trust as it existed on September 25, 1985. The applicable fraction (as defined in section 2642(a)(2)) for the non-chapter 13 portion is deemed to be 1 and the inclusion ratio for such portion is 0. The chapter 13 portion of the trust represents the value of all additions made to the trust after September 25, 1985. The inclusion ratio for the chapter 13 portion is determined under section 2642.

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 exempt from the GST tax under sections 26.2601-1(b)(1), 26.2601-1(b)(2), and 26.2601-1(b)(3) 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 a trust, exempt from the GST tax pursuant to section 26.2601-1(b)(1)(i), 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 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.

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In this case, Trustee is petitioning the court to reconstitute the single trust estate into three trust estates as required by the terms of the trust instrument. This action is necessary to carry out the original terms of the trust instrument, which were ignored by the prior trustee. If the court orders the division of the trust estate into three trust estates, as requested in the petition, the reconstitution of the Trusts will not result in a shift of any beneficial interest in the Trusts to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the reconstitution. Further, the proposed reconstitution will not extend the time for vesting of any beneficial interest in the Trusts beyond the period provided for in the trust instrument.

Because Grandparent made a post-September 25, 1985 addition to the single trust estate, the single trust estate and each of the three resulting Trusts will be deemed to consist of two separate portions for GST purposes, a non-chapter 13 portion and a chapter 13 portion pursuant to sections 2654(b)(1), 26.2601-1(b)(1)(iv)(A), and 26.2654-1(a)(2)(i). It has been represented that the chapter 13 portion of the single trust estate has an inclusion ratio of zero pursuant to the provisions of section 2642, as a result of the automatic allocation at Grandparent's death of Grandparent's remaining GST tax exemption under section 2632(c)(1)(B) to the Addition.

Based upon the facts provided and the representations made, we conclude that the non-chapter 13 portion of each resulting Trust will not lose its exempt status for GST tax purposes as a result of the reconstitution because the standards set forth in section 26.2601-1(b)(4) have been satisfied. In addition, we conclude that the proposed reconstitution will not constitute an addition to the Trusts within the meaning of section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(iv), will not cause the Trusts and the Trustee to be subject to the GST tax under section 2601, and will not cause future distributions to skip persons from the Trusts to be subject to the GST tax under section 2601.

With regard to the chapter 13 portion of each resulting Trust, no guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in a inclusion ratio of zero. At a minimum, a change that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of such a trust.

Based upon the facts provided and the representations made, we conclude that the reconstitution of the Trusts would not cause the chapter 13 portion of each resulting Trust to lose its GST tax exempt status, will not constitute an addition to the Trusts within the meaning of section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(iv), will not cause the Trusts and the Trustee to be subject to the GST tax under section 2601, and will not cause future distributions to skip persons from the Trusts to be subject to the GST tax under section 2601.

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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. Specifically, no opinion is expressed or implied to the effect that the submitted computation of the single trust estate into the three resulting Trusts accurately divides the single trust estate into three trust estates as of Date 1.

This ruling is directed only to the Trustee requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the Trustee.

The rulings contained in this letter are based upon information and representations submitted by the Trustee 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,
Frances D. Schafer
Counsel to the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes