

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Telephone Number:

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Date:

June 28, 2000

Re:

Legend

Trust =

Trustees =

Decedent =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Daughter =

Son =

Grandchild 1 =

Grandchild 2 =

Grandchild 3 =

Grandchild 4 =

Grandchild 5 =

Grandchild 6 =

Grandchild 7 =

Great-grandchild 1 =

Great-grandchild 2 =

\$x =

\$y =

\$z =

Ratio 1 =

Ratio 2 =

Ratio 3 =

Court =

State =

Dear _____ :

This responds to your letter dated March 6, 2000, on behalf of Trust in which you request rulings concerning certain generation-skipping transfer (GST) tax consequences under §§ 2642 and 2654(b) of the Internal Revenue Code.

You represent that Decedent executed a revocable trust agreement, Trust, on Date 1 and amended that agreement on Date 2, Date 3, and Date 4. Decedent died on Date 5. Decedent was survived by her daughter, Daughter. Daughter's children are Grandchild 4, Grandchild 5, Grandchild 6, and Grandchild 7. Decedent's only other child, Son, predeceased Decedent leaving three children, Grandchild 1, Grandchild 2, and Grandchild 3. Grandchild 2 died on Date 6 survived by two children, Great-grandchild 1 and Great-grandchild 2.

As originally executed, Article 1, paragraph a of Trust provided that a specific percentage of the trust was to be distributed to separate subtrusts each for the benefit of a designated beneficiary (the Decedent's Daughter and grandchildren). However, the trust was amended several times and at the time of Decedent's death, Article 1,

paragraph a of Trust provided:

The Trustee shall apportion all property in the Trust as follows:

1) Commencing on the first day of the month following the appointment of the Executor of my Last Will and Testament, and on the first day of each month thereafter until the termination of this Trust, the Trustee shall pay from the net income or principal of the trust property the following amounts:

(1) To [Daughter], the sum of \$[x], so long as [Daughter] shall live, with said payment to cease upon the death of [Daughter].

(2) To [Grandchild 6], the sum of \$[y] per month.

(3) To [Grandchild 5], the sum of \$[y] per month.

(4) To [Grandchild 4], the sum of \$[y] per month.

(5) To [Grandchild 7], the sum of \$[y] per month.

(6) To [Grandchild 1], the sum of \$[y] per month.

(7) To [Grandchild 2], the sum of \$[y] per month.

(8) To [Grandchild 3], the sum of \$[y] per month.

Article I, paragraph b of Trust provides:

The Trustees are authorized at any time or from time to time to make or apply payments from income and corpus of any of the shares held under this Article to or for the benefit of the primary beneficiary of said share in such amounts, including all of the funds held under a share, as the Trustees may, in their sole discretion, deem advisable for the Primary Beneficiaries' comfortable support, maintenance, education and entering a profession or occupation. . . . Any such payment may be charged by the trustee in whole or in part against all of the funds held under a share or against any sub-share or portion thereof as the Trustees in their sole discretion deem advisable.

Article 1, paragraph c.1 provides that the trust shall terminate on the occurrence of the later of: (1) the death of Daughter, or (2) fifteen years from the date of Decedent's death. Article I, paragraph c.2 provides that upon termination, the Trustees shall distribute the then remaining trust corpus and accumulated income, in equal shares to each of Decedent's grandchildren then living, with the exception that no

distribution is to be made to Grandchild 4. In the event that any grandchild is not living at the termination of the Trust, then the share of the deceased grandchild is to be distributed to the issue of the deceased grandchild by right of representation.

Article I, paragraph e of Trust provides:

Each of the sub-shares hereunder shall constitute a separate and distinct trust, but for convenience of administration, the Trustees may mingle or combine any of the investment of property of said trust in common funds in which each contributing sub-share shall have an undivided interest in proportion to its contribution.

You represent that the value of the property passing to the trusts, as of the date of Decedent's death, reduced by federal and state death tax, was \$z. The Trustees interpreted the trust agreement as providing for six separate and equal trusts, one each for the benefit of Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 5, Grandchild 6, and Grandchild 7. On Schedule R of Form 706, the Decedent's executor allocated the Decedent's entire \$1,000,000 GST tax exemption equally to the trusts created for the benefit of Grandchild 5, Grandchild 6, and Grandchild 7. At that time, the attorneys and accountants representing the Decedent's estate determined the inclusion ratio with respect to those trusts to be Ratio 1. Subsequently, the Trustees determined that the inclusion ratio for the trusts created for the benefit of Grandchild 5, Grandchild 6, and Grandchild 7 is Ratio 2. No allocation was made to the trusts created for the benefit of Grandchild 1, Grandchild 2, and Grandchild 3, and, therefore, the inclusion ratio with respect to those trusts is 1.

You also represent that monthly distributions to Daughter and Grandchild 4 required under Article I paragraph a of Trust were distributed equally from the six trusts. Any distributions under Article I paragraph b of income or principal to Daughter or Grandchild 4 are also distributed equally from the six trusts. The Trustees applied an inclusion ratio of Ratio 3 to distributions to Grandchild 4. Ratio 3 was calculated by adding the inclusion ratios of the six trusts and dividing the sum by six.

The Trustees of Trust petitioned Court for an interpretation regarding whether the terms of Trust should be construed as establishing separate trusts for the benefit of the beneficiaries. On Date 7, Court issued its judgment that Trust establishes six separate and independent trusts for the benefit of Decedent's grandchildren, excluding Grandchild 4. The Court also concluded that payment of income, accumulated income or corpus of a trust to one grandchild cannot affect the proportionate share of income, accumulated income or corpus of any of the trusts for the other grandchildren, and that proper adjustments must thereafter be made so that separate and independent trusts exists.

You have requested the following rulings:

1. Six substantially separate and independent trusts are established by Trust for

GST tax purposes.

2. The inclusion ratio with respect to any property transferred in a GST from the trusts established for Grandchild 5, Grandchild 6, and Grandchild 7 is Ratio 2.

3. The inclusion ratio with respect to any property transferred in a GST from the trusts established for Grandchild 1, Grandchild 2, and Grandchild 3 is 1.

4. The inclusion ratio for the distributions to Grandchild 4 is Ratio 3.

Section 2601 imposes a tax on every GST. Under § 2602, the amount of tax imposed under § 2601 is determined by multiplying the taxable amount by the applicable rate. Under § 2641, the applicable rate with respect to a GST is the maximum Federal estate tax rate multiplied by the inclusion ratio with respect to the transfer.

Section 2642(a)(1) provides that the inclusion ratio with respect to any property transferred in a GST shall be the excess (if any) of 1 over (A) the applicable fraction determined for the trust from which such transfer is made, or (B) in the case of a direct skip, the applicable fraction determined for such skip.

Pursuant to § 2642(a)(2), the applicable fraction is a fraction (A) the numerator of which is the amount of the GST exemption allocated to the trust (or in the case of a direct skip, allocated to the property transferred to such skip), and (B) the denominator of which is (i) the value of the property transferred to the trust (or involved in the direct skip), reduced by (ii) the sum of (I) any Federal estate tax or state death tax actually recovered from the trust attributable to such property, and (II) any charitable deduction allowed under §§ 2055 or 2522 with respect to such property.

Section 26.2642-5(b) of the Generation-Skipping Transfer Tax Regulations provides that, with respect to taxable distributions and taxable terminations, the inclusion ratio for a trust becomes final on the later of: (1) the expiration of the period for assessment with respect to the first GST tax return filed using that inclusion ratio; or (2) the expiration of the period for assessment of Federal estate tax with respect to the estate of the transferor.

Section 2654(b)(2) provides that substantially separate and independent shares of different beneficiaries in a trust shall be treated as separate trusts.

Section 26.2654-1(a) provides that, if a single trust consists solely of substantially separate and independent shares for different beneficiaries, the share attributable to each beneficiary (or group of beneficiaries) is treated as a separate trust for purposes of Chapter 13. The phrase “substantially separate and independent shares” generally has the same meaning as provided in § 1.663(c)-3. However, a portion of a trust is not a separate share unless such share exists from and at all times after the creation of the trust. A trust is treated as created on the date of death of the

grantor if the trust is includible in its entirety in the grantor's gross estate for Federal estate tax purposes. Further, treatment of a single trust as separate trusts for GST purposes does not apply for purposes of filing returns and payment of tax or for purposes of computing any other tax imposed under the Code. Also, additions to, and distributions from, such trust are allocated pro rata among the separate trusts, unless the governing instrument expressly provides otherwise.

Under § 1.663(c)-3(a) of the Income Tax Regulations, the applicability of the separate share rule provided by § 663(c) will generally depend upon whether distributions of the trust are to be made in substantially the same manner as if separate trusts are created. Thus, if an instrument directs a trustee to divide the testator's residuary estate into separate shares (which under applicable law do not constitute separate trusts) for each of the testator's children and the trustee is given discretion, with respect to each share, to distribute or accumulate income or to distribute principal or accumulated income, or to do both, separate shares will exist under § 663(c). In determining whether separate shares exist, it is immaterial whether the principal and any accumulated income of each share is ultimately distributable to the beneficiary of such share, to his descendants, to his appointees under a general or special power of appointment, or to any other beneficiaries (including a charitable organization) designated to receive his share of the trust and accumulated income upon termination of the beneficiary's interest in the share. Thus, a separate share may exist if the instrument provides that upon the death of the beneficiary of the share, the share will be added to the shares of the other beneficiaries of the trust.

Section 1.663(c)-3 provides that a share may be considered as separate even though more than one beneficiary has an interest in it. For example, two beneficiaries may have equal, disproportionate, or indeterminate interests in one share which is separate and independent from another share in which one or more beneficiaries have an interest. Likewise, the same person may be a beneficiary of more than one separate share.

Based on the facts presented and Taxpayer's representations, we conclude as follows:

1. The Court's construction of the terms of Trust as creating six separate trusts for the benefit of Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 5, Grandchild 6, and Grandchild 7 is consistent with applicable state law as would be interpreted by the highest court of State. Under § 2654(b), the six trusts created under the terms of Trust for the benefit of Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 5, Grandchild 6, and Grandchild 7 are recognized as separate trusts for GST tax purposes.

2. Decedent's GST tax exemption was allocated equally to the trusts created for Grandchild 5, Grandchild 6, and Grandchild 7, and, therefore, for purposes of § 2642(a) the applicable inclusion ratio for property transferred in a GST from those trusts is Ratio 2.

3. No GST tax exemption was allocated to the trusts created for Grandchild 1, Grandchild 2, or Grandchild 3 and, therefore, for purposes of § 2642(a) the applicable inclusion ratio for property transferred in a GST from those trusts is 1.

4. Distributions to Grandchild 4 are made 1/6 from each of the six trusts. As a result, distributions to Grandchild 4 from the trusts created for Grandchild 5, Grandchild 6, and Grandchild 7 have an inclusion ratio of Ratio 2, and distributions from the trusts created for Grandchild 1, Grandchild 2, and Grandchild 3 have an inclusion ratio of 1.

Except as we have specifically ruled herein, we express no opinion under the cited provisions or under any other provision of the Code.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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,
Assistant Chief Counsel
(Passthroughs and Special Industries)
By George L. Masnik
Chief, Branch 4

Enclosure
Copy for § 6110 purposes