Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4-PLR-116797-97
Date:
December 7, 1998

Re:

Legend

Grantor	=	
Child 1	=	
Child 2	=	
Child 3	=	
Child 4	=	
Individual	=	
Company	=	
Subsidiary	=	
State	=	

Dear

This is in response to an October 7, 1998 letter, and prior correspondence from your authorized representative requesting a ruling on the application of the generation-skipping transfer tax with respect to a proposed transaction.

On December 30, 1976, Grantor created a trust (Trust) for the benefit of his children and grandchildren. Child 1, Child 2 and Individual are the trustees of Trust.

Trust established two trusts. Article II established Children's Trust for the benefit of Grantor's four children, Child 1, Child 2, Child 3, and Child 4. Article III established Grandchildren's Trust for the benefit of Grantor's seven grandchildren. Each trust provides the trustee with the authority to:

> [P]ay or apply so much of the income to or for the reasonable health care, support in his or her accustomed manner of living, and maintenance of

> the children [or grandchildren as the case may be] of the Grantor living from time to time, in such proportions and in such amounts as the trustee or trustees other than a Trustee who is a beneficiary hereunder shall deem proper; subject however, to the aforesaid standard.

The Children's Trust further provides that, upon the death of the last surviving child, the trustees are to divide the trust estate into as many parts as there are deceased children of the Grantor survived by living issue. The trustees are to pay over each part to the surviving issue, per stirpes, of each deceased child.

The Grandchildren's Trust provides that, upon the death of the last surviving child, the trustees are to divide the trust estate into equal parts, to be distributed to each then living grandchild of the grantor and to the issue of a deceased grandchild, per stirpes.

Since it was created, the sole asset of Trust has been 100 percent of the common stock of Company, a State corporation that serves as a holding company that owns approximately 83 percent of the stock of Subsidiary. One-half of the Company shares are held in the Children's Trust, and one-half of the Company shares are held in the Grandchildren's Trust. Two family members, Child 1 and Child 2 are officers and directors of Company and Subsidiary.

During Trust's existence, neither Company nor Subsidiary has ever paid a dividend. As a result, neither Children's Trust nor Grandchildren's Trust has ever received any income from which distributions could be made. In 1992, other family members filed a lawsuit against the officers of Company and the trustees of Trust.

To settle the dispute, the parties have entered into a settlement agreement that was approved by the local court, subject to a favorable ruling from the Service. Under the agreement, Children's Trust will remain in existence, and four new trusts will be created, one for each child of Grantor (New Children's Trusts). The existing Children's Trust will distribute the cash and stock that it holds in Company, equally, to each of the four new trusts. In addition, the Grandchildren's Trust will remain in existence, and seven new trusts will be created, one for each grandchild of Grantor (New Grandchildren's Trust). The existing Grandchildren's Trust will distribute the cash and Company stock that it holds, equally, to the new trusts.

Under the terms of the new trusts as provided in the settlement agreement, the trustees of each of the New Children's Trusts will be the family member that is the primary beneficiary and an independent trustee who is unrelated to the family member. With respect to the New Grandchildren's Trusts, the family of a respective grandchild will be permitted to appoint a trustee and also appoint an independent trustee.

Further, under the settlement agreement, the independent trustee of each new trust will be permitted to make income distributions from the new trusts in accordance with the terms of the original trust agreement, i.e. the standard set out above. In addition, all such distributions of income shall be without regard to any other financial resources available to that Child or Grandchild. Any beneficiary who requests a distribution shall first request distributions from the new trust bearing his or her name. If there is not sufficient income in the beneficiary's new trust necessary to meet the distribution standard set forth in the existing and new trusts, the independent trustee may utilize income, first, from the existing trusts, as the case may be. If there is not sufficient income in the existing trusts, the independent trustee of that beneficiary's new trust may utilize income from the other new trusts for the children or grandchildren, as the case may be. Any additional distribution to that beneficiary's new trust shall be made equally from all other new trusts from which that beneficiary is entitled to receive distributions. With respect to the New Children's Trusts, upon the death of a child, the assets of the child's new trust will be distributed to the existing Children's Trust. Upon the death of the last surviving child, the corpus of the Children's Trust will be distributed in accordance with its terms.

In addition, under the Settlement Agreement, the trustees of the New children's Trusts and the New Grandchildren's Trusts are required to comply with § 62-7-415 of the State Code regarding the payment of "delayed income." In conjunction with the settlement agreement, the court entered a "delayed income order" authorizing the payment of delayed income pursuant to § 62-7-415 in the event the Company shares are sold. The portion of the sales proceeds that will constitute delayed income is determined under the delayed income order consistent with § 62-7-415. Under the order, as represented, the independent trustee will be authorized to make distributions of delayed income, to the extent consistent with the terms of the Children's Trust and the Grandchildren's Trust and the provisions of § 62-7-415. The amount that may be distributed as delayed income from each of the New Children's Trusts cannot exceed the amount that would have been distributed in the particular year under the standard provided in the existing Children's Trust; i.e. income may be distributed only for the child's reasonable health care, support in his or her accustomed manner of living, and maintenance. With respect to the New Grandchild's Trusts, absent exigent circumstances, no amounts may be distributed as delayed income with respect to years before the respective grandchild reached his or her majority. With respect to the years after a grandchild reached majority, the amount that may be distributed as delayed income from his or her respective trust, cannot exceed amounts that would have been distributed for the reasonable health care, support in his or her accustomed manner of living, and maintenance.

The following rulings have been requested:

1. The proposed division of the Children's Trust into four new Children's Trusts and the proposed division of the Grandchildren's Trust into seven new Grandchildren's

Trusts will not prevent the Trust, the existing Children's Trust, the existing Grandchildren's Trust, the New Children's Trust or the New Grandchildren's Trusts from being treated as trusts that were irrevocable on September 25, 1995, for purposes of Chapter 13 of the Internal Revenue Code.

2. The proposed appointment of new trustees for the four New Children's Trusts and new trustees for the seven New Grandchildren's Trusts, including the appointment of an independent trustee, will not prevent Trust, the existing Children's Trust, the existing Grandchildren's Trust, the New Children's Trust or the New Grandchildren's Trusts from being treated as trusts that were irrevocable on September 25, 1995, for purposes of Chapter 13.

3. The provisions of the settlement agreement requiring that the trustees of the New Children's Trusts and the New Grandchildren's Trusts comply with § 62-7-415 of State Code, will not prevent Trust, the existing Children's Trust, the existing Grandchildren's Trust, the New Children's Trust or the New Grandchildren's Trusts from being treated as trusts that were irrevocable on September 25, 1995, for purposes of Chapter 13.

4. The provisions of the agreement specifying that the Trustees of the New Children's trusts and New Grandchildren's trusts need not consider other resources of a Child or Grandchild in making distributions for health care, support, and maintenance will not prevent Trust, the existing Children's Trust, the existing Grandchildren's Trust, the New Children's Trust or the New Grandchildren's Trusts from being treated as trusts that were irrevocable on September 25, 1995, for purposes of Chapter 13.

Law and Analysis

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act), 1986-3 (Vol. 1) C.B. 1, and § 26.2601-1(b)(1)(i) of the Generation-skipping Transfer Tax Regulations provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of principal added to the trust after September 25, 1985 (or out of income attributable to principal so added).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C) (relating to property includible in a grantor's gross estate under §§ 2038 and 2042). In this case, Trust is irrevocable because neither § 2038 nor § 2042 apply under the facts presented.

The trustee of Trust has represented that there have been no additions to Trust after September 25, 1985. However, an additional question bearing upon the retention of Trust's grandfathered status for generation-skipping transfer tax purposes is whether the settlement agreement and delayed income order will change the substantive provisions of Trust in a manner such that it can no longer be considered to be the same trust that was exempt under § 1433(b)(2)(A) of the Act. In general, modifications that change the quality, value, or timing of any of the powers, beneficial interests, rights, or expectancies originally provided for under the terms of a trust will cause an exempt trust to lose its exempt status.

In this case, the parties have entered into an agreement that was approved by the local court, under which Children's Trust will remain in existence, and four new trusts will be created, one for the benefit of each child of Grantor. The existing Children's Trust will distribute cash and stock that it holds in Company, equally, to each of the four New Children's Trusts. The Grandchildren's Trust will also remain in existence, but seven new trusts will be created, one for the benefit of each grandchild of Grantor. The existing Grandchildren's Trust will distribute cash and stock that it holds in Company, equally, to the seven New Grandchildren's Trusts.

The settlement agreement further provides that the trustees of each of the New Children's Trusts will be the family member who is the primary beneficiary of the New Children's Trust and an independent trustee who is unrelated to the family member. With respect to the New Grandchildren's Trusts, the family of a respective grandchild will be able to appoint a trustee and also appoint an independent trustee. The independent trustee of each new trust will be permitted to distribute income from the new trusts in accordance with the terms of Children's Trust and Grandchildren's Trust. That standard, which is provided in Article II and Article III, limits the distribution of income to amounts for the reasonable health care, support in his or her accustomed manner of living, and maintenance of the beneficiary.

The agreement also provides that, in making distributions of income from the New Children's Trusts and the New Grandchildren's Trusts, all such distributions shall be made without regard to any other financial resources available to that Child or Grandchild. The original trust agreement is silent with respect to whether other resources of a beneficiary should be considered in determining the amount properly distributable under the standard provided in the instrument. When the trust instrument is silent, the implication is that other resources need not be considered. Norton Family Trust v. Schmitt, 655 So. 2d 398 (La. App. 1995); Hamilton National Bank v. Childers, 211 S.E. 723 (1975); McElrath v. Citizens & Southern National Bank, 189 S.E. 2d 49 (1972); A. Scott & W. Fratcher, The Law of Trusts, § 128.4 at 353-60 (1989 & Supp. 1996).

In addition, if the stock of Corporation is sold, the trustee will be authorized to make distributions pursuant to a delayed income order under § 62-7-415 of the State Code. Under the settlement agreement and the delayed income order, any distributions must satisfy the standard set forth in the instrument, i.e. distributions may only be made pursuant to the standard set forth above. We note that distributions pursuant to the above standard do not include distributions for customary travel, entertainment, luxury items, or other expenditures not required for meeting the beneficiary's needs for health care, support, and maintenance. See Rev. Rul. 77-60, 1977-1 C.B. 282.

Accordingly, based on the facts submitted and the representations made, we conclude as follows:

1. The division of the Children's Trust into four New Children's Trusts and the division of the Grandchildren's Trust into seven New Grandchildren's Trusts as proposed in the settlement agreement will not change the timing, value or quality of a beneficiary's interest under the original trust agreement. Therefore, the proposed division of Children's trust and Grandchildren's Trust will not affect the status of Trust, the existing Children's Trust, the existing Grandchildren's Trust, the New Children's Trusts and the New Grandchildren's Trusts as trusts that were irrevocable on September 25, 1995, for purposes of Chapter 13 of the Internal Revenue Code.

2. The appointment of new trustees for each of the four New Children's Trusts and new trustees for each of the seven New Grandchildren's Trusts, including the appointment of an independent trustee, as proposed in the settlement agreement will not change the timing, value or quality of a beneficiary's interest under the original trust agreement. Therefore, the proposed appointment of new trustees will not affect the status of Trust, the existing Children's Trust, the existing Grandchildren's Trust, the New Children's Trusts and the New Grandchildren's Trusts as trusts that were irrevocable on September 25, 1995, for purposes of Chapter 13 of the Internal Revenue Code.

3. The provisions of the settlement agreement requiring that the trustees of the New Children's Trusts and the New Grandchildren's Trusts to comply with § 62-7-415 of the State Code will not change the timing, value or quality of a beneficiary's interest under the original trust agreement. Assuming the trustees make distributions of delayed income in accordance with the terms of the trust instrument (consistent with Rev. Rul. 77-60), the provision requiring compliance with § 62-7-415 will not affect the status of Trust, the existing Children's Trust, the existing Grandchildren's Trust, the New Children's Trusts and the New Grandchildren's Trusts as trusts that were irrevocable on September 25, 1995, for purposes of Chapter 13 of the Internal Revenue Code.

4. The provisions of the agreement specifying that the Trustees of the New Children's Trusts and New Grandchildren's Trusts need not consider other resources of a Child or Grandchild in making distributions for health care, support, and maintenance will not change the timing, value or quality of a beneficiary's interest under the original trust agreement. Therefore, this provision will not affect the status of Trust, the existing Children's Trust, the existing Grandchildren's Trust, the New Children's Trusts and the

New Grandchildren's Trusts as trusts that were irrevocable on September 25, 1995, for purposes of Chapter 13 of the Internal Revenue Code.

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 taxpayer(s) requesting it. Section 6110(j)(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 your authorized representative.

Sincerely yours,

George Masnik
Chief, Branch 4
Office of the Assistant Chief Counsel
(Passthroughs & Special Industries)

Enclosure (1)