Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date: October 17, 2001

RE:

LEGEND

Agreement	=
Corporation	=
Court	=
Daughters	=
Date 1	=
Date 2	=
Date 3	=
Grantor	=
Fraction A	=
Fraction B	=
Main Trust	=
Son	=
Spouse	=
State 1	=
State 2	=
Trust A	=
Trust B	=
Trust 1	=
Trust 2	=
Year 1	=

Dear Sir:

This is in response to your letter dated April 28, 1998, and subsequent correspondence, requesting a ruling concerning the generation-skipping transfer ("GST") tax consequences of partitioning Trust A pursuant to the Amended Judgment.

The information submitted and the representations made are summarized as follows. During his lifetime, Grantor created Main Trust and funded it, in part, with Corporation's stock and stock in certain family businesses. Grantor amended Main Trust several times before his death in Year 1. In one amendment, Grantor relinquished his right to amend Main Trust and granted that power to Main Trust's trustees. Prior trustees exercised this power and, as a result, Main Trust became irrevocable prior to September 25, 1985. No additions have been made to Main Trust since September 25, 1985.

Paragraph 3 of Main Trust provides that, during Spouse's lifetime, certain payments are to be made to two shares, Trust A and Trust B. It has been represented that Trust A and Trust B are administered separately and are treated as separate trusts for accounting and tax purposes. It has also been represented that, upon the creation of Trust B, Main Trust became Trust A for accounting and tax purposes. Trust A is the subject of this ruling.

Paragraph 3 of Main Trust also provides that Spouse and Corporation are Trust A's income beneficiaries. Corporation's share of Trust A's income consists of an annual payment of the lesser of $ 25,000 or 20 percent of the Main Trust's income or so much of the income the trustees deem necessary to maintain, upkeep, develop, and preserve real estate Corporation owns in State 1. Paragraph 3 further provides that, after Spouse's death, Trust A's income will be distributed to Corporation pursuant to the terms of Paragraph 4 of Main Trust.

Paragraph 4 of Main Trust provides that Corporation is to receive so much of Trust A's income each year that trustees deem necessary, in their discretion, to maintain, upkeep, develop, and preserve Corporation's real estate. Income from Trust A not expended is to be added to Trust A's principal. It has been represented that for accounting convenience, income not distributed to benefit Corporation's real estate has been held in a separate financial pool called the Accumulation Share.

Paragraph 4 of Main Trust provides that, Trust A will terminate 21 years after the death of the last survivor of Spouse, Son, and Daughters. However, Paragraph 4 also provides that, after Spouse's death, the trustees have the discretion to terminate Trust A if a major portion of the real estate is sold or for any other reason the trustees deem it unwise or unnecessary to make any further payments for the real estate. It has been represented that one Daughter is still living. As a result, Trust A will terminate sometime after Trust B terminates on Date 1. Notwithstanding, it has been represented that the current trustees intend to exercise their discretion and terminate Trust A when Trust B terminates on Date 1.

Finally, Paragraph 4 provides that when Trust A terminates, the principal and the accumulated income (Accumulated Share) will be divided in equal parts and distributed to Daughters or their issue by right of representation. If Daughters or their issue are not then living, the principal and the accumulated income (Accumulated Share) are to be distributed to Son or his issue by right of representation.

As previously stated, when Grantor formed Main Trust, he funded it, in part, with Corporation's stock and stock in certain family businesses. Approximately 30 years after Main Trust was formed, during Spouse's lifetime, in exchange for certain consideration, Son became the owner of all of Corporation's stock.

At this point, Spouse and Corporation were the income beneficiaries of Trust A and Daughters and their issue were the remainder beneficiaries of Trust A. It has been represented that Daughters and their issue no longer had an interest in Corporation's real estate because they had relinquished their rights to Corporation's stock in the exchange and Main Trust no longer owned any shares in Corporation. As a result, an annual conflict arose between Corporation and Daughters and their issue regarding how much of Trust A's income the trustees should distribute to Corporation to maintain, develop, and preserve its real estate. This conflict has never been resolved.

Approximately 10 years after Main Trust divested itself of all of its stock in Corporation. Main Trust's beneficiaries (Spouse, Son, Daughters, and the issue of Son and Daughters) executed a non-binding Agreement ("Agreement"). The Agreement provided, in part, that Daughters and their issue, as the remainder beneficiaries of Trust A, would offer no objection if trustees chose to pay Corporation any amount up to 52 percent of Trust A's income after Spouse's death. Spouse died approximately seven years after the execution of this Agreement.

The Agreement did not resolve the conflict between Corporation and Daughters and their issue, as the remainder beneficiaries of Trust A. Each year the parties disputed the amount of income trustees paid to Corporation. This continuing dispute has caused Trust A to become impossible to administer without excessive expenses for legal fees. As a result, the trustees, Corporation, and Daughters and their issue entered into a settlement agreement to split Trust A into two trusts. In connection with the settlement agreement, the trustees filed a Complaint for Declaratory Relief in Court in State 2 to split Trust A into two trusts retroactive to Date 2. It has been represented that the terms of the settlement agreement were incorporated in the Amended Judgment which was issued by the Court on Date 3.

The Amended Judgment provides for the partitioning of Trust A into two separate trusts, Trust 1 and Trust 2, retroactive to Date 2. Trust 1 is to comprise of that portion of Trust A that results from the application of Fraction A. Trust 2 is to comprise of the remaining portion of Trust A that results from the application of Fraction B.

The Amended Judgment authorizes the trustees of Trust 1 to distribute to Corporation payments consisting of principal and/or income from Trust 1, until it is exhausted.

These payments, however, are not to exceed the combined incomes of Trust 1 and Trust 2. The trustees are to have broad discretion to determine what is necessary to maintain, upkeep, develop, and preserve real estate Corporation owns in State 1. Any property remaining in Trust 1 upon its termination is to be distributed to the trustees of Trust 2 and administered in accordance with the provisions of Trust 2. The Amended Judgment also provides that Trust 2's trustees are to continue to hold in trust the principal of Trust 2 in accordance with the terms of Main Trust, and to accumulate and add the net income therefrom to Trust 2's principal. Any undistributed income or principal in Trust 2, including any income or principal distributed to Trust 2 from Trust 1, will be distributed to the then beneficiaries of Trust 2 in accordance with the terms of Main Trust.

The Amended Judgment declares that the trustees of Trust 1 may be different from the trustees of Trust 2. However, these trustees will be appointed in the same manner and be subject to the same rights and responsibilities governing the trustees of Trust 2, set forth in Main Trust.

The trustees have requested a ruling that the partition of Trust A into Trust 1 and Trust 2 pursuant to the Amended Judgment will not result in the loss of GST exempt status for Trust A 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.

LAW AND ANALYSIS

Section 2601 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), 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 26.2601-1(b)(1)(iv)(A) provides, in pertinent part, that if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from chapter 13 by reason of section 26.2601-1(b)(1) of this section, 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.

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.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if - (1) the settlement is the product of arms' length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

In this case, the settlement agreement that is reflected in the terms of the Amended Judgment is the product of arms' length negotiations and is within the range of reasonable outcomes under Main Trust's terms and applicable state law. The terms of the Amended Judgment reflect a compromise between the positions of the litigating parties and the parties' assessment of the relative strengths of their positions. Accordingly, we conclude that, the division of Trust A into two successor trusts, Trust 1 and Trust 2, and the implementation of the administrative changes set forth in the Amended Judgment, will not cause Trust A to lose its exempt status from the GST tax by reason of section 1433(b)(2) of the Act and section 26.2601-1(b)(1).

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 parties 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 Attorneys on file with this office, a copy of this letter is being sent to the trustees.

The rulings contained in this letter are based upon the information and representations submitted by the trustees 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,
James F. Hogan
Senior Technician Reviewer
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)
Branch 9

Enclosure
Copy for section 6110 purposes