

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

December 2, 1999

Legend

Trust:

Settlor:

Trustees:

Beneficiaries:

Company A:

Company B:

Voting Trust:

Date A:

Date B:

Year A:

\$ x:
\$ y:
\$ z:
State:

Dear

This is in response to a letter, dated June 14, 1999, that you submitted on behalf of Trust and its Beneficiaries. You request a ruling that a proposed amendment to Trust will not cause Trust to lose its exempt status for generation-skipping transfer tax (GSTT) purposes under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations or cause Trust or any distributions from it to be subject to GSTT under § 2601 of the Internal Revenue Code.

Settlor created Trust on Date A to pay for the educational expenses of Beneficiaries, his currently living grandchildren, and subsequently born grandchildren. The Trust was irrevocable on September 25, 1985, and no contributions have been made to the Trust after that date. The grandchildren are the children of Settlor's four sons.

The Settlor's family has had a long association with Company A. The Trust was funded, in part, with units of the Voting Trust, which represented shares of Company A. In Year A, Company A was acquired by Company B. As a result of that acquisition, Company A shareholders, including the Voting Trust, received stock of Company B in exchange for stock in Company A. The Trust currently holds approximately \$x in assets, including Company B stock held in the Voting Trust having a value of approximately \$y. Trust assets other than company B stock have a current value of approximately \$z.

In order to accommodate differing family views as to the desirability of retaining the Company B stock, Trustees propose to divide Trust into two parts, Part A and Part B, so that the stock of Company B currently held in Trust will be segregated from the other assets in Trust. All of the stock of Company B will be placed in Part A where it will be divided proportionately into a separate subtrust, one for each of the four family groups. Each family group will consist of the issue of one of the four sons of Settlor. The Company B shares shall be allocated among the subtrusts for the family groups in the same proportion as the number of grandchildren in each group bears to the total number of grandchildren of Settlor. Part B will consist of the balance of the trust and will continue to be administered under the original terms of the Trust without regard to the proposed amendment. After the proposed amendment, the Trustees will be able to pursue a different investment program for each family group with respect to the Company B stock that has been allocated to that group. The current Trustees of Trust will serve as the initial Trustees of Trust and the subtrusts after the amendment.

In order to avoid affecting the beneficial interests in the Trust, any distributions made from the subtrusts after the amendment will be made proportionately from all four subtrusts. The subtrust for each family group will also be adjusted on the death without issue of a grandchild or the birth of a new grandchild in order to reflect the terms of Trust, which provide for a per capita division of the trust assets among the grandchildren of the Settlor on termination of the Trust.

By its terms, Trust will terminate no later than Date B. Upon termination of Trust, Trustees shall distribute the property held in the subtrust for each family group in equal shares to the then living grandchildren in such family group, with the issue of any grandchild then deceased to receive by right of representation the share that would have been distributable to such deceased grandchild if living.

Article 1 of the Trust provides that the Trust is established to contribute to the educational cost of Settlor's grandchildren, both those now in being and those hereafter born. The Trust may not be amended or revoked, except that Trustees may modify the provisions hereof if they, in their sole discretion, shall determine that such modification is necessary or desirable for tax or administrative reasons, and so long as the beneficial interests hereunder are not materially affected thereby.

Article 2 of Trust provides that, so long as any living grandchild of Settlor is under twenty-five years of age, the Trustees shall, from time to time, pay or apply for the benefit of any one or more of the grandchildren such portion or portions of the net income or accumulated income of the Trust as the Trustees, in their sole discretion, shall deem necessary or desirable for tuition, room, board and other expenses related to the preparatory school (but not earlier than at the seventh grade level), college or post-graduate education of such grandchildren, retaining as accumulated income any net income not so paid or applied. For the guidance of Trustees, Settlor anticipates that, in view of the ages of the grandchildren at the time of execution of Trust, it should be possible to accumulate all or most of the net income for several years, thus creating a fund to more adequately provide for increasing educational cost in subsequent years. Trustees, in exercising their discretion hereunder, may, but need not, consider the financial circumstances of Settlor's own children and their wives. Trustees shall be under no obligation to equalize distributions among the grandchildren individually or by family group.

Article 4 of Trust provides that, at such time as there is no living grandchild of the Settlor under the age of twenty-five years, but no later than thirty years after the date of execution hereof, this trust shall terminate, and Trustees shall pay the principal and any undistributed or accumulated income in equal shares to Settlor's then living grandchildren, the issue of any grandchild then deceased to receive the share which would have been distributable to such deceased grandchild if living.

Article 5 of Trust provides that, notwithstanding anything to the contrary herein

contained, this trust shall, unless sooner terminated in accordance with its terms, terminate in all events twenty-one years after the death of the survivor of all of Settlor's issue living on the date of the creation of this Trust. If, upon the termination of Trust, there are no grandchildren of Settlor or their issue living, Trustees shall pay such principal, together with any then undistributed income therefrom, to the persons to whom and in the proportions in which the same would have been distributable had the Settlor then died intestate, domiciled in State, owning such property absolutely.

Article 10 of Trust provides that the Settlor anticipates that the stock of Company A or the certificates of a voting trust holding such stock may constitute all or a substantial portion of the principal of Trust. The Settlor encourages, but does not require, Trustees to retain such interests, and no trustee shall be subject to liability by reason of such retention.

Section 2601 imposes a tax on every generation-skipping transfer (within the meaning of subchapter B).

Section 26.2601-1(b)(1)(i) provides that the tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) (Property includible in the the gross estate under § 2038) or (C) (Property includible in the gross estate under § 2042), any trust in existence on September 25, 1985, is considered an irrevocable trust.

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 26.2611-1 provides that a generation-skipping transfer is an event that is either a direct skip, a taxable distribution, or a taxable termination. The determination as to whether an event is a generation-skipping transfer is made by reference to the most recent transfer subject to the estate or gift tax.

Section 2612(a)(1) provides that the term "taxable termination" means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless—(A) immediately after the termination, a non-skip person has an interest in the property, or (B) at no time after the termination may a distribution (including distributions on termination) be made from the trust to a skip person. Section 2612(b) provides that the term "taxable distribution" means any distribution from a trust to a skip person (other than a taxable termination or a direct skip). Section 2612(c)(1) provides that the term "direct skip" means a transfer subject to a tax imposed by chapter

11 or 12 of an interest in property to a skip person.

Section 2613(a) provides that the term “skip person” means—(1) a natural person assigned to a generation which is two or more generations below the generation assignment of the transferor, or (2) a trust—(A) if all interest in the trust are held by skip persons, or (B) if —(i) there is no person holding an interest in the trust , and (ii) at no time after such transfer may a distribution (including distributions on termination) be made from the trust to a non-skip person.

The modification of a generation-skipping trust that is otherwise exempt under § 26.2601-1(b)(1)(i) will generally result in a loss of its exempt or “grandfathered” status, if the modification changes the quality, value, or timing of any powers, beneficial interest, rights, or expectancies originally provided for under the terms of the trust.

Trust is a generation-skipping trust because it provides for distributions to persons that are two or more generations below the generation assignment of the transferor. Under § 26.2601-1(b)(1)(i), however, the GSTT does not apply to Trust because it was irrevocable on September 25, 1985 and no additions have been made after September 25, 1985.

In this case, the proposed amendment to Trust relates to the segregation of certain trust assets, the stock of Company B, from the other assets in Trust in order to accommodate different family views as to the desirability of retaining Company B stock. The stock of Company B will be divided proportionately into a separate subtrust for each of four family groups. Shares of stock will be allocated in the same proportion as the number of grandchildren in each family group bears to the total number of grandchildren. After the proposed amendment, the Trustees will be able to pursue a different investment program for each family group with respect to the Company B stock that has been allocated to that group. However, the proposed amendment to the Trust will not change any of the substantive terms of the Trust. Distributions or other events prior to the termination of Trust, such as the birth or death of a grandchild, will have the same effect on the other beneficiaries as if the division had not been made. The amendment has been proposed under the discretionary authority granted to Trustees by Article 1 of the Trust. The Trustees have determined that the proposed modification of Trust is desirable for administrative reasons and does not materially affect the beneficial interests under Trust.

We conclude that, based on the facts presented and the terms of the Trust, the proposed amendment will not change the quality, value, or timing of any powers, beneficial interest, rights or expectancies originally provided for under the terms of Trust. Accordingly, the proposed amendment to Trust will not cause it to lose its exempt status for generation-skipping transfer purposes under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) or cause Trust or any distributions from Trust to be subject to GSTT under § 2601.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This letter 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,

James C. Gibbons

James C. Gibbons
Assistant to the Chief, Branch 7
Office of the Assistant Chief Counsel
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Enclosure

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