

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:4-PLR-118120-99

Date:

November 14, 2000

Legend

Decedent =

Spouse =

Child A =

Child B =

Child C =

Trust =

Charity =

Date =

Dear :

This responds to a letter dated November 9, 1999, submitted by your authorized representative on your behalf in which a ruling is requested concerning the federal gift and generation-skipping transfer (GST) tax consequences of a proposed transaction regarding a testamentary trust.

The facts are represented to be as follows:

Decedent died on Date survived by Spouse and their three children, Child A, Child B, and Child C. Under Article THIRD of Decedent's Will, the Decedent directed that, in the event Spouse survived Decedent, one-third the value of Decedent's adjusted gross estate (within the meaning of § 6166(b)(6) of the Internal Revenue Code), as finally determined for federal estate tax purposes, is to be held in a separate trust (Trust) in accordance with the provisions of Article SIXTH of the Will.

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Article SIXTH:A. directs that an annuity be paid to Charity, if it is then a qualified charitable beneficiary as defined in the will, in an amount equal to a specified percentage of the initial fair market value of the assets passing to Trust, for a term of twenty-five years. The annuity is to be paid out of the net income of trust and, to the extent the net income is insufficient, out of the principal. If Charity is not a qualified charitable beneficiary, the trustees are to pay the amount to one or more qualified charitable beneficiaries.

Article SIXTH:C. provides that, upon the expiration of the twenty-five year term, the trustees shall allocate the principal and income of the trust, other than any amount due the qualified charitable beneficiaries, into as many equal shares as will create one such equal share for each child of Decedent who is then living and one such equal share for each child who is not then living but who leaves issue then living. Any equal share for a deceased child shall be further divided into shares for the then living issue per stirpes of such deceased child so that every such share is created in respect of a living descendant who does not have an ancestor descended from Decedent then living. Paragraph (i) of Article SIXTH:C. defines "beneficiaries" of the separate trusts to include (1) the child (or child of a deceased child as the case may be) for whom the trust is established, (2) such person's descendants, and (3) charitable organizations or trusts or governmental entities described in § 2651(f)(3) of the Code, including Charity.

Paragraph (ii)(a) of Article SIXTH:C. provides that the trustee shall pay a stated percentage of the net income of each of the trusts at least annually to Charity (or to one or more qualified charitable beneficiaries if Charity is not a qualified charitable beneficiary). The trustees have the discretion to distribute so much or all of the remaining net income to any one or more of the beneficiaries, without any duty of equalization, or to accumulate the income. Paragraph (ii)(b) provides that the trustees shall pay to any one or more beneficiaries, without any duty of equalization, so much or all, if any, of the principal as the trustee may determine to be advisable from time to time. Pursuant to Paragraph (ii)(c), each trust is to terminate on the first to occur of (1) the death of the Decedent's child (or child of a deceased child as the case may be) for whom the trust was originally established, and (2) the twenty-first anniversary of the death of the last to die of Spouse and the descendants of Decedent's father who survive Decedent. Upon the termination of each separate trust, the trustees shall pay the entire principal, together with all accrued and undistributed income, to such one or more members of the class of beneficiaries, in equal or unequal shares as the trustees in their discretion, deem advisable.

Article SIXTH:C., paragraph (iv) provides that the trustees (other than any descendant of Decedent) shall have the power, acting alone, to amend the dispositive or administrative provisions of the trusts governed by Subdivision C of Article SIXTH in any manner; provided that only Decedent's descendants (or their estates) or charitable organizations or trusts or governmental entities described in § 2651(f)(3) of the Code shall be the beneficiaries of any dispositive amendment and, provided further, that all

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trusts shall terminate no later than the twenty-first anniversary of the death of the last to die of Spouse and the descendants of Decedent's father who survive Decedent. The trustees may exercise this power from time to time prior to the expiration of the term of a trust governed by Subdivision A of Article SIXTH, but not thereafter. The trustees may release the power of amendment in whole or in part and such release shall be binding upon the trustees and their successors.

Pursuant to the power to amend granted in paragraph (iv) of Article SIXTH:C., the trustees of Trust (other than any descendant of Decedent) propose to: (1) amend the dispositive provisions of Trust to provide that on the termination of the twenty-five year charitable lead term of Trust, one-sixth of the then remaining principal of Trust is to vest in Child A; and (2) release their right to change the disposition to Child A. Child A then proposes to assign his remainder interest in the Trust corpus created by the trustees' designation to his children and file a gift tax return.

You have requested a ruling that, upon termination of Trust at the expiration of the 25 year charitable term, the payment of assets from Trust to Child A's children as the assignees, will not constitute a generation-skipping transfer subject to generation-skipping transfer tax, because Child A will be treated as the transferor.

LAW AND ANALYSIS

Section 2601 provides that a tax is imposed on every generation-skipping transfer made by a "transferor" to a "skip person." Section 2611 defines the term "generation-skipping transfer" to mean a taxable termination, a taxable distribution, or a direct skip.

Section 2612(b) defines the term "taxable distribution" to mean any distribution from a trust to a skip person (other than a taxable termination or a direct skip). Section 2613(a)(1) defines the term "skip person" as including a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor.

Section 2652(a) provides generally that the term "transferor" means—

(A) in the case of any property subject to the tax imposed by chapter 11, the decedent, and

(B) in the case of any property subject to the tax imposed by chapter 12, the donor.

An individual shall be treated as transferring any property with respect to which such individual is the transferor.

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Section § 26.2652-1(a)(1) provides that the individual with respect to whom property was most recently subject to Federal estate or gift tax is the transferor of that property for purposes of chapter 13. An individual is treated as transferring any property with respect to which the individual is the transferor. Thus, an individual may be a transferor even though there is no transfer of property under local law at the time the Federal estate or gift tax applies. Section 26.2652-1(a)(2) provides that, for purposes of chapter 13, a transfer is subject to Federal gift tax if a gift tax is imposed under § 2501(a) (without regard to exemptions, exclusion, deductions, and credits). A transfer is subject to Federal estate tax if the value of the property is includible in the decedent's gross estate as determined under § 2031 or § 2103.

In general, under § 2602 the GST tax imposed is determined by multiplying the taxable amount by the "applicable rate." Under § 2641, the applicable rate is the product of the maximum Federal estate tax rate, and the inclusion ratio with respect to the transfer. Section § 2642(a)(1) provides that the inclusion ratio with respect to a transfer is the excess of 1 over the applicable fraction with respect to the trust from which the transfer was made. Under § 2642(a)(2), the applicable fraction with respect to a trust is a fraction, the numerator of which is the amount of GST exemption (provided for under § 2631) allocated to the trust, and the denominator of which is the value of the property transferred to the trust reduced by certain items, including any estate or gift tax charitable deduction allowed with respect to the transfer. Generally, under § 2642(b) the value of the property transferred to the trust (the denominator of the applicable fraction) is determined as of the date of death in the case of testamentary transfers.

Section 2631 provides that for purposes of determining the inclusion ratio, each individual is allowed a GST tax exemption of \$1,000,000, adjusted as provided in § 2631(c), which may be allocated by such individual (or his or her executor) to any property with respect to which such individual is the transferor.

Section 2642(e) provides a special rule for determining the inclusion ratio for any "charitable lead annuity trust." Under § 2642(e) and the applicable regulations, in the case of a charitable lead annuity trust the applicable fraction is a fraction (1) the numerator of which is the adjusted generation-skipping transfer tax exemption ("adjusted GST exemption"), and (2) the denominator of which is the value of all property in the trust immediately after the termination of the charitable lead annuity. The adjusted GST exemption is the amount of GST exemption allocated to the trust increased by an amount equal to the interest that would accrue if an amount equal to the allocated GST exemption were invested at the rate used to determine the amount of the estate or gift tax charitable deduction, compounded annually, for the actual period of the charitable lead annuity. The amount of GST exemption allocated to a charitable lead annuity trust is not reduced even though it is ultimately determined that the allocation of a lesser amount of GST exemption would have resulted in an inclusion ratio of zero. Under § 2642(e)(3), a "charitable lead annuity trust" is defined as any trust providing an interest in the form of a guaranteed annuity for which the transferor is

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allowed a charitable deduction for Federal estate or gift tax purposes under §§ 2055 or 2522.

In the absence of § 2642(e), little or no GST tax would ever be imposed with respect to certain charitable lead annuity trusts, even if no GST exemption is allocated to the trust. That is, if the value of the assets transferred to the trust was equal to the estate tax charitable deduction allowed with respect to the transfer, then under the general rules of § 2642, the inclusion ratio with respect to the trust would be zero and the trust would be exempt from GST tax. Even if the charitable deduction did not equal the value of the transferred assets, an allocation of only a small amount of GST exemption would have resulted in no GST tax. Congress was concerned that allowing the present value of the charitable interest to reduce the denominator of the applicable fraction permitted the leveraging of the GST tax exemption. If the trust assets sufficiently outperform the rate of return assumed in computing the present value of the charitable interest, the amount passing to noncharitable persons can exceed the amount which would have passed to them had there been no charitable interest in the trust. S. Rep. No. 445, 100th Cong., 2d Sess. 368 (1988).

Congress remedied this situation by the enactment of § 2642(e). Under this special rule for charitable lead annuity trusts, the numerator of the applicable fraction is the adjusted GST exemption and the denominator is the value of all property in the trust immediately after termination of the charitable lead interest. The adjusted GST exemption is the GST exemption allocated to the trust increased by the interest rate used in determining the charitable deduction for federal gift or estate tax purposes for the actual period of the charitable lead annuity.

In light of § 2642(e), all generation-skipping transfers made with respect to a charitable lead annuity trust will be subject to the GST tax if no GST exemption is allocated to the trust. Even if GST exemption is allocated to a trust, there is no way to guarantee that it will be sufficient to ensure that the trust is exempt from GST tax.

The series of transactions proposed in the ruling request have the effect of circumventing the rules of § 2642(e) using the same type of leveraging that prompted Congress to enact § 2642(e). The trustees propose to designate Child A as the beneficiary of one-sixth of the remainder interest in Trust. Child A will then assign Child A's one-sixth remainder interest to Child A's children in a transaction that is subject to gift tax.

Based on the above, we conclude that for GST tax purposes, and consistent with the purpose of § 2642(e), there will be two transferors with respect to the trust assets in Trust as of the date of the assignment. Child A will be considered the transferor with respect to the portion of the trust assets equal to the present value of the one-sixth remainder interest on the date of the gift. The Decedent will remain the transferor with respect to the balance of the Trust.

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We also note that under the facts presented in the ruling request, the form of the transaction might be disregarded and the series of transactions viewed as the designation by the Trustee of Child A's children as remainder beneficiaries. Under this analysis, Decedent would be treated as the transferor of the entire Trust estate for GST tax purposes. See Estate of Bies v. Commissioner, T.C. Memo. 2000-338; Estate of Cidulka v. Commissioner, T.C. Memo. 1996-149; Griffin v. United States, 42 F.Supp.2d 700 (W.D. Tex. 1998).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,
Associate Chief Counsel
(Passthroughs and Special Industries)
By: George Masnik
Chief, Branch 4

Enclosure
Copy for § 6110 purposes