Internal Revenue Service

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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4 - PLR-104982-99
Date: March 3, 2000

Re:

TIN:
LEGEND:

Spouse =

Decedent =

K =

L =

M =

N =

County =

State =

Date 1 =

Date 2 =

Date 3 =

$x =

$y =

$z =

Dear :

We received your letter, dated February 15, 1999, requesting a ruling on behalf of L, as trustee of a marital trust, concerning the application of § 2651(e) of the Internal Revenue Code. This letter responds to your request.

The facts and representations submitted are summarized as follows: Decedent died testate on Date 1, a resident of County, State. Decedent was survived by his wife, Spouse, who is also a resident of County, State. Decedent and Spouse lived for the entire 22-year duration of their marriage in State, which is a community property state. Decedent and Spouse had no children. Spouse has five children from a prior marriage. Decedent was also survived by his nephew, K, and his grandnephews, L and N. L and N are the sons of Decedent's niece, M, who predeceased Decedent.

Under the terms of Decedent's will, certain tangible personal property was bequeathed to Spouse and to other individuals. The residue of Decedent's estate was bequeathed one-fourth to a marital trust governed by Article FOURTH of the will and three-fourths (or the entire residue if Spouse predeceased the Decedent) to be held, managed and distributed in accordance with Article FIFTH of the will.

Article FOURTH of the will provides that, commencing on the date of Decedent's death, the trustee is to pay or apply for Spouse's benefit all of the income from the Marital Trust, not less often than quarterly. The trustee is authorized, in the trustee's discretion, to pay or apply additional funds from the principal of the Marital Trust to provide for Spouse's reasonable maintenance, support, comfort and welfare as the trustee deems necessary or advisable.

Article Fourth further provides that upon the death of Spouse, all income of the Marital Trust which is undistributed is to be distributed to Spouse's estate and the balance of the trust property is to be held, managed and distributed in accordance with the provisions of Article FIFTH, in the same manner as though Decedent had died immediately after the death of Spouse.

The pertinent terms of Article FIFTH are as follows: The trustee is to divide the Article FIFTH property into two equal parts. One part is to be held in trust for the benefit of Decedent's nephew, K ("K Trust"). The other part is to be distributed free of trust to the living descendants (i.e., L and N) of Decedent's deceased niece, M, by right of representation.

The trustee of the K Trust is to pay or apply all of the net income from the K Trust to K or for his use or benefit, for and during his lifetime. Upon K's death, the remaining balance of the K Trust is to be distributed, free of trust, to K's descendants, and if K has no descendants then living, to the surviving descendants of Decedent's deceased niece, M, by right of representation.

Decedent's estate timely filed a federal estate tax return (Form 706). A qualified terminable interest property (QTIP) election under § 2056(b)(7) was made on the return

for one-fourth of the residuary estate passing to the Marital Trust (hereinafter "QTIP Trust"). On Schedule R of Decedent's estate tax return, the estate made the election under § 2652(a)(3).

After Decedent's death, Spouse claimed that certain properties included in Decedent's gross estate on the federal estate tax return belonged to her as her separate property and her one-half interest in community property. Spouse alleged that the trustee of the QTIP Trust, L, improperly exercised his discretion to invade principal of the trust for her reasonable maintenance, support, comfort and welfare by refusing to make any distributions of principal to her. Spouse also objected to the investment strategy that the trustee pursued with regard to the QTIP Trust.

On Date 2, Spouse, K, L, and N reached an agreement to settle Spouse's claims. The stated purpose of the agreement is to resolve separate property claims and community property claims of Spouse, the administration of the probate estate and the QTIP Trust, and to preserve the relationships the parties have among themselves, their extended families, and mutual friends.

Under the terms of the settlement agreement, the amount of $x will be paid to Spouse in cash or other property in settlement of her claims for separate and community property. The agreement also directs that the trustee of the QTIP Trust pay the amount of $y to Spouse in exchange for Spouse's release of her rights to any part of the principal of the QTIP Trust. The agreement further provides that Spouse will sell her income interest in the QTIP Trust to K Trust, L, and N for cash or other property valued at $z. The consideration will be paid proportionately in accordance with the respective interests of K Trust, L and N in the remainder of the QTIP Trust. Upon completion of the sale, the QTIP Trust will terminate and the property in trust will be distributed to the remainder beneficiaries according to their respective interests therein. The settlement agreement is contingent on court approval, which has been obtained by the parties, and favorable rulings from the Internal Revenue Service.

You requested a ruling that under §2651(e) the terminating distributions from the QTIP Trust to L and N are not subject to the generation-skipping transfer tax (GSTT).

Section 2601 imposes a tax on every generation-skipping transfer (GST). A generation-skipping transfer is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) 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 trust unless (A) immediately after such termination a non-skip person has an interest in such property; or (B) at no time after such termination may a distribution (including distributions on termination) be made from such 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).

Under § 2612(c), the term "direct skip" means a transfer subject to a tax imposed under the gift tax or estate tax provisions of an interest in property to a skip person. Section 2613(a) provides that a "skip person" means (1) a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or (2) a trust - (A) if all interests in the trust are held by skip persons, or (B) if there is no person holding an interest in such trust, and at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 2651 sets forth rules to determine the generation to which any person (other than the transferor) belongs.

Section 2651(b) provides that an individual who is a lineal descendant of a grandparent of the transferor shall be assigned to that generation which results from comparing the number of generations between the grandparent and such individual with the number of generations between the grandparent and the transferor.

Section 2651(e)(1), as added by the Taxpayer Relief Act of 1997, effective in the case of terminations, distributions, and transfers occurring after December 31, 1997, provides a special rule for determining the generation assignment of individuals with a deceased parent, as follows:

> For purposes of determining whether any transfer is a generation-skipping transfer, if–
>
> (A) an individual is a descendant of a parent of the transferor (or the transferor's spouse or former spouse), and
>
> (B) such individual's parent who is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse) is dead at the time of the transfer (from which an interest of such individual is established or derived) is subject to the estate tax or the gift tax upon the transferor...
>
> such individual shall be treated as if such individual were a member of the generation which is 1 generation below the lower of the transferor's generation or the generation assignment of the youngest living ancestor of such individual who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse), and the generation assignment of any descendant of such individual shall be adjusted accordingly.

Under section 2651(e)(2), this special rule does not apply with respect to a transfer to any individual who is not a lineal descendant of the transferor (or the transferor's spouse or former spouse) if, at the time of the transfer, the transferor has any living lineal descendants.

Section 2652(a)(1) provides that, generally, the term "transferor" means (A) in the case of property subject to the estate tax, the decedent, and (B) in the case of property subject to the gift tax, the donor.

Section 2652(a)(3) provides that in the case of any trust with respect to which a deduction is allowed to the decedent under § 2056(b)(7), (i.e., qualified terminable interest property), the estate of the decedent may elect to treat all of the property in such trust, for GSTT purposes, as if the election to be treated as qualified terminable interest property had not been made. This election is commonly referred to as the "reverse QTIP election."

Section 26.2652-1(a)(3) of the Generation-Skipping Transfer Tax Regulations provides that if a transferor of QTIP property elects under § 2652(a)(3) to treat the property as if the QTIP election had not been made, the identity of the transferor of the property is determined without regard to the application of §§ 2044, 2207A, and 2519.

In the present case, after the sale of Spouse's qualifying income interest for life, the QTIP Trust will terminate. The QTIP Trust property will be distributed to the remainder beneficiaries, L, N, and K Trust, according to their respective remainder interests in the QTIP Trust under the terms of Decedent's will.

The analysis of the present facts under the rule of § 2651(e) is as follows: L and N are both descendants of a parent of the transferor (Decedent), and L's and N's parent (M) is a lineal descendant of the parent of the transferor (Decedent), and M, the parent, was dead at the time of Decedent's death when the transfer of one-fourth of the residuary estate to the QTIP Trust occurred. This transfer is the transfer from which L's and N's interests are derived and to which the estate tax applied. In addition, at the time of Decedent's death, Decedent had no living lineal descendants. Under § 2651(e), L and N are treated as if each were a member of the generation which is one generation below the lower of the transferor's (Decedent's) generation or the generation assignment of the youngest living ancestor of L and N who is also a descendant of the parent of the transferor (Decedent). Accordingly, L and N are treated as if each were a member of the generation that is one generation lower than that of the transferor (Decedent). Therefore, we conclude that the distributions to L and N as a result of the termination of the QTIP Trust will not be taxable terminations and will not be subject to the GSTT.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code.

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,
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)
By Katherine A. Mellody
Senior Technician Reviewer
Branch 4

Enclosure
Copy for section 6110 purposes