

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4/PLR-107390-00

Date:

March 21, 2001

In Re:

Legend:

Grantors -
Trust -
Trustee -
Partnership -
LLC -
Corporation -
Date -

Dear :

This is in reference to your December 14, 2000 correspondence, and prior submissions, requesting a ruling regarding the generation-skipping transfer tax consequences of a proposed transfer of Trust assets to LLC and the amendment of the bylaws of Corporation owned by Trust.

The facts submitted are as follows:

On Date, Grantors created Trust, an irrevocable trust, primarily for the benefit of their lineal descendants. Trustee, an independent corporation, is the trustee of Trust. Under the terms of Trust, all trust income is to be distributed, pursuant to a complex distribution scheme, to the lineal descendants of the Grantors. There are currently ten income beneficiaries of Trust. The trust will terminate at the death of the last to die of three individuals, all of whom are currently over age 80. At that time, the assets of Trust will be distributed to individual members of five different family lines. Currently, there are approximately 45 contingent remainderpersons who will take an interest upon the death of the last to die of the measuring lives, assuming they survive the individuals who are the measuring lives.

The current assets of Trust consist of commercial real property, which is owned outright by the trust, and all the stock in Corporation, a wholly-owned S corporation that holds only liquid investment assets. Corporation, which was initially incorporated as a C

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corporation several years prior to the creation of Trust, recently elected S corporation status. Corporation's current investments primarily consist of common stock in publicly traded companies, government and agency obligations, corporate bonds, and a money market account.

In order to avoid condemnation by the local jurisdiction of the commercial real estate, Trust entered into negotiations with representatives of the local jurisdiction and other interested parties for the redevelopment of the commercial real estate. The negotiations were subject to the approval of the appropriate local court having jurisdiction over Trust. Pursuant to the negotiations, Trust executed a ground lease with Partnership for the development and management of the real estate. Partnership is a limited partnership, none of the partners have any relationship to Trust or any of the current or contingent beneficiaries of Trust. The ground lease will be in effect for a specified term of years and may be extended for two additional specified periods. Under the terms of the ground lease, Partnership may exercise an option to purchase the property at various times during the term of the lease at a price determined under a formula set out in the lease. If the real estate is sold by Trust prior to termination of the trust, the proceeds will be distributed to the trustee for ultimate distribution to the remainderpersons. The appropriate local court having jurisdiction over Trust has approved the ground lease as being in the best interest of the trust beneficiaries.

Proposed Transaction:

Due to the probability that the trust will terminate before the ground lease, Trustee has formed LLC, a limited liability corporation, to facilitate the ultimate distribution of the property upon termination of Trust. Upon receiving a favorable letter from the Internal Revenue Service, the Trust will transfer the commercial real estate to LLC. The appropriate local court having jurisdiction over Trust has approved the transfer to LLC as being in the best interest of the trust beneficiaries. Trustee will be the only member of the LLC and the sole owner and manager of the membership interests. Trustee, with the consent of the beneficiaries, will contribute the commercial real estate to LLC. Prior to termination of Trust, any income from LLC will be distributed to Trust and, in turn, to the trust income beneficiaries. Upon termination of Trust, the LLC interests will be divided and distributed to the remainder beneficiaries and Trustee will resign as manager of Trust. The beneficiaries will then elect a new manager and LLC will continue its operation.

Under the terms of LLC, a member can freely transfer a membership interest to a "Family Trust" (a trust for the benefit of the members' wife, husband and lineal descendants) of which a member is the trustee. Further, a membership interest can be transferred without restriction if the transfer occurs by reason of the death of a member. If a member desires to sell or transfer a membership interest other than to a "Family Trust," the member must give each other LLC member the right to purchase the

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proportionate share of the membership interest pursuant to a right of first refusal. Under this procedure, a member who receives a “bona fide offer” from a third party to buy his or her entire interest must first offer to sell the interest to other members under the same terms and for the same price as the offer. In the event of the occurrence of certain events, such as withdrawal of a member, the member will be paid the “Fair Option Price,” which is defined as that which a willing buyer would pay a willing seller. LLC will not terminate until the sale or distribution of all LLC assets or the affirmative vote of the manager and a majority of the members.

Currently, the shares of Corporation, of which Trust is the sole shareholder, are not subject to any restrictions on transfer. On termination of Trust, the shares in Corporation will be distributed to the Trust remainder beneficiaries. Trustee proposes to amend the bylaws of Corporation to provide the same right of first refusal provision as will be contained in the LLC agreement. The Trustee contends that this right of first refusal provision will facilitate retention of Corporation’s S status.

Trustee has represented that no additions have been made to Trust after September 25, 1985.

Trustee requests a ruling that the transfer by Trust of the commercial real estate owned by Trust to LLC whose membership interests will be subject to the right of first refusal provision, and the amendment of the Corporation bylaws to include the right of first refusal provision, is not a modification of Trust that will affect the exempt status of Trust for generation-skipping transfer tax purposes.

Law and Analysis:

Section 2601 imposes a tax on every generation-skipping transfer (GST) made after October 26, 1986.

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 a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in trust where the property passes to a skip person with respect to the transferor of the property. 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)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person.

Under § 1431(a) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax does not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985.

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However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(iv) states that, if an addition is made after September 25, 1985, to a trust which was irrevocable on September 25, 1985, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the GST tax provisions. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to the GST tax and a portion subject to the GST tax.

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 generation-skipping transfer tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of a trust by judicial reformation or nonjudicial reformation that is valid under applicable state law will not cause the trust to lose its GST exempt status if the modification does not shift any beneficial interest in the trust to a lower generation beneficiary and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Under § 26.2601-1(b)(4)(i)(D)(2), a modification of an exempt trust will result in a shift in beneficial interests to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

In the present case, Trust was irrevocable on September 25, 1985. Trustee has represented that no additions, actual or constructive, have been made to the trust after that date.

In this case, neither the transfer by Trust of the commercial real estate to LLC, nor the amendment of the bylaws of Corporation to provide for the right of first refusal results in a shift of any beneficial interest in Trust to lower generation beneficiaries and does not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in Trust. The terms of the right of first refusal with respect to both LLC and Corporation establish a potential purchase price based on a "bona offer" or, in the case of a withdrawal from the LLC, a price based on what a willing buyer would pay a willing seller. Thus, the purchase price will be an arm's length price that will reflect fair market value.

We conclude that the transfer by Trust of the commercial real estate to LLC, with

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the right of first refusal provision, and the amendment of the Corporation bylaws to include an identical right of first refusal provision, will not affect the exempt status of Trust for generation-skipping transfer tax purposes, and will not result in a transfer of property that will subject Trust, or distributions thereunder, to the generation-skipping transfer tax imposed under § 2601.

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the 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. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

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

Enclosure
Copy for section 6110 purposes