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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:1-PLR-118061-02
Date:

April 18, 2002

Legend:

Trust

A

B

C

Date 1

Date 2

a

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e

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County

State

Bank

Court

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Dear

This responds to your January 17, 2002 letter and prior correspondence requesting a ruling that the modification of Trust by judicial reformation will not affect the generation-skipping transfer (GST) tax exempt status of Trust under § 2601 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: On Date 1, A, A's spouse B, and A's father C (collectively, "Trustors") established Trust, an irrevocable inter vivos trust. Initially, C contributed a shares of stock to Trust, A contributed b insurance policies on A's life, and A and B together contributed c community property life insurance policies, d on A's life and e on B's life (these c insurance policies are called "A and B's community property or community policies" in the trust instrument). The c insurance policies contributed jointly by A and B have been redeemed.

Paragraph 1 of Trust provides, in pertinent part, that Trust will terminate, if not sooner fully distributed under the provisions of Paragraphs 2 and 3, five years after A and B both have died. The Trust shall be distributed, upon such termination date, subject to the provisions of paragraph 5, to A's issue.

Paragraph 2 of Trust provides as follows:

If B shall survive A, the Trustee shall serve as collection agent only with respect to the proceeds attributable to the B's one-half ($\frac{1}{2}$) community interest in the insurance policies shown on Exhibit A [the c insurance policies contributed by A and B jointly], and immediately upon collection thereof shall distribute such portion of such proceeds, outright, to B. For the purposes of this paragraph, B shall be entitled to one-half ($\frac{1}{2}$) of the proceeds on community policies, reduced by an amount equal to one-half ($\frac{1}{2}$) of the premiums paid out of non-community funds, and shall be entitled to an amount equal to one-half ($\frac{1}{2}$) of the premiums on separate policies paid out of community funds.

Paragraph 3 of Trust provides, in pertinent part, as follows:

After A's death, and during the life and celibacy of B, but subject to the provisions of Paragraph 4, the Trustee shall distribute to B, such amounts of the Trust Estate as, in the Trustee's discretion, are sufficient to provide for B as described below. During the life of B (following the death of A) and while she is unmarried, the income, if any, remaining in

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such Trust Estate after any distribution to be made to [B] at the time has been made, and at any other time during the term of such Trust Estate, may be accumulated and retained, in whole or in part, or the Trustee, from time to time, may distribute to any one or more of [A]'s issue such amounts of such trust estate as, in the sole discretion of the Trustee, are in the best interests of such distributees. Trustors' primary concern is for the support and maintenance of [B] during her life and celibacy in the standard of living to which she is accustomed at the death of [A] and Trustors' next greatest concern is for the other current beneficiaries of each Trust, and each Trust shall be managed and distributions made therefrom, accordingly.

Paragraph 4 of Trust provides, in pertinent part, as follows:

For the purposes of Paragraph 3, Trust shall be deemed to be comprised of two separate portions, one such portion being that part of such Trust Estate attributable to [A]'s contributions and being referred to as "the [A] portion", and the other such portion being all the rest of such Trust Estate, and being referred to as "the other portion." The Trustee shall maintain such records as shall be necessary to identify such portions. All distributions of income or corpus from such Trust Estate following [A]'s death (other than those under Paragraph 2) shall be charged, subject to the provisions of the immediately succeeding sentence, entirely against the [A] portion unless, and except to the extent, the Trustee shall deem it to be for the best interests of [B] to charge such distributions to the other portion, in which event such distributions shall be charged in such proportions as are determined by the Trustee. Anything to the contrary in the immediately preceding sentence notwithstanding, for the purposes of Paragraph 8, and for the purposes of Paragraph 3 as it applies to the [A] portion, [B] shall be considered to have died on the last date of the calendar year, if any, in which she first makes transfers, following [A]'s death, to a person or entity other than one of [A]'s issue, in excess of \$[f] for a calendar year. For the purposes of Paragraph 3 as it applies to the other portion, [B] shall be considered to have died on the date, if any, when she first exercises, following [A]'s death, any general power of appointment given her by the terms of any inter vivos or testamentary trust created by [A] and of which trust the Trustee hereunder has written notice.

Paragraph 10 of the trust instrument provides as follows:

Trustors hereby divest themselves of all reversionary interests hereunder, if any, whether by operation of law or otherwise. None of the Trust Estate of any trust as it exists at any time shall ever, under any

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circumstances, be distributed to or vest in Trustors. If, regardless of the foregoing, under any circumstances, any part or all of a Trust Estate would be distributed to or would vest in Trustors, or any of them, then the Trustee shall convey and deliver such part of such Trust Estate to such charity, using the term "charity" in its broadest legal sense, as would be, in the sole judgment of the Trustee, in the best interests of the citizens of [County], [State].

A, B, and the trustee of Trust desire (1) to eliminate Paragraph 2 in its entirety because the insurance policies mentioned in Paragraph 2 have been redeemed and, therefore, do not exist anymore, (2) to eliminate Paragraph 4 in its entirety because the provision removing B as beneficiary, if B makes transfers to any person other than A's descendants in excess of \$f, prevents achieving Trustors' primary concern to provide the support and maintenance of B during her life in the standard of living to which she is accustomed at the death of A and (3) to modify Paragraphs 3 and 10 to remove outdated language and clarify conflicting provisions.

A, B, and the trustee of Trust petitioned Court to modify the terms of Trust. In its order dated Date 2, Court approved the deletion of Paragraphs 2 and 4 and the modification of Paragraphs 3 and 10. The Court found that \$g represents the accumulated cash value of B's original transfer to Trust. The order also states that the trustee shall pay out of Trust principal to B the sum of \$g and, after such payment, B shall not be considered a trustor under any provision of Trust.

Paragraph 3 is modified to read, in pertinent part, as follows:

[A]'s primary concern is for the support and maintenance of his wife, [B], during her life in the standard of living to which she is accustomed at the death of [A], and [A]'s next greatest concern is for the other current beneficiaries of such Trust, and such Trust shall be managed and distributions made therefrom, accordingly. After the death of [A], and during the life of [B], the Trustee shall distribute to [B] from time to time, such amounts of the Trust Estate of Trust as, in the discretion of the Trustee, are sufficient to provide for the support and maintenance of [B] in the standard of living to which she is accustomed at the death of [A]. The income, if any, remaining in such trust estate after any distribution to be made to [B] may be accumulated and retained, in whole or in part, or the trustee, from time to time, may distribute to any one or more of [A]'s issue such amounts of such Trust Estate as, in the sole discretion of the Trustee, are in the best interests of such distributees.

Paragraph 10 is modified to read as follows:

Trustors hereby divest themselves of all reversionary interests

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hereunder, if any, whether by operation of law or otherwise. [B] shall not be considered a Trustor under any provisions of this Indenture of Trust. None of the Trust Estate of any trust as it exists at any time shall ever, under any circumstances, be distributed to or vest in Trustors. If, regardless of the foregoing, under any circumstances, any part or all of a Trust Estate would be distributed to or would vest in Trustors, or any of them, then the Trustee shall convey and deliver such part of such Trust Estate to such charity, using the term "charity" in its broadest legal sense, as would be, in the sole judgment of the Trustee, in the best interests of the citizens of [County], [State].

The current trustee of Trust is Bank. The trustee represents that no additions, actual or constructive, have been made to Trust after September 25, 1985.

The trustee has requested that we rule that the proposed judicial modification of Trust will not constitute an addition to Trust or otherwise subject Trust to the GST tax provisions of Chapter 13 of the Code, and will not cause the corpus of Trust to be treated as if it had been added to Trust after September 25, 1985, and will not cause Trust to lose its exempt status under § 2601 and Treas. Reg. § 26.2601.

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) provides that, for purposes of the GST tax, the term "generation-skipping transfer" means (1) a taxable distribution, (2) taxable termination, and (3) a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply if additions (actual or constructive) are made to the trust after September 25, 1985. Under § 26.2601-1(b)(1)(ii)(A), 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 §§ 2038 and 2042, if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(4) 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 under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the

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trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, 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.

Section 26.2601-1(b)(4)(i)(D)(2) provides, in pertinent part, that for purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest 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. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification.

In the present case, Trust was created and became irrevocable on Date 1, and there have been no additions made to Trust after September 25, 1985. Accordingly, Trust is exempt from the GST tax under § 26.2601-1(b)(1).

Based on the facts submitted and the representations made, the modification of Trust will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the persons who held the beneficial interest prior to the modification. Further, the modification will not extend the time for vesting of any beneficial interest beyond the period provided for in Trust before the modification.

Accordingly, based on the information submitted and representations made, we conclude that the proposed modification of Trust will not constitute an addition to Trust or otherwise subject Trust to the GST tax, will not cause the corpus of Trust to be treated as if it had been added to Trust after September 25, 1985, and will not cause Trust to lose its GST tax exempt status.

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. Specifically, no opinion is expressed concerning whether any portion of Trust will be includible in B's estate under § 2036 or whether any of the

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beneficiaries of Trust, other than B, have made a gift to B under § 2503.

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

Sincerely,

Melissa Liquerman

Melissa Liquerman
Chief, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures:

Copy of this letter

Copy for § 6110 purposes

CC: