

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-105351-02

Date:

DECEMBER 04, 2002

Re:

LEGEND:

- Grandparent =
- Child A =
- Child B =
- Grandchild A =
- Grandchild B =
- Grandchild C =
- Trust =
- Grandchild A Trust =
- Grandchild B Trust =
- Grandchild C Trust =
- Corporate Trustee =
- Date 1 =
- Date 2 =
- Date 3 =
- Court =
- First Order =

- Second Order =

- State Statute =

Dear :

This is in response to the August 9, 1999 letter and subsequent correspondence requesting a ruling regarding the generation-skipping transfer tax (GSTT) consequences of a judicial construction of Trust.

Facts

The facts submitted and representations made are as follows.

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Grandparent irrevocably created Trust on Date 1, before September 25, 1985, and designated Corporate Trustee as trustee.

Three Schedules are included as part of Trust, Schedule A, Schedule B, and Schedule C. Grandchild A's name is designated on Schedule A, Grandchild B's name is designated on Schedule B, and Grandchild C's name is designated on Schedule C. Each schedule lists a specified number of corporate shares.

Under Article I, paragraph (a) of Trust, the trustee is to: (i) set apart the property described in each Schedule as a separate fund for the primary benefit of the respective grandchild named on that Schedule; and (ii) administer and dispose of each fund as a separate and distinct trust fund as though created by separate instrument. Pursuant to this directive, the trustee established Grandchild A Trust, Grandchild B Trust, and Grandchild C Trust. It is represented that no additions, actual or constructive, were made to Trust or to Grandchild A Trust, Grandchild B Trust, or Grandchild C Trust after September 25, 1985.

Under Article I, paragraphs (c) and (d), after a grandchild attains age 21, the trustee is to distribute to him or her so much of the current income of the fund held for that grandchild's benefit as the trustee in its absolute discretion deems advisable for the grandchild's comfortable support, education, welfare and happiness. The trustee may either accumulate the remaining income or distribute so much of it to any one or more of Grandparent's lawful descendants, except Child A and Child B, and the spouses of those descendants, in such proportions as the trustee in its absolute discretion deems advisable. In addition, the trustee may add the accumulated income to principal, or the trustee may distribute any part of the accumulated income in the same manner as it may distribute current income. After a grandchild has attained age 21, the trustee may, if in the trustee's discretion it is deemed advisable, distribute part or all of the principal of a grandchild's fund to the grandchild.

Under Article I, paragraphs (e) and (f), if a grandchild dies before all of the fund held for him or her has been fully distributed, the grandchild may appoint by will the fund to such of Grandparent's then living descendants and subject to such trusts and conditions as the grandchild directs. To the extent a grandchild fails to exercise his or her testamentary power of appointment, the fund held for that grandchild is to be distributed equally per stirpes to the grandchild's then living lawful descendants. If there are none, the fund is to be distributed equally per stirpes among Grandparent's descendants, assuming for that purpose that Child A and Child B have died. If a son of Child A leaves a spouse but no living descendant, the trustee is to distribute the income of the fund to the spouse until her death or remarriage, whichever occurs first, whereupon the trustee is to distribute the fund to Grandparent's then living descendants, equally per stirpes, assuming for that purpose that both Child A and Child B have died. Nevertheless, if the trustee deems a person incapable of using to good advantage the share otherwise receivable in default of a grandchild's testamentary

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direction, the trustee may dispose of the unqualified person's share among any of the remaining of Grandparent's descendants in such proportions as the trustee deems proper. If any part of the principal of a fund becomes distributable to one who has not attained age 30, the trustee is to hold that portion in trust for that person until he or she attains age 30.

Under Article I, paragraph (k), the trustee has the full power and authority to determine whether and in what proportions any receipts or disbursements are to be credited or charged to or apportioned between trust principal and income.

Under applicable local law governing the ascertainment of income and principal and the apportionment of receipts and expenses, a trust is to be administered with due regard to the respective interests of income beneficiaries and remaindermen. A trust is so administered with respect to the allocation of receipts and expenses if a receipt is credited or an expense is charged to income or principal or partly to each in accordance with the terms of the instrument. State Statute.

Corporate Trustee is now the sole trustee of the trusts. On Date 2, in response to the trustee's request for instructions relating to its authority to manage and invest the trust assets, Court issued First Order authorizing the trustee to: (1) invest the assets on a joint or pooled basis; and (2) retain professional investment managers having expertise in managing the type of investments appropriate to meet the investment objectives of a trust or joint investment fund, if the trustee deems it appropriate in accordance with the exercise of its fiduciary responsibility.

The trustee subsequently petitioned Court for instructions concerning the power to allocate expenses and receipts under Article I, paragraph (k). On Date 3, Court issued Second Order concluding that, pursuant to the express language of Trust, the trustee has the power and authority in the exercise of its fiduciary responsibilities to credit realized capital gains to income and to charge income expenses to principal.

Requested ruling

You have asked us to rule that the exercise of the trustee's discretion to allocate capital gain receipts to income and to charge certain income expenses to principal pursuant to Second Order does not adversely affect the trusts' status as exempt from the generation-skipping transfer tax.

Discussion

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 ("the 1986 Act") and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that

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the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(ii) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in the grantor's gross estate under sections 2038 and 2042).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from the application of chapter 13 by section 1433(b)(2)(A) of the 1986 Act, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of Chapter 13.

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. 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.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument will not cause an exempt trust to be subject to the provisions of chapter 13 if - (1) the judicial action involves a bona fide issue; and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state.

In the instant case, Trust and Grandchild A Trust, Grandchild B Trust and Grandchild C Trust were irrevocable on September 25, 1985, and no additions, actual or constructive, have been made to Trust or Grandchild A Trust, Grandchild B Trust or Grandchild C Trust after that date. The judicial construction of Article I, paragraph (k), that the trustee is authorized under the provision to allocate capital gain receipts to income and charge certain income expenses to corpus, is consistent with the language of the provision and applicable state law.

Accordingly, based on the facts submitted and the representations made, we rule that the entry of the Second Order authorizing the trustee to allocate capital gain receipts to income and charge certain income expenses to corpus, and the trustee's exercise of discretion in accordance with the court order, will not adversely affect the status of Grandchild A Trust, Grandchild B Trust, and Grandchild C Trust as exempt from generation-skipping transfer tax. Section 26.2601-1(b)(4)(i)(C).

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

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 L. Masnik
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes