

# Internal Revenue Service

Department of the Treasury

Number: **200324001**

Washington, DC 20224

Release Date: 6/13/2003

Index Number: 2601.00-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC: PSI:B09 / PLR-161436-01

Date:

November 4, 2002

## Legend

Trust =

Decedent =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Court =

Date 10 =

Bank 1 =

Individual =

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Beneficiary 1 =  
 Beneficiary 2 =  
 Beneficiary 3 =  
 Nephew =  
 Corporation =  
 Date 11 =  
 Date 12 =  
 Date 13 =  
 Date 14 =  
 Charity 1 =  
 Charity 2 =

Dear Sir or Madam:

This is in response to your letter dated August 15, 2002, and prior correspondence, requesting a ruling under § 2601 of the Internal Revenue Code, submitted on behalf of Trust.

Trust was created under Decedent's Will. The will was executed on Date 1. Codicils were executed on Date 2 (First Codicil), Date 3 (Second Codicil), Date 4 (Third Codicil), Date 5 (Fourth Codicil), Date 6 (Fifth Codicil), Date 7 (Sixth Codicil) and Date 8 (Seventh Codicil). Decedent died on Date 9. Court issued a final judgment settling Decedent's estate on Date 10. Dates 1 through 10 are all prior to September 25, 1985.

The relevant provisions of Trust are found in the Eleventh paragraph of Decedent's Will. Paragraph Eleventh provides that all the rest, residue, and remainder of Decedent's estate, whether real or personal, of every kind and description and wherever situated, in which Decedent has any right, title or interest at the time of Decedent's death is given to Bank 1, a national banking association, and Individual, or her alternate, in trust, to be held, administered, and distributed in accordance with the following provisions.

The Sixth Codicil to the Will amended Paragraph Eleventh by inserting a new paragraph, Paragraph A, and adding a number of subparagraphs under Paragraph A. Paragraph Eleventh A, Subparagraph 1, as revised, instructs the trustees to divide the trust estate, without requiring the physical segregation of the assets, except as where

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specifically provided, as follows: Sub-paragraph A.1.(a) provides that one-third of the assets shall be set aside and held as a separate trust designated as a charitable trust for the benefit of certain charitable organizations. Sub-paragraph A.1.(b) provides that the remaining two-thirds thereof shall be set aside and held as a separate trust designated as the Trust for the benefit of each of Decedent's grandnieces and grandnephew, Beneficiary 1, Beneficiary 2, and Beneficiary 3.

Sub-paragraph A.3 of paragraph Eleventh, as revised, provides that the net income from the Trust shall be paid and distributed as follows: Sub-paragraph A.3.(a) provides for a payment of \$1,000 per month to Nephew until his death or until termination of Trust, whichever first occurs. Sub-paragraph A.3.(b) provides for a payment of \$1,000 per month to Individual until her death or until termination of Trust, whichever first occurs.

Sub-paragraph A.3.(c) provides that the remainder of the net income shall be distributed as follows: (1) Until each of Decedent's grandnieces and grandnephew referred to above reaches the age of 21 years, the trustees shall pay to or apply for the benefit of each of Decedent's grandnieces and grandnephew, after deducting therefrom the pro rata share attributable to the annual payments required for the repayment of the indebtedness that may be created pursuant to Paragraph Tenth, the amount of income as the trustees, in their absolute discretion, from time to time determine is necessary or proper for the child's care, support, maintenance and education (including college or professional education), illness or extreme emergency. Any income not so paid shall be accumulated and added to principal. (2) When a grandniece or grandnephew attains the age of 21 years, the trustees shall pay to or for the benefit of the grandniece or grandnephew and to or for the benefit of the issue of the grandniece or grandnephew until termination of the trust, after deducting therefrom the pro rata share attributable to the annual payments required for the repayment of the indebtedness that may be created pursuant to Paragraph Tenth, the amount of the net income as the trustees in their absolute discretion from time to time determine is necessary or proper for the education (including college or professional education), illness or extreme emergency of the grandniece or grandnephew and the issue of the grandniece or grandnephew. Any income not so paid shall be accumulated and added to principal.

Sub-paragraph A.4 provides that Trust shall terminate upon the date the youngest grandniece or grandnephew living at the date of Decedent's death reaches the age of 55 years; or should the youngest die prior to attaining 55 years of age, then upon the date the next youngest reaches the age of 55 years, unless sooner terminated.

Sub-paragraph A.5 provides that, in the event of the death of any of Decedent's grandnieces and grandnephews who are beneficiaries prior to the termination of this trust, the share of the deceased shall be distributed to the then living lawful issue of the deceased beneficiary by right of representation. If there are no lawful living issue of the

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deceased beneficiary, the share shall be proportionately divided between and added to and distributed to the trust for the surviving grandnieces and grandnephews.

Sub-paragraph A.6 provides that, upon termination of trusts, all of the assets set aside for the benefit of Decedent's grandnephews and grandnieces shall be distributed to them or if any be deceased to his issue by right of representation; provided, however, that with reference to the shares of stock in Corporation, should any beneficiary desire to sell his or her share upon distribution, the same shall be sold or offered for sale to the remaining distributees at the fair market value thereof as determined by the trustees, it being Decedent's specific direction that all of Decedent's shares of stock in Corporation remain with members of Decedent's family and shall not be sold to any third party.

Sub-paragraph A.7 provides that, unless terminated at an earlier date under the foregoing provisions, all trusts shall terminate at the expiration of twenty-one years after the death of the last to die of the beneficiaries in being at the time of Decedent's death. In case of termination, the trust estate shall be distributed as provided above.

Sub-paragraph A.8 provides that, if the payments to any beneficiary of the Trust shall be insufficient, in the discretion of the trustees, to provide for the education, illness or extreme emergency of the beneficiary, the trustees may pay to the beneficiary or apply for his or her benefit a limited sum as they may deem proper or necessary for that purpose. Decedent requests that the trustees exercise the discretion granted only in the event of dire need, on a temporary basis, and only in the event the payment can be made without injury to or sale of the business assets and real property in the trust estate.

Beneficiary 1 was born on Date 11. Beneficiary 2 was born on Date 12. Beneficiary 3 was born on Date 13. Decedent was born on Date 14. Individual is no longer living.

Trustee plans to petition Court to modify Trust to clarify certain ambiguities in the trust instrument.

Sub-paragraph A.3.(c)2, as modified, will provide that after each of Decedent's grandnieces and grandnephews referred to above reaches the age of twenty-one years, the trustees shall pay to or apply for the benefit of the grandnieces and grandnephew until termination of the trust the amount of the net income as the trustee, in its absolute discretion from time to time determines is necessary or proper for the care, support, maintenance, education (including college or professional education), illness or extreme emergency of the grandnieces or grandnephew without the trustee considering any other income or resources of the beneficiary. Trustee shall also pay for the benefit of the issue of such grandnieces and grandnephew until termination of the trust such amount of the net income as Trustee in its absolute discretion from time to time

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determines as necessary or proper for the education (including college or professional education), illness or extreme emergency of such issue. Any income not so paid shall be accumulated and added to principal.

Sub-paragraph A.4, as modified, will provide that the trusts shall terminate upon the date of the youngest grandniece or grandnephew, living at the date of Decedent's death, reaches the age of 55 years; or should the youngest die prior to attaining 55 years of age, then upon the date the next youngest reaches the age of 55 years, unless sooner terminated. If prior to termination of this trust and in the absence of any judicial determination of incompetency the trustee has reason to believe that any beneficiary is or may be incompetent or unable to manage his or her affairs, the trustee shall be guided by the following provisions. In initiating its investigation that a beneficiary is incompetent or has been restored to capacity, the trustee is authorized and directed to consult with the beneficiary's parents, siblings, adult children, and any treating physician. Further, the trustee shall at the expense of the trust engage the services of other doctors, including specialists, lawyers, investigators or others as will secure all pertinent information to assist the trustee in its investigation. All reports and recommendations of the experts shall be made in signed writings to the trustee. Upon written request, the trustee shall make copies of all reports available to the family members. During any period while a grandniece or grandnephew is incompetent and therefore unable to receive distribution of income of the trust estate, the trustee shall pay or apply the net income of the trust as provided in sub-paragraph 3.c.2. A beneficiary determined by the trustee to be incompetent shall be reevaluated by a similar investigation as often as medically appropriate but at least annually. If, however, net income is not sufficient to satisfy the needs of the incompetent beneficiary, the trustee, in its discretion, may pay or apply principal for the benefit of the incompetent grandniece or grandnephew, up to the whole thereof, in accordance with the provisions of sub-paragraph 8.

Sub-paragraph A.5, as modified, will provide that, in the event of the death of any of Decedent's grandnieces and grandnephews who are beneficiaries prior to the termination of this trust, the share of the deceased shall be distributed to the then living lawful issue of the deceased beneficiary by right of representation. If there are no lawful living issue of the deceased beneficiary, the share shall be proportionately divided between and added to and distributed to the trust for the surviving grandnieces and grandnephews. If prior to the termination of the trust, the provisions of paragraph 5 would require the trustee to distribute to any such issue his or her legally vested share prior to the date the issue attains the age of majority, then the trustee shall defer distribution until termination of the trust estate or when such issue attains that age, whichever first occurs, whereupon the trustee shall promptly distribute to such issue or his or her guardian the remaining share of his or her trust; or, that if an issue under the age of majority dies prior to either of such events occurring, then the trustee shall promptly distribute the deferred share of the trust estate to such issue's estate in accordance with the applicable laws of his or her domicile as of the date of his or her

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death. During the continuance of any such trust for the benefit of an issue under the age of majority, net income shall be disbursed pursuant to the provisions of sub-paragraph A.3.(c)2 and principal shall be invaded pursuant to paragraph 8.

Sub-paragraph A.6, as modified, will provide, in relevant part, that upon termination of the trust all of the assets set aside for the benefit of my grandnephews and grandnieces shall be distributed to them in equal shares or if any be deceased, to his issue by right of representation.

A definition of the term "education" will be added in the modification of Trust providing that the term, as used anywhere in the Trust agreement, shall be construed to include, but not be limited to, occupational or professional training, college and postgraduate study, as long as pursued to advantage by any beneficiary at an institution of his or her choice; and in determining any payment to be made for education, the trustee shall take into consideration the beneficiary's related living and incidental expenses to the extent that they are reasonable.

The Trust instrument will be generally modified to eliminate all reference to indebtedness with the representation that the debts had been paid. The Trust instrument will also be generally modified to eliminate references to shares of Corporation stock that Trust no longer owns.

Sub-paragraph 6 will be modified by correctly naming the charities that are contingent remaindermen to Trust. The relevant provision, as modified, will provide that if upon termination of the trust there are then no living issue of Nephew, or of my grandnieces and grandnephews who are beneficiaries of the trust, the trust property and undisbursed income shall be distributed one-half to Charity 1 and one-half to Charity 2.

Sub-paragraph 8, as modified, will provide that, if the income payments to a grandniece or grandnephew is insufficient, in the discretion of the trustee, to provide for the care, support, maintenance, education (including college or occupational), illness or extreme emergency of a grandniece or grandnephew without the trustee considering any other income or resources of the grandniece or grandnephew, the trustee may pay to a grandniece or grandnephew or apply for her, his or their benefit sums from principal of the trust estate as the trustee may deem proper or necessary for these purposes. If the income payments to the issue of a grandniece or grandnephew shall be insufficient, in the discretion of the trustee, to provide for the education (including college or occupational), illness or extreme emergency of the issue, the trustee may pay to the issue or apply for her, his or their benefit sums from principal of the trust estate as the trustee may deem proper or necessary for these purposes.

The trustee represents that there have been no additions, actual or constructive, since September 25, 1985. The trustee has requested a ruling that the proposed

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modifications will not cause Trust to lose its status as exempt from the generation-skipping transfer tax.

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

Section 2611(a) defines the term “generation-skipping transfer” to include a taxable distribution, taxable termination, and a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 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 to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust.

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 rules contained in § 26.2601-1(b)(4) 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 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 § 26.2601-1(b)(4)(i)(A), (B), or (C) of this section) 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 in the original trust. Furthermore, 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 a shift in a beneficial interest in a trust.

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Section 26.2601-1(b)(4)(i)(D)(2) provides 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. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. 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 a shift in a beneficial interest in a trust.

Section 2651(a) provides that, for purposes of the generation-skipping transfer tax, the generation to which any person (other than the transferor) belongs shall be determined in accordance with the rules set forth in this section. Section 2651(b)(1) 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 the individual with the number of generations between the grandparent and the transferor.

In this case, Trust is a generation-skipping trust because it provides for distributions to more than one generation of beneficiaries below the grantor's generation. Trust was irrevocable on September 25, 1985, and there have been no additions, actual or constructive, since that date. Therefore, Trust is exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i).

The modifications requested do not shift a beneficial interest in 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 modifications. In addition, the modifications do not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Furthermore, the modifications relating to the elimination of references to Corporation and correctly naming the charities that are contingent remaindermen to Trust are administrative in nature. Therefore, the modifications are within the scope of § 26.2601-1(b)(4)(i)(D) and we conclude that the modifications, if approved by Court as presented in this letter will not affect the exempt status of Trust. Accordingly, future distributions to skip persons from Trust will not be subject to the generation-skipping transfer tax imposed by § 2601.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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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 an 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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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

Sincerely,

James F. Hogan

James F. Hogan  
Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

Copy of this letter for § 6110 purposes