

Internal Revenue Service

Department of the Treasury

Number: **200341011**
Release Date: 10/10/2003
Index Number: 2601.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09-PLR-121770-03
Date:
July 3, 2003

Legend

- Trustee =
- Decedent =
- Date 1 =
- Trust =

- Daughter 1 =
- Daughter 2 =
- Daughter 3 =
- Date 2 =
- Date 3 =
- Date 4 =
- Instruments =
- State Statute =

Dear :

This is in response to your letter dated June 27, 2003, and prior correspondence, submitted on behalf of Trustee, requesting a ruling regarding the generation-skipping transfer (GST) tax consequences of proposed modifications to a trust.

The information submitted and representations made are summarized as follows. Decedent died testate on Date 1, a date prior to September 25, 1985. Decedent's will bequeathed the remainder of his estate to Trust. Pursuant to Decedent's will, Trust will terminate twenty-one (21) years after the death of both

PLR-121770-03

Daughter 1 and Daughter 2. Trustee represents that there have been no actual or constructive additions to Trust after September 25, 1985.

Paragraph II of Decedent's will authorizes the surviving original trustees to appoint a successor trustee in the event of the death of an original trustee. Any appointed trustee has the power to appoint additional trustees as vacancies may occur because of the death or resignation of existing trustees. Such appointments, however, may at no time cause the number of trustees to exceed three.

Paragraph III provides for monthly sums to be paid to Decedent's sisters and niece for their lifetime. Subject to these payments, Paragraph IV provides the trust estate be used for benefit of Daughter 1, Daughter 2, Daughter 3, or the descendants of any deceased child of Decedent, share and share alike. Until Decedent's children reach the age of twenty-one years, the trustee, in his discretion, is to pay such amounts necessary for the proper support, maintenance, and education of the children. When a child reaches the age of twenty-one years, the trustee is to pay to the child, all the net income from that child's share of the trust estate. At the age of twenty-five, in addition to the income, the child is to receive a specified amount from the principal of the trust estate. If a child of Decedent dies prior to the termination of Trust without leaving any descendants, that child's portion of the trust estate is to be divided among Decedent's other living children, or descendants of such children, share and share alike. Upon termination of Trust, the trust estate is to be distributed to each of Decedent's children then living, or the descendants of any deceased child, share and share alike.

Pursuant to Paragraph IV (1), the trustee is to sell all of Decedent's real estate, except the homestead, and invest the proceeds in specified bonds. Paragraph IV (2) and (3) require the proceeds from the liquidation or sale of any stock and any dividends and interest received by Trust to be invested in bonds. Paragraph IV (4) requires that within 20 years after Decedent's death, all funds coming into Trust and all sale proceeds must be invested in bonds.

Daughter 1 died on Date 2 and Daughter 2 died on Date 3. Accordingly, on Date 4, which is twenty-one (21) years following the death of the last to die of Daughter 1 or Daughter 2, Trust will terminate, and the assets of Trust will be distributed to Decedent's then living descendants, per stirpes.

The last surviving original trustee failed to name a successor trustee under Paragraph II. As a result, each subsequent appointment of a successor trustee has required a court proceeding and unanimous consent of all income beneficiaries. Trustee would like to modify Trust to permit the current income beneficiaries, by unanimous consent, to remove and replace a trustee with another corporate trustee who is not related or subordinate to any beneficiary within the meaning of § 672(c). The modification would avoid the expense and time consuming nature of litigation when the appointment of a successor trustee is necessary.

PLR-121770-03

Trustee asserts that it was Decedent's intent that Trust's purposes were to provide an adequate annual income to Decedent's daughters and their descendants and to distribute principal to the descendants upon Trust's termination. However, due to the decline in interest rates over the last few years, these purposes have not effectively been fulfilled. Consequently, Trustee determined that Trust should be expanded to allow for investments in Instruments, in addition to certain bonds. Because Paragraph IV (1) through (4) limits Trustee's ability to invest in anything other than certain bonds, Trustee would like to modify Trust to expand each part of Paragraph IV (1) through (4) to provide in lieu of "Bonds," Trustee may invest in "Bonds and Instruments."

State Statute provides that by written consent of all named beneficiaries of a trust, the trust may be revoked, modified, or terminated upon a finding by the court having jurisdiction over the trust, that the trust's purposes, as expressed in or implied by the circumstances surrounding the trust, as a result of circumstances not foreseen to the settlor are not effectively being fulfilled or are frustrated.

Trustee requests a ruling that the proposed modifications to Trust pursuant to State Statute will not forfeit Trust's GST tax exempt status under § 2601 of the Internal Revenue Code.

LAW AND ANALYSIS:

Section 2601 imposes a tax on every generation-skipping transfer. Section 2611(a) defines the term "generation-skipping transfer" as a taxable distribution, a 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 if additions (actual or constructive) are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides, generally, that any trust in existence on September 25, 1985, will be considered an irrevocable trust unless otherwise provided in § 26.2601-1(b)(ii)(B) or (C), relating to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, the Trust is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

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

PLR-121770-03

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)) 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 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 to shift a beneficial interest in the trust.

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, Trustee seeks to modify the terms of Trust in a manner that would allow the current income beneficiaries to remove and replace a trustee without court intervention. Such a modification pertains to the administration of a trust. Trustee also proposes a modification that would allow Trustee to invest trust assets in both Investments and certain bonds. This

PLR-121770-03

modification effectuates a change in the form of investment held by Trust and is administrative in nature.

Accordingly, the proposed modifications to Trust are administrative changes and will 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. In addition, the proposed modifications do not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Provided that the state court approves the proposed agreement, the modifications will not violate § 1433(b)(2)(A) of the Tax Reform Act of 1986 and will not affect the GST exempt status of Trust.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect. 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 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.

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.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to Trustee.

Sincerely yours,

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

Enclosure:

Copy for section 6110 purpose