

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B9-PLR-150934-02
Date:
August 19, 2003

Re:

Legend

- Trustor =
- Trust =
- Date 1 =
- Date 2 =
- Son =
- X =

Dear :

This is in response to your letter dated August 15, 2002, requesting a ruling regarding the generation-skipping transfer (“GST”) tax consequences of a proposed modification of a trust.

The facts submitted and representations made are as follows: Trustor created Trust on Date 1. Trust became irrevocable as of Trustor’s death on Date 2, a date prior to September 25, 1985. Son is the sole current beneficiary of Trust.

Article 3 of Trust provides for the payment of the net income of Trust quarterly, or at more frequent intervals, to Son during his lifetime.

Article 4 provides that the trustee may pay to Son so much of the principal of Trust, up to the whole thereof, as in the trustee’s sole discretion is reasonably required for his support in his accustomed manner of living.

Article 5 provides that in addition to any other payments that Son may receive from Trust, the trustee shall pay to Son from the principal of Trust, such amounts as he may request in writing, not exceeding in any calendar year the greater of the following amounts: five thousand dollars or five percent of the value of the principal of Trust, determined as of the end of the calendar year (hereinafter "withdrawal power"). This right of withdrawal is noncumulative. Thus, if Son does not withdraw during any calendar year the full amount to which he is entitled under this provision, his withdrawal right shall lapse at the end of the calendar year.

Article 6 provides that upon the death of Son, the trustee shall distribute the trust estate to such one or more persons and on such terms and conditions, either outright or in trust, as Son shall appoint by will; provided, however, that Son shall not exercise the power of appointment for the benefit of Son, his estate, his creditors, or the creditors of his estate.

Article 7 provides that if Son fails to exercise his testamentary power of appointment, the trustee shall divide the whole trust estate, or part thereof not appointed, into as many equal shares as there are children of Son then living and children of Son then deceased represented by issue then living, so that there will be one equal share set apart for each then living child of Son and one equal share set apart for the then living issue, collectively, of each deceased child of Son.

Article 7, paragraph (a) provides that each share set apart for the issue of a deceased child of Son shall be distributed free of trust. Paragraph (b) provides that each share set apart for a living child of Son shall be held as a separate trust for the benefit of such child. The trustee shall apply so much of the net income and such portion of the principal as in the trustee's discretion is necessary for the support, education, and medical care of such child until the child attains the age of twenty-one years. Thereafter, the entire net income shall be paid to such child quarter-annually or at more frequent intervals.

Article 7, paragraph (c) provides that (i) upon such child of Son attaining the age of twenty-five years, one fourth of such share shall be distributed to such child; (ii) upon such child of Son attaining the age of thirty years, one-third of the remainder shall be distributed to such child; (iii) upon such child of Son attaining the age of thirty-five years, one-half of the remainder shall be distributed to such child; and (iv) upon such child of Son attaining the age of forty years, the balance of the remainder shall be distributed to such child and the trust for such child shall terminate.

Article 7, paragraphs (d), (e), and (f) provide that the trustee shall distribute, free of trust, the trust fund of a child of Son who has attained any of such respective ages at the time when such trust fund is directed to be set apart. If any surviving child of Son dies during the term of his or her trust, the property shall be distributed to such child's

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issue by right of representation. Any property not otherwise disposed of shall pass to the heirs of Son.

It has been represented that no additions, actual or constructive, have been made to Trust.

The trustee has proposed to file a petition with the court having jurisdiction over Trust requesting that the court direct modification of Trust to limit the time during which Son may exercise his withdrawal power each year to the month of X.

The trustee of Trust requests a ruling that the modification of Trust to limit the sole beneficiary's withdrawal power to the month of X each year and the administration of Trust pursuant to that modification will not cause Trust to lose its status as a trust that is exempt from the GST tax, and that distributions from Trust, as modified, will not be subject to the GST tax.

Section 2041(a)(2) of the Internal Revenue Code provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) provides that the term "general power of appointment" means a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

Under § 2041(b)(2), the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power, during any calendar year, to the extent that the property, which could have been appointed by exercise of such lapsed power, exceeds in value the greater of (1) \$ 5,000, or (2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied.

Section 20.2041-3(d)(3) of the Estate Tax Regulations provides that the failure to exercise a power of appointment created after October 21, 1942, within a specified time, so that the power lapses, constitutes a release of the power. However, such a lapse during any calendar year is treated as a release only to the extent that the property which could have been appointed by exercise of such lapsed power exceeds in value the greater of (1) \$ 5,000, or (2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied.

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Under § 2514(b), the exercise or release of a general power of appointment created after October 21, 1942, is deemed the transfer of property by the individual possessing such power.

Section 2514(c) defines a "general power of appointment" as a power which is exercisable in favor of the individual possessing the power ("the possessor"), his estate, his creditors, or creditors of his estate.

Under § 25.2514-3(c)(4), the failure to exercise a general power of appointment created after October 21, 1942, within a specified time so that the power lapses, constitutes a release of the power. However, under § 2514(e), a lapse during any calendar year is considered as a release for gift tax purposes only to the extent that the property which could have been appointed exceeds the greater of (1) \$ 5,000, or (2) 5 percent of the aggregate value, at the time of the lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied.

Section 2601 imposes a tax on each generation-skipping transfer made by a transfer to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, 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 tax does not apply to a transfer from a trust if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), 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 or § 2042, if the settlor had died on September 25, 1985.

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. 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) provides that a modification 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. A modification of an exempt trust will result in a shift in beneficial interest to a lower

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generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. To determine whether a particular amendment to a trust shifts 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.

After the proposed modification, Son will continue to have a noncumulative power to withdraw the greater of five thousand dollars or five percent of Trust. However, Son's right of withdrawal will be limited to the month of X. The proposed modification of Trust will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification. Further, the modification of Trust will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. Under these circumstances, based on the facts submitted and the representations made, we conclude that the proposed modification will not cause Trust to lose its exempt status for GST tax purposes and that distributions from Trust, as modified, will not be subject to the GST tax.

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. While this office has not verified any of the material submitted in support of the request for ruling, 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(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

James F. Hogan
Acting Branch Chief, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy for section 6110 purposes