

Internal Revenue Service

Department of the Treasury
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Person To Contact:

Telephone Number:

Refer Reply To:

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Date:

May 26, 2004

DO:

TIN:

Legend:

Mother =

Trustee =

Son =

Grandson =

Guardian =

Trust =

State =

x =

y =

z =

Date 1 =

Date 2 =

Date 3 =

State Statute =

Probate Court =

Dear :

This is in response to your correspondence dated November 11, 2003, requesting a ruling concerning the generation-skipping transfer tax consequences of the proposed extension of Trust pursuant to section 2601 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: Mother created a testamentary trust for the benefit of her son, Son. Mother died on Date 1.

Article V of Mother's will provides that after payment and distribution of certain specific bequests, Mother bequeaths one-half of the remainder of Mother's estate to Son, however, any mineral interests which Mother may own and which are devised to Son are devised and bequeathed to Trustee, for the benefit of Son, to be held and administered by Trustee as provided.

Article V(A) provides that Trustee is to pay all taxes and incidental expenses of the trust, and the Trustee is authorized and empowered, in its sole and absolute discretion at any time, and from time to time, to distribute from the principal and corpus of Trust (even to the point of completely exhausting the same), to Son, such amounts as Trustee may deem advisable to provide adequately and properly for any living or emergency expense of the beneficiary, but not by way of limitation, expenses incurred by reason of illness or disability.

Article V(B) provides that the Trustee is to have the power to hold, possess, manage and control all of the trust estate, and each part thereof, with full power to sell, transfer, convey and dispose of the same, upon such terms and in such manner, and for such prices as the Trustee deems right and proper.

The Trustee is given full power and authority to borrow money in the name of Trust as it deems advisable for any purpose, to invest and reinvest all or any part of Trust property which may come into its hands, in such manner and in such securities or other property, personal or real, and upon such terms, and for such length of time, as Trustee deems right and proper; it being intended to give Trustee full and complete authority to hold, possess, manage, control, encumber, lease, invest and reinvest the whole and every part of Trust according to its sole judgment and discretion, without any limitation upon its power and authority to do so.

Article V(C) provides that the Trustee, or its successors or assigns, is to have all of the powers, rights, duties and responsibilities granted to or imposed upon trustees by the State Trust Act and any amendments thereof.

Article V(D) provides that Trust is to continue for and during the lifetime of Son. Upon the death of Son, then the trust properties and estate is to be held and administered by Trustee in trust, and Trust is to be continued for the benefit of Grandson, until such time as Grandson reaches the age of z , at which time the remaining trust corpus and estate is to be distributed to Grandson and Trust is to terminate.

Son died on Date 2. Grandson has been the beneficiary of Trust since Date 2. Grandson is now x years old. Grandson has been mentally incompetent since Date 3 (after Date 2). Since Grandson is unable to care for himself, a guardian has been appointed to care for him. It is represented that Grandson's disability has caused him to spend time in mental hospitals and otherwise to incur substantial debt.

Grandson will reach the age of z in a few years. It is represented that Grandson's inability to care for himself, his finances and a potential inheritance are unforeseen circumstances, that frustrates the purpose of Trust. If Mother had known of the unforeseen mental incapacity of Grandson she would have made a different disposition of the Trust property. For this reason Mother requests that the term of Trust be extended to provide for Grandson for the rest of his life or until his disability is removed, whichever occurs first. The Trust will terminate into Grandson's estate if he never regains legal competence. Such modification is allowed under State Statute.

State Statute provides that on the petition of a trustee or a beneficiary, a court may order that the trustee be changed, that the terms of the trust be modified, and that the trustee be directed or permitted to do acts that are not authorized or that are forbidden by the terms of the trust, that the trustee be prohibited from performing acts required by the terms of the trust, or that the trust be terminated in whole or in part, if: because of circumstances not known to or anticipated by the settlor, compliance with the terms of the trust would defeat or substantially impair the accomplishment of the purposes of the trust.

The Trustee intends to petition the Probate Court for a modification of Trust pursuant to State Statute. Wils v. Robinson, 934 S.W. 2d 774 (Tex. App. Houston 14th Dist. 1996); Gregory v. MBank Corpus Christi, 716 S.W. 2d 662 (Tex. App. Corpus Christi 1986). Guardian has executed and filed a waiver of citation in the proceeding.

The taxpayer requests a ruling that a judicial amendment of Trust to extend the term of the Trust for the lifetime of Grandson or until he regains legal capacity, whichever occurs first, will not cause Trust to lose its exempt status for generation-skipping transfer tax purposes.

LAW AND ANALYSIS

Section 2001 of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of his or her death.

Section 2601 imposes a tax on every generation-skipping transfer (GST), which is defined under section 2611 as a taxable distribution, a taxable termination, or a direct skip.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act), 1986-3 (Vol. 1) C.B. 1, and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, provide that 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 was 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)(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 under section 26.2601-1(b)(1), (b)(2), or (b)(3), will not cause the trust to lose its exempt status. The rules of section 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 section 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust 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 section 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 a beneficial interest to a lower 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.

In the present case, the proposed modification of Trust provides that Grandson's interest in Trust will continue to be held in Trust for the exclusive benefit of Grandson during his lifetime. Upon Grandson's death, Trust will terminate into and will be

includible in Grandson's gross estate for federal estate tax purposes under section 2033.

Under these circumstances and based on the facts presented and the representations made, we conclude that proposed modification complies with the provisions of section 26.2601-1(b)(4)(i)(D)(1) and will not cause Trust to be subject to the tax on generation-skipping transfers under chapter 13.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

A copy of this letter should be attached to any gift, estate, or GST tax returns that you may file relating to this matter.

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 the appropriate party. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

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,

Lorraine E. Gardner
Senior Counsel
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy of letter for section 6110 purposes

cc: