

**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-133666-01**

Date:

**November 28, 2001**

Re:

LEGEND:

Settlor =

Spouse =

Trust =

Amended Trust =

Local Court =

Child A =

Child B =

Child C =

Child D =

Child E =

Child A Family Share =

Child B Family Share =

Child C Family Share =

Child D Family Share =

Child E Family Share =

Co-trustee 1 =

Co-trustee 2 =

Co-trustee 3 =

Date 1 =

Date 2 =

Dear :

This is in response to the August 21, 2001 letter and other correspondence requesting a ruling on the generation-skipping transfer tax consequences of the judicial amendment of Amended Trust.

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### Trust

Settlor irrevocably created Trust on Date 1. Under Item IV, Paragraph (a) of the Trust instrument, the trustee is to use income and principal as necessary to provide for the health, support, education and maintenance of Settlor's children and their descendants. Under Item IV, Paragraph (b), Trust will terminate on the fifth anniversary of the death of the survivor of Settlor and Spouse. At that time, Trust will be divided into separate and equal shares, one share for each of Settlor's then living children and deceased children with descendants then living. The share created for a deceased child's descendants will be distributed outright to them.

Under Item IV, Paragraph (c), the share of a living child is to continue in trust. The trustee is to distribute income and principal of a child's share in such amounts as the trustee deems necessary in the trustee's discretion to provide for the support, health and maintenance of the child. Under Item IV, Paragraphs (d) and (e), each child is to have a power, exercisable during life or at death, to direct that any part of that child's share be distributed to his or her descendants, siblings, or nieces and nephews, in trust or otherwise, except that the child is to have no power to appoint any of the property to himself or herself, the child's estate, the child's creditors, or the creditors of the child's estate. On the child's death, the property remaining in the child's share, as to which the child has not exercised the power, will be distributed per stirpes among the child's descendants then living or, if none, among the shares of Settlor's other children or their descendants.

Under Item V, the trustee is not required to distribute income or principal if the trustee concludes that it would financially impair or destroy the value of any assets of the trust. Under Item VIII, Child A, Child B, Child C, Co-trustee 1, and Co-trustee 2 were designated as the co-trustees of Trust. Child D and Child E were to also act as co-trustees upon reaching age 18.

### Amended Trust

The trustees petitioned Local Court to amend Trust. On Date 2, Trust was amended by a judicial order pursuant to which the Trust property was divided into five equal Family Shares. The Child A Family Share was created for the benefit of Child A and his family. The Child B Family Share was created for the benefit of Child B and his family. The Child C Family Share was created for the benefit of Child C and his family. The Child D Family Share was created for the benefit of Child D and his family. The Child E Family Share was created for the benefit of Child E and her family. The amended trust ("Amended Trust") governs each of the Family Shares and includes all of the original Trust provisions except for the following changes.

Under Item IV, Paragraph (b) of Amended Trust, the property in Trust is divided into as many separate and equal shares as Settlor has children then living and deceased children with descendants. Any share created for a living child or for a deceased child's descendants will be that child's "Family Share." The "primary

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beneficiary” of a respective Family Share is the child for whom the share was created or, in the case of a deceased child, the child’s descendants.

Under Item IV, Paragraph (b.5), until the fifth anniversary of Spouse’s death, the First Co-trustee and Independent Co-trustee of a Family Share are to distribute income and principal as the Independent Co-trustee deems necessary for the health, support, education, and maintenance of any descendant of Settlor. However, all of the Family Shares are to share equally in any such distributions. Under Item IV(c), on the fifth anniversary of Spouse’s death, the Family Share created for the descendants of a Settlor’s child who was deceased on Date 2 will be distributed per stirpes among the deceased child’s descendants then living. Also, on the fifth anniversary of Spouse’s death, the co-trustees are to hold the Family Share of each child then living and distribute income and principal of each child’s Family Share in such amounts as the Independent Co-trustee deems necessary to provide for the support, health, and maintenance of the child.

Under Item VIII, there are to be two co-trustees of each Family Share. The “First Co-Trustee” of a given Family Share is to be the child for whose primary benefit that Share is created. The First Co-Trustee may exercise all trustee powers except to direct distributions to the beneficiaries. The “Independent Co-trustee” of a given Family Share is to be the second co-trustee. Co-Trustee 2 is designated as the Independent Co-trustee. Subsequent to Date 2, Co-trustee 2 died. Co-trustee 3 was designated as Independent Co-trustee of each Family Share. Settlor has died.

There have been no additions to Trust, constructive or otherwise, after September 25, 1985.

#### Proposed modification

The co-trustees propose to ask Local Court to modify Item IV, Paragraph (b.5) of Amended Trust to provide that, prior to the fifth anniversary of Spouse’s death, distributions from the Family Share created for a child of Settlor and the child’s descendants will be made only to them. In contrast to the current provision of Amended Trust requiring all the Family Shares to contribute equally to any distribution, the modification will limit distributions from a particular Family Share to the respective child for whom the share is held and that child’s descendants.

#### Requested Ruling

You have asked us to rule that the proposed modification of Amended Trust will not cause the Child A Family Share to lose its exempt status for purposes of the generation-skipping transfer tax.

#### Discussion:

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a

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taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), the generation-skipping transfer (GST) tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable 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 under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains 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 GST tax 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 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.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from the GST tax authorizes the trustee to distribute income and principal, at the trustee's discretion, for the benefit of A and B and their respective issue. On the death of the last to die of A and B, the corpus is to be distributed to the issue of A and B per stirpes. Pursuant to a court order, the trust is divided equally into two trusts, one for the benefit of A and A's issue, and one for the benefit of B and B's issue. The example concludes that, under the facts presented, the division of the trust into two trusts does not shift any 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 division, and the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Accordingly, the two partitioned trusts will not be subject to the provisions of chapter 13.

In this case, under the proposed modification, the division of Amended Trust into separate Family Shares will apply for distribution purposes so that, until the fifth anniversary of Spouse's death, distributions from a particular Family Share are to be made only to the child for whom the share is held and that child's descendants. The

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modification will not result in a shift of any beneficial interest in Amended Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the division. Further, the proposed modification will not extend the time for vesting of any beneficial interest in Amended Trust beyond the period provided for in the original Trust.

Accordingly, based on the facts submitted and the representations made, after the modification of Amended Trust, the Child A Family Share will be treated as a trust that was irrevocable on September 25, 1985, for purposes of § 1433(b)(2)(A) of the Tax Reform Act of 1986, and will be exempt from the generation-skipping transfer tax imposed under § 2601.

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 ruling, 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 yours,  
Lorraine E. Gardner  
Acting Senior Technician Reviewer, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure  
copy for § 6110 purposes