

Internal Revenue Service

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November 04, 2011

Legend

- Settlor =
- Trust =
- Trust 1 =

- Trust 2 =

- Trust 3 =

- Child 1 =
- Child 2 =
- Child 3 =
- Company =
- Corporation =
- Date 1 =
- Spouse/Trustee =
- State 1 =
- State 2 =
- State 3 =
- Court =

- Foundation =
- Individual 1 =
- Individual 2 =
- Individual 3 =
- Individual 4 =

Dear _____ :

This letter responds to the April 29, 2011 letter and subsequent correspondence from your authorized representative, requesting gift and generation-skipping transfer (GST) tax rulings with respect to the proposed modifications and restatement of Trust.

The facts and representations submitted are summarized as follows:

On Date 1, a date after September 25, 1985, Settlor established Trust, an irrevocable trust, to benefit his three children, Child 1, Child 2, and Child 3, and their issue. Trust directed the trustee to establish three separate and equal trusts: Trust 1 to benefit Child 1 and Child 1's issue, Trust 2 to benefit Child 2 and Child 2's issue, and Trust 3 to benefit Child 3 and Child 3's issue. The trustee is Settlor's spouse, Spouse (also referred to herein as Trustee). This letter ruling pertains to Trust 1.

When Trust was created, Settlor and Spouse resided in State 1. Currently, Settlor and Spouse reside in State 3. The corpus of Trust consists entirely of intangible investment assets. It is represented that Settlor allocated sufficient GST exemption to Trust to cause Trust and the trusts created thereunder to have an inclusion ratio of zero. Currently, Trust 1 is administered under the laws of State 1.

Trustee proposes to petition Court for a Court order to change the situs of Trust 1 to State 3 and to modify Trust as follows.

Trust will be modified to change the reference to "beneficiary" to "primary beneficiary" and to change the reference to State 1 to State 3 throughout Trust.

Article III contains the distribution and termination provisions. Article III provides that, if there are no surviving descendants of Settlor, the trust estate will pass to Settlor's heirs at law under State 2 law. The parties represent that "State 2" is a scrivener's error. This article will be modified to replace "State 2" with the following: "under the laws of the state in which Settlor is domiciled immediately prior to the date of the distribution or his death, whichever is earlier." Article III also provides that Trust and trusts created thereunder will terminate not later than one day less than twenty-one (21) years after the death of the last survivor of Settlor and Settlor's issue who are living on the date of execution of Trust. This provision will be modified by inserting Date 1 in place of "on the date of execution."

Article IV contains the trustee administration provisions. Article IV.A. describes the trustee's powers and duties. Paragraph (1) gives the trustee the power to retain property transferred to the trust, including stock in Company, without liability. This provision will be modified to insert "Corporation" for "Company."

The last sentence of Article IV.A. provides that: “Notwithstanding anything herein to the contrary, any power granted to any Trustee hereunder shall be limited to the extent necessary to cause such power not to constitute a general power of appointment under § 2041 of the Code.” The proposed modification adds the following:

or to cause any trust created hereunder to be treated as a “grantor trust” with respect to Settlor under the provisions of Subchapter J of the Code. In addition, Trustees shall have no liability with respect to any investment in or purchase or sale of interests in any corporation, partnership, general or limited, limited liability company or other entity that is controlled, directly or indirectly, by a group consisting of Settlor, Spouse and/or one or more of Settlor’s descendants so long as the price is the fair market value of the stock, partnership interest, membership interest or other securities (the “family securities”) being acquired or sold, determined on the basis of either (i) a qualified independent appraisal or (ii) a written agreement between the trust and the purchaser or seller, as applicable, that provides for adjustment of an agreed purchase price or quantity of family securities based upon a final agreement with the Internal Revenue Service or a final and non-appealable determination of value by a court of appropriate jurisdiction, nor shall they have any duty to sell, for reasons of diversification or otherwise, the family securities.

Article IV.B. refers to “any applicable uniform gift to minors act.” The proposed modification inserts the words “or transfer” after the word “gift.”

Article IV.C. sets forth what considerations a trustee should consider in exercising his or her discretion in making discretionary distributions to any beneficiary. The proposed modification removes a sentence that relieved the trustee from the requirement to seek out any beneficiary for purposes of determining the circumstances of such beneficiary.

Article IV.D. requires the trustee to provide statements to the beneficiaries regarding the trust accounts. The proposed modification eliminates this requirement.

The proposed modifications will add a new paragraph (E) to Article IV. This paragraph allows the trustees to divide a trust at any time there is more than one primary beneficiary of any trust. The trustees are also authorized to divide a trust at any time when the GST exemption is allocated to a portion, but less than all, of the trust in order to create two separate trusts, with one resulting trust having an inclusion ratio of zero and the other resulting trust having an inclusion ratio of one.

The proposed modifications will add a new Article V which, to the extent Trust or trusts created thereunder hold shares of an S Corporation governed by § 1361 et seq. of the Code, gives the trustees authority to make an election under § 1361(e)(3) to be

treated as an “Electing Small Business Trust” and in the absence of such election, to administer the trust as a Qualified Subchapter S Trust.

Article V will be renamed Article VI. This article prohibits a beneficiary from selling, transferring, or alienating any interest in Trust. The proposed modification will expressly provide that each trust created under Trust is a spendthrift trust.

Article VII contains the successor trustee provisions. Paragraph B provides that when Spouse ceases to be a trustee, then Individual 1 and Individual 2 will serve as co-trustees. If Individual 1 fails or declines to serve, then Individual 3 shall serve as a successor co-trustee. If Individual 2 fails or declines to serve, then Individual 4 shall serve as a successor co-trustee.

Paragraph C provides that at such time when Spouse ceases to serve as a trustee, then the beneficiary shall, upon attaining the age of twenty-five (25) years, become a co-trustee. Upon attaining the age of thirty (30) years, such beneficiary shall serve in place of every co-trustee who is not an Independent Trustee. In addition, at such time as Spouse is no longer serving as a trustee, any beneficiary who is over the age of thirty (30) may remove or appoint any trustee or co-trustee, including such beneficiary, provided, following such removal and appointment, at least one-half of all trustees are Independent Trustees.

Paragraph D provides that the individual trustee or co-trustees may appoint any corporate trustee to serve with or in place of said individual trustee, and may remove any corporate trustee with or without appointment of a successor corporate trustee. Any corporate trustee may resign at any time upon the appointment of a successor corporate trustee. If any removal is by a non-Independent Trustee, or if a successor trustee is not an Independent Trustee, then the remaining trustees shall appoint such number of Independent Trustees as necessary to cause at least one-half of all trustees at all times to be Independent Trustees.

Paragraph G provides that if the office of trustee becomes vacant, and is not filled under paragraphs B through F of Article VII, then the majority of competent adult beneficiaries may act as trustees, or any one of the beneficiaries may act as trustee.

Paragraph I defines “Independent Trustee” to mean a trustee who is not “a related and subordinate party” within the meaning of § 672(c) of the Code, and who is not Settlor’s spouse, or anyone occupying the following named relations to Settlor: father, mother, descendant, brother or sister; an employee of Settlor; a corporation or any employee of a corporation in which the stock-holdings of Settlor and the trust are significant from the standpoint of voting control; or a subordinate employee of a corporation in which Settlor is an executive. Following the death of Settlor, or at any other time when a determination is being made as to whether a trustee is an “Independent Trustee” with respect to one or more of the then beneficiaries of a trust,

such determination shall be made by treating the beneficiary as if the beneficiary were Settlor of the affected trust.

On Date 2, Individuals 1, 2, 3, and 4 each irrevocably and absolutely disclaimed his right to serve, at any time, as successor trustee of Trust 1. Article VII will be renamed Article VIII and will be modified to reflect these renunciations and provide for alternative successor trustees as follows:

Paragraph B provides that Trustee is given the right during her lifetime to remove or appoint any trustee, including a corporate trustee; provided that Trustee may only remove a trustee if at least one-half of the remaining trustees are Independent Trustees and she may only appoint a trustee who is an Independent Trustee.

Paragraph C provides that Settlor may never serve as a trustee. During Settlor's life, Settlor has the power to remove and replace any trustee with a person who is an Independent Trustee.

Paragraph D provides that after the death or incapacities of Settlor and Spouse, or at such time as Trustee ceases to serve as a trustee, and no successor trustee appointed by Settlor or Trustee is serving, all of Settlor's children who are then living shall automatically become co-trustees of each such trust. The trustee who is the child of Settlor for whom the trust is named and identified (the "named child"), together with any trustees appointed by the named child or who succeed to the named child's position as trustee, shall collectively have two votes with respect to all matters to be decided by the trustees of such trust, and each of the other two children of Settlor shall have, in his or her capacity as a trustee, one vote. Should one of Settlor's children, other than the named child, not be living, fail to qualify or for any other reason cease to serve as a trustee of such trust, the total number of votes cast by all trustees shall be reduced to two, with one being cast collectively by the named child and his or her appointees and successors in his, her, or their capacity as trustee(s), and the remaining vote being cast by the other child of Settlor who is serving as trustee. Upon the death, resignations, or ceasing to serve of both children of Settlor who are not the named child, the named child shall serve as sole trustee of such trust. The named child may, at any time and from time to time, name any person to serve in the named child's place as trustee or to serve as co-trustee with such named child, and/or remove any person so appointed but all such trustees so appointed by the child shall collectively share the vote or votes allotted to the trustee who is the named child, and such appointments shall not increase such vote or votes; provided, at such time as no child of Settlor who is not the named child is serving as trustee of the named child's trust, the named

child may only appoint or remove the trustees of such trust in a manner which results in at least one-half of the trustees of the trust being Independent Trustees.

Paragraph E provides that upon the death of any primary beneficiary, his or her surviving spouse shall serve as a co-trustee of any trust of which all succeeding primary beneficiaries or permissible distributees other than such surviving spouse are under the age of twenty-five years. If such surviving spouse would at any time be the sole trustee of such trust, no action shall be taken by the trust until Foundation appoints a co-trustee of such trust. Such co-trustee, together with the surviving spouse, will serve as the sole trustees, with each trustee having a single vote. At such time as any descendant of the named child attains the age of twenty-five years and is a primary beneficiary of a trust (Adult Descendent), such Adult Descendant shall automatically become a trustee of the trust in the place of the children of the Settlor who are then serving as trustees or the trustee appointed by Foundation. Such Adult Descendant may serve as the sole trustee of such trust. A majority of Adult Descendants who are then serving as the trustee(s) of the trust may appoint or remove the trustees of such trust in a manner which results in at least one-half of the trustees of the trust being Independent Trustees. A trustee appointed by Foundation shall serve as sole trustee in the absence of both the surviving spouse trustee and an Adult Descendant trustee. Any trustee appointed by Foundation must be an Independent Trustee.

Paragraph F provides that if at any time a trustee is prohibited by this instrument from acting because that trustee is not an Independent Trustee, such trustee may appoint an Independent Trustee to act in his or her place and exercise such vote as the trustee otherwise would have been able to exercise.

Article VIII contains miscellaneous provisions. Paragraph C explains under what circumstances a trustee may be held liable. This provision will be renamed Article IX and is modified to provide that a corporate trustee may, notwithstanding the duties, restrictions and liabilities otherwise imposed by State 3 law, lend funds to a corporate trustee or an affiliate of the corporate trustee, purchase assets from or sell assets to a trustee or an affiliate of the trustee, purchase and sell assets between two trusts of which the corporate trustee is the trustee, and purchase or sell share, securities, or other financial instruments of a corporate trustee or affiliate.

Paragraph F provides that the governing law of Trust is the law of State 1. This provision is modified to provide that Trust will be governed, construed, and administered according to State 3 law and expressly provides that the trustees may change the situs of Trust.

Article IX provides that Trust is irrevocable and that Settlor has no reversionary interest in Trust. This article will be renamed Article X and is modified by adding the following: “the Independent Trustees of any trust created hereunder shall have the power, exercisable in their sole discretion, to make modifications as are reasonably necessary to ensure that such trust continues to qualify as a GST Exemption Trust.”

Trustee requests the following rulings:

1. The change in situs of Trust 1 from State 1 to State 3 will not cause Trust 1 to lose its exempt status from GST tax.
2. The proposed modifications and restatement of Trust will not cause any distribution from or termination of any interests in Trust 1 and trusts created thereunder to be subject to the GST tax.
3. The proposed modifications and restatement of Trust will not cause any beneficiary of Trust 1 to have made a gift for gift tax purposes.

LAW AND ANALYSIS

Rulings 1 and 2

Section 2601 of the Internal Revenue Code imposes a tax on every GST made after October 26, 1986. A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term “taxable termination” means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that the term “taxable distribution” means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax of an interest in property to a skip person.

Section 2631(a), as in effect for applicable years of the trust, provides that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 (adjusted for inflation) which may be allocated by such

individual (or his executor) to any property with respect to which such individual is the transferor.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is defined as the excess (if any) of 1 over the applicable fraction. The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of the GST exemption allocated to the trust, and the denominator of which is the value of the property transferred to the trust or involved in the direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST 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), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). 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 GST tax under paragraph (b)(1), (2), or (3) of this section (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus (unless specifically noted), 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 gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to become subject to the provisions of chapter 13 if the judicial action involves a bona fide issue; and the construction is consistent with applicable state law that would be applied by the highest court of the state.

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 paragraph (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 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.

Section 26.2601-1(b)(4)(i)(E), Example 4 provides as follows. In 1980, Grantor, who was domiciled in State X, executed an irrevocable trust for the benefit of Grantor's issue, naming a State X bank as trustee. Under the terms of the trust, the trust is to terminate, in all events, no later than 21 years after the death of the last to die of certain designated individuals living at the time the trust was executed. The provisions of the trust do not specify that any particular state law is to govern the administration and construction of the trust. In State X, the common law rule against perpetuities applies to trusts. In 2002, a State Y bank is named as sole trustee. The effect of changing trustees is that the situs of the trust changes to State Y, and the laws of State Y govern the administration and construction of the trust. State Y law contains no rule against perpetuities. In this case, however, in view of the terms of the trust instrument, the trust will terminate at the same time before and after the change in situs. Accordingly, the change in situs 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 transfer. Furthermore, the change in situs does not extend the time for vesting of any beneficial interest in the trust beyond that provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13. If, in this example, as a result of the change in situs, State Y law governed such that the time for vesting was extended beyond the period prescribed under the terms of the original trust instrument, the trust would not retain exempt status.

Section 26.2601-1(b)(4)(i)(E), Example 10, considers the following situation. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's issue, naming

a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and 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. In addition, 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. Therefore, the trust will not be subject to the provisions of chapter 13.

No guidance has been issued concerning judicial modifications that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a modification that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of such a trust.

In this case, Trust provides that State 1 law governs the trust and all trusts created thereunder. When Settlor executed Trust, Settlor and Spouse resided in State 1. Currently, they reside in State 3. The proposed modification provides that Trust will be governed, construed, and administered according to State 3 law. The proposed change in situs and governing law will not change the termination date of any trust created under Trust. Thus, the proposed change in situs will not shift any beneficial interest in Trust 1 and will not extend the time for vesting of any beneficial interest in Trust 1. Accordingly, based upon the facts submitted and representations made, and assuming Court issues an order modifying Trust, as described above, we conclude that the change in situs of Trust 1 from State 1 to State 3 will not cause Trust 1 to lose its exempt status from GST tax.

The proposed modifications of Trust to replace the reference to State 2 to “under the laws of the state in which Settlor is domiciled immediately prior to the date of the distribution or his death, whichever is earlier “ will correct a scrivener’s error. Thus, under § 26.2601-1(b)(4)(i)(C), this modification will not shift a beneficial interest or extend the time for vesting of any beneficial interest. The other proposed modifications of Trust are administrative in nature and, under § 26.2601-1(b)(4)(i)(D)(2), will not be considered to shift a beneficial interest to a lower generation in the trust. See Example 10 of § 26.2601-1(b)(4)(i)(E). Further, as discussed above, the proposed modifications will not change the termination date of Trust 1. Accordingly, based upon the facts submitted and the representations made, and assuming Court issues an order modifying Trust, as described above, we conclude that the proposed modifications and restatement of Trust will not cause Trust 1 to be subject to the GST tax.

Ruling 3

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual.

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

In this case, the beneficiaries of Trust 1 will have the same interest after the proposed modifications that they had prior to the modifications. Because the beneficial interests of the beneficiaries are substantially the same, no transfer of property will be deemed to occur as a result of the modifications. Accordingly, based on the facts submitted and the representations made, and assuming Court issues an order modifying Trust, as described above, we conclude that the proposed modifications and restatement of Trust will not cause any beneficiary of Trust 1 to have made a gift for gift tax purposes.

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

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. The § 2601 rulings are based upon a representation that Settlor allocated sufficient GST exemption to Trust to cause Trust and the trusts created thereunder to have an inclusion ratio of zero. This office has not verified whether Trust has sufficient GST exemption to cause Trust and the trusts created thereunder to have an inclusion ratio of zero. The proposed modifications will not cause the inclusion ratio of Trust to change, whether the inclusion ratio is zero or between one and zero. However, Trust will be subject to GST tax if the inclusion ratio is not zero. Further, no opinion is expressed or implied concerning the estate tax consequences of the taxpayers requesting the rulings in this letter.

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.

The rulings in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

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

Sincerely,

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

Enclosures

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cc: