

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09-PLR-134508-01

Date:

April 22, 2002

Re:

Legend:

Decedent =

Trust =

Testamentary Trust =

Trustee 1 =

Trustee 2 =

Child 1 =

Child 2 =

Child 3 =

Child 4 =

Corporation 1 =

Corporation 2 =

Family =

Realty Company =

Foundation =

Local Court =

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Bank 1	=
Bank 2	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Year 1	=
x	=
y	=
\$a	=
\$b	=
\$c	=

Dear :

This is in response to your letter dated June 11, 2001 in which you requested rulings under § 2601 of the Internal Revenue Code.

The facts submitted and representations made are as follows: Decedent created an irrevocable inter vivos trust (Trust) on Date 1 with Trustee 1, Trustee 2, and Bank 1 as initial trustees. The assets of Trust consist of cash and marketable securities having a value of approximately \$a, plus x shares of Corporation 1.

Article Third of the Trust provides that Trust shall continue until the death of the survivor of the four children of Decedent, Child 1, Child 2, Child 3, and Child 4.

Article Fourth provides that during the continuation of Trust, the net income from the Trust estate, or the part thereof that the trustees determine to be available for distribution, shall be paid by the trustees not less frequently than annually, to Decedent's children in equal shares or to the survivors or survivor of them living at the time of the particular distribution of income, provided however, that if any child of Decedent shall predecease the termination of Trust leaving issue living during the continuation of Trust, the share of income that the deceased child would have taken had he or she continued to live shall go to the issue, per stirpes.

Article Fifth provides that Trust shall terminate on the death of the survivor of the children of Decedent, and the entire trust estate shall be distributed in equal

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shares to the then living grandchildren of Decedent, per capita, provided however, that if any grandchild of Decedent shall predecease the termination of Trust leaving issue then living, such issue shall take, per stirpes, the share that the grandchild would have taken had he or she survived the termination of Trust.

Article Sixth provides that Trust is irrevocable and not subject to amendment.

Article Seventh, Subparagraph 1 provides the trustees with the authority to hold any property at any time constituting a part of a trust estate so long as the trustees may deem it advisable to do so, including but without limiting the generality of the foregoing, the power to hold and retain, solely at the risk of the trust estate, the capital stock of Corporation 2 and Realty Company, whenever required, regardless of any failure of either or both companies to pay or distribute dividends, and regardless of any risk involved in holding either or both stocks.

Article Twelfth provides that if any part of the Trust estate is undisposed of under Articles Fourth and Fifth, the trustees shall distribute it to Foundation.

Article Thirteenth of the Trust provides that, if Bank 1 shall cease to act as a trustee, the trustees shall appoint any bank or trust company as successor to Bank 1.

On Date 4, Decedent died. Decedent's will created a trust, Testamentary Trust, that currently holds, among other assets, a small amount of shares of stock in Corporation 1 (y shares).

In Year 1, Bank 1 merged with and into Bank 2. The trustees and beneficiaries have agreed that it is in the best interest of the Trust and beneficiaries for Bank 2 to cease to serve as co-trustee of the portion of Trust that holds the Corporation 1 stock. The trustees and beneficiaries also agree that Bank 2 should continue to serve as trustee of the portion of Trust that holds the cash and marketable securities.

To facilitate Bank 2 ceasing to serve as co-trustee of the portion of Trust that holds Corporation 1 stock, trustees filed a Petition for Division and Modification with Local Court requesting the division of Trust into two trusts, Trust A and Trust B. Trust A will hold the shares of Corporation 1 currently held by Trust and other assets totaling \$b, and Trust B will hold the remaining cash and marketable securities. Trustees also requested that the court eliminate the requirement that Trust A continue to have a bank or trust company as a trustee, and that Trust A be modified to add stock in Corporation 1 to the list of assets that the trustees may hold solely at the risk of the trust.

In order to consolidate all of the Corporation 1 shares owned by the Family trusts into one trust, trustees filed a Petition for Approval of Sale of Corporation 1 Shares with Local Court, requesting that Local Court approve the sale of the shares of Corporation 1 shares held by Testamentary Trust to Trust. Trustees represent that the y shares of stock of Corporation 1 held by Testamentary Trust are worth a total of \$c.

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On Date 3, Local Court approved all of the relief requested in the Petition for Division and Modification. On Date 3, Local Court also approved all of the relief requested in the Petition for Approval of Sale of Corporation 1 Shares. Both of these orders are conditioned on favorable rulings from the Internal Revenue Service. Pursuant to the order approving the sale of Corporation 1 shares, the trusts shall be governed and administered as follows:

1. Subsequent to the sale of the y shares of Corporation 1 stock to Trust by Testamentary Trust, Trust will be divided into Trust A, which will hold the shares of Corporation 1 stock and \$b, and Trust B, which will hold the remaining assets of the Trust.

2. Trustee 2 and Bank 2 will resign as trustees of Trust A. Child 3 and Child 4 will become the trustees of Trust A and serve without bond.

3. Trustee 2 will resign as trustee of Trust B, and Bank 2, Child 3, and Child 4 will become trustees of Trust B, without bond. All of the trustee fees for administration of Trust B shall be payable to Bank 2.

4. Article Thirteenth of the Trust will be modified by deleting the requirement that Trust have a bank or trust company as a trustee.

5. Article Seventh, Paragraph 1, of the Trust will be modified by adding Corporation 1 stock to the list of assets that the trustees may hold solely at the risk of Trust.

Trustees have requested the following rulings:

1. The proposed sale of Corporation 1 stock by the Testamentary Trust to Trust will not cause either trust to lose its exempt status with respect to the GST tax.
2. The proposed division of Trust into two separate trusts, Trust A and Trust B, will not cause Trust, Trust A, or Trust B to lose their exempt status with respect to the generation-skipping transfer tax.
3. The proposed modification of Trust A to add Corporation 1 stock to the list of assets that the trustees may hold solely at the risk of the trust will not cause Trust A to lose its exempt status with respect to the GST tax.
4. The proposed modification of Trust A to eliminate the requirement that Trust A continue to have a trustee who is a bank or trust company will not cause Trust A to lose its exempt status with respect to the GST tax.
5. The proposed modification of Trust A to eliminate the requirement that Trust A continue to have a trustee that is a bank or trust company will not cause the remaining individual trustees or beneficiaries of Trust A to be deemed to possess a general power of appointment under § 2514 or § 2041.

Section 2601 imposes a tax on each generation-skipping transfer made by a

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transferor to a skip person.

Under Section 1433(a) of the Tax Reform Act of 1986, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986.

Section 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping transfer (GST) tax shall not apply to any generation-skipping transfer from 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 will not cause a trust that was irrevocable on September 25, 1985, to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification will not cause a trust that was irrevocable on September 25, 1985, 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 generation beneficiary if the modification can result in either an increase in the amount of a GST or the creation of a new GST. 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.

Section 26.2601-1(b)(4)(i)(E), Example 10, involves an irrevocable trust for the benefit of Grantor's issue, which names a Bank and five other individuals as trustees. The appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative expenses. The example concludes that the modification pertains to the administration of the trust and that the trust will not be subject to the provisions of Chapter 13.

Section 2501 imposes a tax on an individual's transfer of property by gift. Section 2511 provides, in part, that the gift tax imposed by § 2501 shall apply 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.

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Section 2512(b) provides, in part, 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 shall be deemed a gift.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing the power.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property with respect to which the decedent has at the time of his death a general power of appointment, or with respect to which the decedent has at any time released such power of appointment by a disposition which 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 through 2038.

Section 2041(b) provides, in part, that a general power of appointment is a power which is exercisable in favor of the decedent, his estate, his creditors or the creditors of his estate.

Section 20.2041-1(b)(1) provides, in part, that the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment.

In the present case, the modifications do not shift a beneficial interest in Trust or Testamentary 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 modifications do not extend the time for vesting of any beneficial interest in the trusts. Therefore, we conclude that:

1. The proposed sale of Corporation 1 stock by Testamentary Trust to Trust will not cause either trust to lose their exempt status with respect to the GST tax.
2. The proposed division of Trust into two separate trusts, Trust A and Trust B, will not cause Trust, Trust A, or Trust B to lose their exempt status with respect to the generation-skipping transfer tax.
3. The proposed modification of Trust A to add Corporation 1 stock to the list of assets that the trustees may hold solely at the risk of the trust will not cause Trust A to lose its exempt status with respect to the GST tax.

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4. The proposed modification of Trust A to eliminate the requirement that Trust A continue to have a trustee who is a bank or trust company will not cause Trust A to lose its exempt status with respect to the GST tax.

In addition, after the sale of y shares of stock in Corporation 1 stock to Trust by Testamentary Trust, Trust will be divided into Trust A and Trust B. Trust A will also be modified to eliminate the requirement that it continue to have a trustee that is a bank or trust company. This modification will not cause the individual trustees or beneficiaries of Trust A to be deemed to possess a general power of appointment under either § 2514 or § 2041.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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

Sincerely,  
James F. Hogan  
Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

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