

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09-PLR-165140-02
Date:
March 14, 2003

In Re:

LEGEND:

Trustee =

Decedent =

Date 1 =

Spouse =

Son =

Daughter =

Grandchild 1 =

Grandchild 2 =

Grandchild 3 =

Trust =

Date 2 =

Date 3 =

Date 4 =

Probate Court =

Great Grandchild 1 =

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Great Grandchild 2 =

Great Grandchild 3 =

Date 5 =

Date 6 =

Dear :

This is in response to your letter dated November 22, 2002, submitted on behalf of Trustee, requesting a ruling regarding the generation-skipping transfer (GST) tax consequences of a proposed modification to a trust.

The information submitted and representations made are summarized as follows. Decedent died testate on Date 1, several years prior to September 25, 1985, survived by Spouse, Son, Daughter, Grandchild 1, Grandchild 2, and Grandchild 3. Decedent's will provided for a number of specific bequests, a marital bequest, and established a residuary trust (Trust) for the benefit of Son, Daughter, and their issue. The Trustee represents that there have been no actual or constructive additions to the trust after September 25, 1985.

Item VII(d) of Decedent's will provides that Decedent devises and bequeaths the residue of his estate to Trustee to be held in trust until twenty-one (21) years after the death of the last survivor among his children and grandchildren who are in being at the time of his death and, upon termination, the principal of Trust shall be divided among its income beneficiaries, per stirpes. The trustee shall divide the residue into two separate and equal trusts to be designated "Fund A" and "Fund B."

Item VII(d-1) provides that Fund A shall be held by Trustee for the benefit of Daughter and her issue. Daughter shall receive two-thirds of the net income so long as she may live, in monthly or quarterly installments as she may direct. The issue of Daughter, per stirpes, shall receive one-third of the net income so long as Daughter shall live, in monthly or quarterly installments as she may direct. If all of Daughter's issue predecease her, Daughter shall thereafter receive the entire net income so long as she shall live. Upon Daughter's death or upon Decedent's death if Daughter should predecease Decedent, Fund A shall be held for the benefit of the surviving issue of Daughter, per stirpes, and Daughter's issue shall receive the entire net income until the termination of this trust. If any of Daughter's issue should die during the life of the trust, the share of income of the deceased issue shall be paid to the then living issue of Daughter, per stirpes. Upon the death of Daughter without issue surviving, or upon the death of Daughter's last surviving issue prior to termination, the assets of Fund A shall be added to Fund B.

Item VII(d-2) provides that Fund B shall be held by Trustee for the benefit of Son and his issue. Son shall receive the entire net income until he shall have issue in being. Thereafter, he shall receive two-thirds of the net income so long as he may live, in

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monthly or quarterly installments as he may direct. Son's issue, per stirpes, shall receive one-third of the net income so long as Son shall live, in monthly or quarterly installments as he may direct. Upon Son's death or upon Decedent's death if Son should predecease Decedent, Fund B shall be held for the benefit of the surviving issue of Son, per stirpes, and his issue shall receive the entire net income until the termination of this trust. If any issue of Son should die during the life of the trust, the share of income of the deceased issue shall be paid to the then living issue of Son, per stirpes. Upon the death of Son without issue surviving, or upon the death of his last surviving issue prior to termination, the assets of Fund B shall be added to Fund A.

Item IX provides the powers granted to the executor and also to the trustee, subject to the approval of the advisory committee.

Item X provides for an advisory committee consisting of Spouse, Son, and Daughter. Item X further provides that the fiduciaries shall consult with the advisory committee regarding all important matters affecting the Trust and that the prior written consent and approval of two members of the advisory committee shall be deemed the consent of the committee. After the death of two members of the advisory committee, the surviving member shall constitute the advisory committee. After the death of all members of the advisory committee, the executors and trustees and their successors shall exercise their own powers and discretion. For all actions taken in accordance with the directions or consent of the advisory committee, the fiduciaries shall have full and complete acquittance. No party dealing with the executor or trustee or their successors shall be required to ascertain whether the direction or consent of the committee shall have been obtained and all parties dealing with the fiduciaries may do so as though the fiduciaries were possessed of full, complete, and independent power and authority. Members of the advisory committee may receive from the executor or trustee or their successors, reasonable compensation for their services and reimbursement for their expenses incident to their services.

Son died on Date 2, prior to the funding of the Trust and without children. Spouse died on Date 3. Due to the deaths of Son and Spouse, Daughter was the last surviving member of the advisory committee. After Daughter's death, the Trust does not provide for the continuation of the advisory committee.

On Date 4, the Probate Court issued an order, pursuant to an agreement executed by Trustee, Daughter, Grandchild 1, Grandchild 2, and Grandchild 3, providing for the appointment of Daughter's children as successor advisory committee members upon Daughter's death and provisions for the continuation of the advisory committee for the remaining term of the trust.

The Trustee represents that Daughter, Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 1's children (Great Grandchild 1, Great Grandchild 2, and Great Grandchild 3) would like to make further modifications to the Trust. Specifically, they would like to enlarge the advisory committee by adding Daughter's three children, Grandchild 1, Grandchild 2, and Grandchild 3, as equal voting members of the advisory

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committee, along with Daughter, during Daughter's lifetime. In addition, they would like to convert the portion of the Trust consisting of marketable securities and reinvestments to a total return share.

On Date 5, Daughter, Grandchild 1, Grandchild 2, Grandchild 3, Great Grandchild 1, Great Grandchild 2, Great Grandchild 3, and Trustee executed an agreement that provides it shall only be effective upon an order of the Probate Court. The agreement provides, in relevant part, as follows:

1. Grandchild 1, Grandchild 2, and Grandchild 3 shall be added as equal voting members of the advisory committee of the Trust with Daughter during Daughter's lifetime, with the same powers and authority conferred upon the advisory committee in the Trust.
2. Upon the death of Grandchild 1 during Daughter's lifetime, Grandchild 1's eldest then living child shall automatically succeed Grandchild 1 as a member of the advisory committee. If Grandchild 1's eldest child who is then serving as a member of the advisory committee shall fail or cease to serve, Grandchild 1's next eldest child shall automatically become a member of the advisory committee in place of such member.
3. Upon the death of the last survivor of Grandchild 1, Grandchild 2, and Grandchild 3 during Daughter's lifetime, each of Grandchild 1's then living children shall be allowed to function and serve as a member of the advisory committee of the Trust with Daughter, with the same powers and authority conferred upon the advisory committee in the Trust.
4. The Date 4 Probate Court order shall continue to remain in effect with respect to the Trust upon Daughter's death.
5. The portion of the Trust consisting of marketable securities and reinvestments shall be converted to a total return share whereby Trust distributions shall equal the greater of: (a) the net income of the total return share, or (b) six percent (6%) of the net fair market value of the total return share assets valued as of the last business day of the prior taxable year, not to exceed the amount of corpus appreciation of the total return share assets during the prior taxable year.

On Date 6, Daughter, Grandchild 1, Grandchild 2, Grandchild 3, Great Grandchild 1, Great Grandchild 2, Great Grandchild 3, and Trustee filed a petition with the Probate Court seeking approval of the Date 5 agreement.

Trustee has requested a ruling that the proposed enlargement of the advisory committee and the conversion of a portion of the Trust to a total return share will not violate §1433(b)(2)(A) of the Tax Reform Act of 1986 and thus, the Trust will continue to be exempt from the GST tax.

LAW AND ANALYSIS:

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term “generation-skipping transfer” as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply if additions (actual or constructive) are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides, generally, that any trust in existence on September 25, 1985, will be considered an irrevocable trust unless otherwise provided in § 26.2601-1(b)(ii)(B) or (C), relating to property includible in a grantor’s gross estate under §§ 2038 and 2042. In the present case, the Trust is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(4) 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)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 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 § 1001.

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 § 26.2601-1(b)(4)(i)(A), (B), or (C)) 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 8, illustrates the application of paragraph (b)(4) as follows:

Conversion of income interest into unitrust interest. In 1980, Grantor established an irrevocable trust under the terms of which trust income is payable to A for life and, upon A's death, the remainder is to pass to A's issue, per stirpes. In 2002, the appropriate local court approves a modification to the trust that converts A's income interest into the right to receive the greater of the entire income of the trust or a fixed percentage of the trust assets valued annually (unitrust interest) to be paid each year to A for life. The modification does not result in a shift in beneficial interest 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. In this case, the modification can only operate to increase the amount distributable to A and decrease the amount distributable to A's issue. 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 of the Internal Revenue Code.

Section 26.2601-1(b)(4)(i)(E), Example 10, illustrates the application of paragraph (b)(4) as follows:

Administrative change to terms of a trust. In 1980, Grantor executed 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 of the Internal Revenue Code.

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In the present case, the Trust was created and became irrevocable on Date 1, and there have been no additions made to the Trust after September 25, 1985. Accordingly, the Trust is exempt from the GST tax under § 26.2601-1(b)(1).

Based on the facts submitted and the representations made, the proposed appointment of Grandchild 1, Grandchild 2, and Grandchild 3 as equal voting members of the advisory committee, along with Daughter, during Daughter's life effectuates an administrative change and will 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. See § 26.2601-1(b)(4)(i)(E), Example 10. The proposed conversion of a portion of the Trust to a total return share will 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. See § 26.2601-1(b)(4)(i)(E), Example 8. In addition, the proposed modifications do not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Provided that the Probate Court approves the proposed agreement, the modification will not violate § 1433(b)(2)(A) of the Tax Reform Act of 1986 and will not affect the GST exempt status of the Trust.

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. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect. 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.

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 requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to Trustee.

Sincerely yours,

Melissa C. Liquerman
Branch Chief, Branch 9
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy for section 6110 purposes