

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:9-PLR-125719-03
Date:
August 1, 2003

Re:

LEGEND:

Settlor	=
Deed of Trust	=
Trust A	=
Trust B	=
Trust C	=
Trust D	=
Company	=
Date 1	=
Date 2	=
Charity I	=
Charity II	=
Charity III	=
Charity IV	=
Charity V	=
Local Court	=

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Dear :

This letter responds to your letter, dated April 8, 2003, and subsequent correspondence, submitted on behalf of Trust A, Trust B, Trust C, and Trust D, that requests a ruling on the consequences of a judicial reformation of a Deed of Trust under § 2601 of the Internal Revenue Code ("Code").

The facts and representations submitted are summarized as follows. On Date 1 (a date prior to September 25, 1985), Settlor executed an irrevocable Deed of Trust for the benefit of his four children. Settlor contributed Company stock as the initial principal of the trust. Since Date 1, there have been no additions, actual or constructive, to any trust created under the Deed of Trust.

Article First of the Deed of Trust provides that the trustees shall divide the principal into four equal shares, so that there will be one for each of Settlor's children and each share shall be invested as a separate trust. The trusts created hereunder are known as Trust A, Trust B, Trust C, and Trust D.

Article First-A(1) of the Deed of Trust provides that until the termination of a child's trust, as long as the child for whom the trust was established or any of his or her issue is living, the trustees may distribute as much of the net income and the principal of the trust to such one or more of that child, his or her spouse, his or her living issue, the spouses of his or her issue, any issue of any spouse of that child or of any of his or her issue, charitable organizations and the income accumulation trusts for the above-described persons, in such amounts or proportions as the trustees may from time to time think appropriate, and any income from a child's trust not so distributed shall be accumulated and added to the principal of that trust.

Article First-A(2) of the Deed of Trust provides that if at any time prior to the termination of a child's trust neither the child for whom the trust was established nor any of his or her issue is living, thereafter until the termination of that child's trust the trustees may distribute: (a) as much of the net income of the trust to such one or more of that child's spouse, the issue of any spouse of that child or of any of his or her issue, and the spouses of his or her issue, if any is then living, and; (b) as much of the remaining net income and the principal of the trust to such one or more of Settlor's issue, the spouse of Settlor's issue, charitable organizations and the income accumulation trusts for those persons, in the trustee's sole discretion. Any undistributed net income shall be accumulated and added to the principal of that trust.

Article First-B of the Deed of Trust provides that a child's trust shall terminate (i) twenty-one years after the death of the survivor of Settlor's sister-in-law and such of Settlor's parents' issue (other than Settlor) as are living on the date of the execution of the Deed of Trust or (ii) at such earlier time as the trustees of that particular trust think appropriate. Article First-B(1) provides that upon such termination, the then remaining principal of that trust shall be paid first to such one or more of that child, his or her spouse, his or her issue, the issue of any spouse of that child or of any of his or her

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issue, the spouses of his or her issue and charitable organizations and in such amounts or proportions as the trustees may specify. If the trustees do not specify how the principal of that child's trust is to be distributed, the principal will be paid to that child, or if he or she is not then living, in equal shares to such of his or her children and the children of any spouse of that child as are living (with the then living issue of a deceased child taking his or her share, per stirpes). If there are no such persons then living, the principal will be distributed to the Settlor's descendants, per stirpes. If Settlor has no living descendants when a child's trust terminates, the principal will be paid to such one or more charitable organizations as the independent trustees shall select.

Article Eleventh-C of the Deed of Trust defines the term "charitable organizations" as organizations described in § 170(c) of the Code that are not private foundations within the meaning of § 509(a).

The trustees of each child's trust seek to judicially reform the definition of "charitable organizations" in Article Eleventh-C of the Deed of Trust in order to qualify the trusts as electing small business trusts (ESBTs) within the meaning of § 1361(c)(2)(A)(v) and § 1361(e)(1).

On Date 2, Local Court issued an "Order Reforming Article Eleventh-C of the Deed of Trust," subject to the receipt by the trustees of Trust A, Trust B, Trust C, and Trust D of a favorable ruling from the Internal Revenue Service. Pursuant to the Order, Article Eleventh-C of the Deed of Trust is amended to provide as follows:

The term "charitable organizations" shall mean the following organizations: CHARITY I, CHARITY II, CHARITY III, CHARITY IV, AND CHARITY V; provided that each such organization is described in § 170(c)(2) of the Internal Revenue Code of 1986, as amended, and is not a private foundation within the meaning of § 509(a) of that Code; and further provided that prior to the beginning of each calendar year (effective for such year, and subsequent years unless modified by the trustees as provided in this sentence), the trustees of each trust hereunder may by an instrument in writing filed with the trust records substitute as to such trust another organization which is so described in place of a previously-named organization, add an organization which is so described or remove an organization which is so described; and further provided that there shall always be at least one, but no more than five such organizations so named.

The trustees of Trusts A, B, C, and D have requested a ruling that the judicial reformation of Article Eleventh-C of the Deed of Trust will not constitute a constructive addition or otherwise cause the trusts to lose their generation-skipping transfer (GST) tax exempt status under § 2601 and Treas. Reg. § 26.2601-1(b)(4).

Section 2601 imposes a tax on every GST.

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Under § 1433(a) of the Tax Reform Act of 1986, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. 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 of the Code, if the settlor had died on September 25, 1985. In this case, the trusts created under the Deed of Trust are considered to be irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust that is otherwise exempt from the application of Chapter 13 by section 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of Chapter 13. Section 26.2601-1(b)(1)(v) describes "constructive" additions to trusts in certain situations involving powers of appointment and relief from liability.

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 will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the modification, judicial construction, settlement agreement, or trustee action (a) results in a gift subject to gift tax, (b) causes the trust to be included in the gross estate of a beneficiary, or (c) results in the realization of capital gain for purposes of § 1001 of the Code.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust by judicial reformation 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. 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.

Currently, the trustees of each child's trust may distribute the income and principal of the trust, in the sole discretion of the independent trustees, to one or more of a group of beneficiaries; included therein are charitable organizations as defined in Article

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Eleventh-C of the Deed of Trust. After the judicial reformation, the definition of “charitable organizations” contained in Article Eleventh-C of the Deed of Trust is narrowed by the type and number of charitable organizations that come within the definition. Under these circumstances, the judicial reformation of the Deed of Trust will not result in a shift of any beneficial interest in the trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the date the order becomes effective. Further, the judicial reformation of the Deed of Trust will not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Based on the facts submitted and the representations made, we rule that the judicial reformation of Article Eleventh-C of the Deed of Trust by Order of Local Court will not constitute a constructive addition to Trusts A, B, C, or D or otherwise cause the trusts to lose their GST tax exempt status under § 2601 and § 26.2601-1(b)(4).

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

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

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

Sincerely,

Melissa C. Liquerman
Branch Chief, Branch 9
Passthroughs and Special Industries

Enclosure

Copy for section 6110 purposes