Internal Revenue Service

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Person To Contact:
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Refer Reply To:
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Date: MARCH 24, 2005

Re:

Legend:

Date 1	=
Date 2	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Grantor	=
Trust	=
Stock	=
Bank	=
Spouse	=
Nephew	=
Charity	=
Court	=
$X	=
$Y	=
State	=
State Statute 1	=

Dear :

This is in response to correspondence requesting a ruling regarding the generation-skipping transfer (GST) tax consequences of a proposed modification of Trust.

The facts submitted and representations made are as follows. Grantor died on Date1, a date prior to September 25, 1985. Under Paragraph V of Grantor's Will, Grantor created a testamentary trust (Trust) for the primary benefit of the Grantor's sisters and their descendants. Trust was funded with Stock. It is represented that the situs of Trust is State. Bank, Spouse and Nephew were appointed the initial trustees of Trust.

Paragraph V provides that the trust estate is to be divided into separate portions, one portion for each individual beneficiary of the class indicated who is living at the Grantor's death. It provides for eight percent (8%) of the trust estate for the benefit of each of Grantor's sisters; four percent (4%) percent for the benefit of each of Grantor's nieces and nephews; two percent (2%) for the benefit of each child of a niece or nephew; and one percent (1%) for the benefit of each grandchild of a niece or nephew. The annual net income of each portion is to be paid to or for the benefit of the beneficiary in quarterly or more frequent installments for life.

Paragraph V further provides that upon the birth of any other grandchild of Grantor's niece or nephew, during the terms of the trust and so long as there remains some part of the trust estate not set apart for individual beneficiaries, a separate one percent (1%) portion of the trust will be set apart for the benefit of that grandchild, equal in value and held upon the same terms as the other one percent (1%) portion held for other beneficiaries.

Paragraph V further provides that if any beneficiary is in need of additional funds for support, accident, illness or misfortune or education, the trustees may in their sole discretion pay to or apply for the benefit of such beneficiary so much of the current or accumulated income of the remaining portion of the trust as they deem advisable.

Paragraph V further provides that the rest of the net income of the remaining portion of the trust estate, after a reserve in cash has been accumulated equal to two years' aggregate income payments to beneficiaries, is to be distributed annually to Charity.

Paragraph V further provides that the trust will terminate 50 years after Grantor's death or upon the death of the last survivor of Grantor's nieces, nephews, and their children living at the date of Grantor's death, whichever occurs first. When the trust terminates, any principal remaining is to be distributed to named charities.

Paragraph V further provides that there will always be at least one corporate trustee and two individual trustees.

From time to time the trustees have sought and received instructions from Court to guide them in administering Trust. In Year 1, pursuant to an order of Court, the trustees were directed to accumulate from the unallocated income a reserve account of

$X for possible future discretionary distributions to individual beneficiaries. The reserve account as of Date 2 was $Y, slightly less than $X. Pursuant to an order of Court issued in Year 2, the trustees were directed to treat income earned on the reserve account as any other income earned by Trust which is to be distributed among the beneficiaries according to their respective percentage interests. Pursuant to an order of Court issued in Year 3, adopted great-grandnieces and great-grandnephews are entitled to a 1% income share in Trust.

At Grantor's death 100% of the income was allocable to individual beneficiaries named in Grantor's will and there were no potential beneficiaries to which shares were not allocated. Over the years, as 8% beneficiaries died and more 1% beneficiaries were born, less than 100% of the income was allocated to individual beneficiaries. In Year 4, for the first time since Grantor's death,100% of the income became currently allocated to individual beneficiaries. Since Year 4,100% of the income has continued to be allocated, and there are now grandchildren of nieces and/or nephews to whom 1% shares cannot be allocated. As a result, in Year 4 the trustees petitioned Court for an order interpreting the Will and directing them how to administer the trust under these circumstances.

Pursuant to the petition, Court entered an order that Trust be interpreted to mean that any grandchild of a niece or nephew of Grantor is a beneficiary of Trust at birth and that the trustees may exercise their discretion to make distributions to such a grandchild from the reserve account. The order is effective only upon the trustees obtaining a ruling that Trust will continue to be exempt from generation-skipping transfer tax.

Trustees may only make distributions from the reserve account for expenses of accident, illness or other misfortune or for the reasonable education of a beneficiary. This standard must be exercised by unanimous agreement of all three trustees who include not only two family members but also a corporate trustee, Bank. Trustees have executed certificates certifying that they will strictly adhere to the standard in exercising their authority to make distributions from the reserve account.

You have requested a ruling that if, under an order of Court, (construing the Will to provide that under the terms of Trust any grandchild of a niece or nephew of Grantor is a beneficiary of Trust at birth) the trustees of Trust exercise their discretion to make a distribution to such grandchild from funds in Trust's reserve account, such a distribution will not cause Trust to be subject to the generation-skipping transfer tax imposed by chapter 13.

Section 2601 imposes a tax on each generation skipping transfer. Under section 1433(b)(2)(A) of the Tax Reform Act of 1986 Act and § 26.2601-1(b)(1)(I) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus

added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

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 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 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 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, but only if –

> (1) 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
>
> (2) 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.

State Statute 1 provides that the trustee may petition the court concerning the internal affairs of the trust. Proceedings concerning the internal affairs of a trust include determining questions of construction of a trust instrument and ascertaining beneficiaries.

Based on the facts presented and representations made, we conclude that the judicial modification to Trust, discussed above, will not shift any beneficial interest in 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. In addition, the modification of Trust will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trust. Accordingly, based on the facts submitted and the representations made, if, under an order of Court, (construing

the Will to provide that under the terms of Trust any grandchild of a niece or nephew of Grantor is a beneficiary of Trust at birth) the trustees of Trust exercise their discretion to make a distribution to such grandchild from funds in Trust's reserve account, such a distribution will not cause Trust to be subject to the generation-skipping transfer tax imposed by chapter 13 of the Internal Revenue Code.

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 who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

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

Enclosure
Copy for section 6110 purposes

cc: