

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201320004**

Release Date: 5/17/2013

Index Number: 2632.01-00, 9100.00-00

Person To Contact:

, ID No.

Telephone Number:

Re:

Refer Reply To:

CC:PSI:B04

PLR-132414-12

Date:

January 14, 2013

Legend

Settlor	=
Trust	=
Date 1	=
Date 2	=
Child 1	=
Child 2	=
Child 3	=
Court	=
State Statute 1	=
State Statute 2	=

Dear :

This letter responds to correspondence dated July 19, 2012, requesting rulings under §§ 1001, 2501, and 2601 of the Internal Revenue Code concerning the income, gift, and generation-skipping transfer (GST) tax consequences of a proposed modification of Trust.

The facts submitted and representations made are as follows:

On Date 1, a date after September 25, 1985 and prior to December 31, 2000, Settlor created an irrevocable trust (Trust) for the benefit of his then living children, Child 1 and Child 2, and for any of his after-born or adopted children. Subsequently, Child 3 was born on Date 2, and became an additional beneficiary of Trust.

Article V, Section 1, of Trust provides that the trust estate is to be held in equal separate shares, one for the primary benefit of each of Grantor's children.

Article V, Section 3, of Trust provides that the net income from each separate share is to be paid to the primary beneficiary of each share during his or her lifetime at convenient intervals, but at least annually. The trustees, in their sole discretion, may also pay to or apply for the benefit of the primary beneficiary so much of the corpus of the trust estate of each separate share as the trustee considers beneficial, proper and suitable to provide for maintenance, education and support of the primary beneficiary in accordance with his or her accustomed standard of living.

Article V, Section 4, of Trust provides that each primary beneficiary with a present interest in Trust will have a testamentary limited power of appointment, to modify the provision of this article to increase or decrease the share provided for an issue of that issue, alter the terms of distribution of trust assets to such issue's issue or redirect the disposition of remaining trust assets at termination of Trust among the issue's issue and spouses of their issue.

Article V, Section 5, of Trust provides that upon the death of a primary beneficiary, the trust share held for such beneficiary terminates and any remaining trust estate is to be delivered to such beneficiary's then-living issue by right of representation, and if there are no such living issue then to Grantor's then-living children and then-living issue of any deceased child by right of representation, but if there are continuing trusts established in Trust for such beneficiaries, then to such trusts.

The primary beneficiaries, Child 1, Child 2 and Child 3, individually and on behalf of their minor children, entered into an agreement (Agreement) that modifies the duties and authorities of the trustees regarding the requirement for current annual distributions of net income. The Agreement provides that the trustees will have no duty to distribute net income annually to the primary beneficiary of each separate trust share, but will have the discretion to pay or apply for the benefit of each beneficiary the net income in the same manner as provided for the distribution of corpus of the trust share. Any net income that is not distributed will be retained and set aside as accumulated net income. Such accumulated net income together with any earnings thereon, if not distributed to the primary beneficiary during his or her lifetime, will be paid to the estate of the deceased primary beneficiary. The Agreement does not modify any other provisions of Trust.

If favorable rulings are issued pursuant to this ruling request, a petition will be filed with Court seeking an order (Order) approving the modification contained in the Agreement. It is represented that Settlor allocated sufficient GST exemption to the transfers to Trust to cause Trust to have an inclusion ratio of zero and that there have

been no distributions of corpus since Date 1. It is represented that since the establishment of Trust, any net income from each separate share that was required to be distributed has been paid to the primary beneficiary of such share.

State Statute 1 provides that the court may, on petition of an interested person, approve an interpretation, construction, modification, or other settlement that is agreed upon in writing by all presently identified and competent beneficiaries whose interests in the trust may be affected to resolve a contest, controversy, or question of construction or interpretation concerning the existence, administration, or termination of an irrevocable trust. State Statute 2 provides that there is no need to appoint a guardian ad litem to represent minor and unborn beneficiaries if, under the statute, such minor and unborn beneficiaries are adequately represented by his or her parent.

You have requested the following rulings:

1. The proposed modification of the income distribution provisions of Trust will not adversely affect the GST exemption of Trust.
2. The proposed modifications of the income distribution provisions of Trust will not cause any beneficiary of Trust to have made a gift that is subject to gift tax under § 2501.
3. The proposed modification of the income distribution provisions of Trust will not cause Trust or any beneficiary of Trust to recognize gain or loss from the sale or disposition of property under § 61 or 1001.

LAW AND ANALYSIS

Ruling 1

Section 2601 imposes a tax on every generation-skipping transfer made after October 26, 1986.

Section 2611(a) provides that the term "generation-skipping transfer" means a tax distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of tax imposed by § 2601 is the taxable amount, multiplied by the applicable rate. Section 2641(a) provides that, for purposes of chapter 13, the term "applicable rate" means, with respect to any generation-skipping transfer, the product of the maximum federal estate tax rate, and the inclusion ratio with respect to the transfer.

Section 2642(a)(1)(A) provides, in relevant part, that, for purposes of chapter 13, the inclusion ratio with respect to any property transferred in a generation-skipping transfer shall be the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. Section 2642(a)(2) provides, in relevant part, that the applicable fraction 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, reduced by the sum of any federal estate tax, or state death tax actually recovered from the trust attributable to such property, and any charitable deduction allowed under § 2055 or 2522 with respect to such property.

Section 2631 provides, for the year in issue, that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. The transfer in this case was made prior to the enactment of § 2632(c) (Deemed Allocation to Certain Lifetime Transfers to GST Trusts). The transfer in this case has GST potential. It is represented that Settlor allocated sufficient GST exemption to all transfers to Trust to cause Trust to have an inclusion ratio of zero.

No guidance has been issued concerning the modification of a trust that may affect the status of a trust that is 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.

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 § 26.2601-1(b)(1), (2), or (3) will not cause the trust to lose its exempt status. Under the regulation, unless specifically provided otherwise, these rules 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)(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 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.

In this case, the proposed agreement to modify Trust provides that the trustees have no duty to distribute income annually to the primary beneficiary of each separate trust share but will have the discretion to pay or apply the income for the benefit of each beneficiary. In addition, the proposed agreement to modify Trust provides that any accumulated income not distributed prior to the death of the beneficiary will be paid and distributed to the estate of the deceased beneficiary. Accordingly, the accumulated income will be included in the beneficiary's gross estate for estate tax purposes and the beneficiary will be treated as the transferor of the accumulated income for GST tax purposes. 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. Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed agreement to modify Trust pursuant to Court Order will not cause Trust, as modified, to lose its GST exempt status as a result of allocating Settlor's GST exemption to Trust.

Ruling 2

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

Section 2511 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.

In this case, the income distribution provisions will be modified to give the trustees discretion to distribute income to the primary beneficiaries or to accumulate

such income. However, the accumulated income will be included in each primary beneficiary's estate upon the death of the beneficiary. Accordingly, at the time of the modification, none of the income interest will be gratuitously transferred from the primary beneficiary to any other beneficiary of Trust. The beneficial interests in the modified Trust will be substantially similar to the interests prior to the modification. Accordingly, based upon the facts submitted and representations made, we conclude that the proposed modification to Trust will not cause any beneficiary of Trust to have made a gift that is subject to gift tax under § 2501.

Ruling 3

Section 61(a)(3) provides that gross income includes gain derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

In this case, the Trust modifications will result in increased trustee discretion and will not confer new rights to the beneficiaries or result in any relative shifting of interests between beneficiaries. Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed modification to Trust will not result in the realization of gain or loss under §§ 61 and 1001 to either Trust or any beneficiary.

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.

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

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.

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: