

## Internal Revenue Service

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Date:  
February 05, 2018

Re:

### LEGEND

Date 1 =  
Date 2 =  
Settlor =  
Spouse =  
Son 1 =  
Son 2 =  
Trust =

Trust A =

Trust B =

Trust C =  
State =  
State Statute =

Dear :

This letter responds to your authorized representative's letter of August 1, 2017, requesting a ruling regarding the generation-skipping transfer (GST) tax consequences of a proposed distribution from Trust B to Trust C.

FACTS

The facts submitted and representations made are as follows.

On Date 1, a date after September 25, 1985, Settlor established and funded an irrevocable trust, Trust, to be administered under State law. Pursuant to Article III of Trust, two separate trusts were established with identical terms for the benefit of Settlor's two sons, Son 1 and Son 2. Trust A is an irrevocable trust for the benefit of Son 1, and Trust B is an irrevocable trust for the benefit of Son 2. This letter ruling pertains to Trust B, and its successor, Trust C.

Under Paragraph (a) of Article III, the trustee currently may pay to or apply for the benefit of Son 2 all or any part of the net income of Trust B as the trustee shall determine to be necessary or advisable for the support, maintenance, education, and health of Son 2. Any income that is not distributed shall be accumulated and added to principal at least annually. Under Paragraph (c) of Article III, the trustee may pay to or apply for the benefit of Son 2 all or any part of the principal of Trust B in such amounts and at such intervals as the trustee determines to be necessary or desirable for the support, maintenance, education, and health of Son 2.

Under Paragraph (d) of Article III, upon the death of Son 2, Trust B shall be transferred and delivered to such appointee or appointees among the living issue of the Settlor and in such amounts or proportions and upon such terms and provisions as Son 2 shall appoint and direct in an effective will or codicil specifically referencing this limited power of appointment. Paragraph (d) of Article III further provides that if this limited power of appointment is not exercised as to all or any portion of Trust B, then the remaining trust property will vest in and be delivered and conveyed to Son 2's then living issue, *per stirpes*, subject to the provisions in Paragraph (e) of Article III. If Son 2 leaves no surviving issue, the remaining trust property will be divided into equal shares: one for each surviving son of Settlor and one share for the then living issue *per stirpes* of each son of Settlor who shall be deceased with issue then living, subject to the provisions in Paragraph (e) of Article III.

Under Paragraph (e) of Article III, if any trust property vests in an issue of a deceased son of Settlor who is under 21 years old, then the property vesting in such issue will be held in trust as a separate trust. The trustee shall distribute all or any part of the net income and principal for such person's support, maintenance, education and health until such person attains 21 years of age. Upon such person attaining 21 years of age, the principal and any undistributed income of such trust will be conveyed to such person discharged of the trust. If such person dies prior to his or her attaining 21 years of age, the trust shall be delivered to such person's estate free and clear of all trusts.

Paragraph (f) of Article III provides that notwithstanding any other provision of Trust to the contrary, no trust created under Article III shall continue beyond 21 years after the

death of the last to die of the Settlor and the Settlor's sons who were living at the date of the execution of Trust. Upon the expiration of such period, all trusts shall terminate and the assets shall be distributed outright to such persons as are then entitled to the income.

On Date 2, the trustee, pursuant to and in accordance with the requirements of State Statute, as in effect on Date 2, appointed all of the principal and accumulated income of Trust B to a new trust, known as Trust C, effective upon the receipt of a favorable private letter ruling. State Statute was not in effect on Date 1.

During Son 2's lifetime, the distribution standard in Trust C is identical to the distribution standard in Trust B. Under Article IV, Paragraph A of Trust C, Son 2 will continue to be entitled to discretionary distributions of principal and income for Son 2's support, maintenance, education, and health; however, the distributions will be in the discretion of an Independent Trustee. No person other than Son 2 is eligible to receive distributions from Trust C during Son 2's life.

Under Paragraph B of Article IV of Trust C, Son 2 will continue to have a testamentary power to appoint all or any part of the principal and income remaining at his death to one or more living lineal descendants of the Settlor, in such proportions and amounts as Son 2 shall so designate in his absolute discretion. The class of permissible appointees of Son 2's limited power of appointment is identical under Trust B and Trust C. However, while Trust B provides generally that Son 2 may appoint property upon such terms and provisions as Son 2 directs in his will or codicil, Trust C expressly provides that Son 2 may create new trusts for the benefit of the permissible appointees and establish the terms and conditions under which such new trusts will be administered. If Son 2 fails to specify whether the appointed property shall be distributed to the designated appointees outright or in further trust, then any property appointed to a lineal descendant of the Settlor shall be held as a separate trust for the benefit of the designated appointee in accordance with Article V (an "Article V Trust").

Similar to Trust B, Paragraph B of Article IV of Trust C prohibits any trust created by the exercise of Son 2's power of appointment from continuing in existence beyond the date which is 21 years after the last to die of the Settlor's sons who were living at the time of execution of Trust.

If Son 2 does not exercise his power of appointment, then the property remaining in Trust C at Son 2's death will be apportioned among Son 2's living issue, *per stirpes*. If Son 2 is not survived by any living issue, then the remaining property of Trust C will be divided among the Settlor's living issue, *per stirpes*. Any property apportioned for a descendant of Son 2 or the Settlor upon Son 2's death will be held in further trust for that descendant in a trust described in Article V (an "Article V Trust").

Paragraph A of Article V of Trust C provides that the Independent Trustee of each Article V Trust may distribute principal and income of the trust to the beneficiary of such trust, in the Independent Trustee's sole and absolute discretion. Paragraph B provides that the beneficiary of each Article V Trust will have a testamentary general power of appointment over the property of that beneficiary's trust. The beneficiary may use his or her general power of appointment to appoint all or any part of the principal and income of the beneficiary's Article V Trust remaining at the time of the beneficiary's death to one or more lineal descendants of the Settlor and/or such beneficiary's estate, in such proportions and amounts as the beneficiary shall so designate in his or her absolute discretion. The beneficiary shall have the broadest possible discretion in appointing the trust property, including the ability to appoint property outright or in further trust for the benefit of one or more lineal descendants of the Settlor.

If upon the death of a beneficiary of an Article V Trust, the testamentary general power of appointment is not exercised, then the property remaining in that Article V Trust will be divided among that beneficiary's living issue, *per stirpes*. If the beneficiary is not survived by any living issue, then the remaining property of the Article V Trust will be divided among the beneficiary's living siblings and the descendants of any deceased siblings of the beneficiary, *per stirpes*. If the beneficiary is not survived by any living issue, siblings, or descendants of siblings, the remaining property of the Article V Trust will be divided among the Settlor's living issue, *per stirpes*.

Trust C includes modifications to the administrative terms of Trust B. In particular, Trust C provides for the appointment of an Independent Trustee who is granted the authority to make discretionary distribution decisions, the appointment of a Family Trustee whose authority will be limited to investment and administrative decisions, and the future appointment of a trust Protector who will have the authority to remove and replace trustees. Under Article VII, Paragraph B of Trust C, an Independent Trustee must not be the Settlor, the Settlor's spouse, a beneficiary of Trust C, a spouse of a beneficiary of Trust C, a lineal descendant of a beneficiary of Trust C, or a spouse of a lineal descendant of a beneficiary of Trust C. Under Article VII, Paragraph E of Trust C, a Protector must not be the Settlor, any beneficiary, or any person related or subordinate to the Settlor or any beneficiary within the meaning of § 672(c).

It is represented that Settlor and Spouse (who is treated as the transferor of one-half of the transfer pursuant to §§ 2513 and 2652(a)(2)) allocated sufficient GST exemption to cause Trust B to have an inclusion ratio of zero.

You have requested a ruling that the proposed transfer of Trust B assets to a successor trust, Trust C, and the modifications caused by the distribution to Trust C will not cause Trust B or Trust C to lose their exempt status for purposes of the GST tax.

LAW AND ANALYSIS

Section 2601 provides that a tax is imposed on every GST. Section 2611(a) provides that the term “generation-skipping transfer” means a taxable distribution, a taxable termination, and a direct skip.

Section 26.2601-1(b)(4)(i) of the Generation-Skipping Transfer Tax Regulations 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 paragraph (b)(1), (2), or (3) of this section will not cause the trust to lose its exempt status. Unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus, 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)(A) provides that the distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the provisions of chapter 13, if either the terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court; and the terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation.

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 paragraph (b)(4)(i)(A), (B), or (C) of § 26.2601-1) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause the 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 § 26.2601-1, 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 10* considers the following situation. In 1980, Grantor established 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.

State Statute provides that a trustee of an original trust may, without authorization by the court, exercise the discretionary power to distribute principal or income to or for the benefit of one or more current beneficiaries of the original trust by appointing all or part of the principal or income of the original trust subject to the power in favor of a trustee of a second trust. The trustee of the original trust may exercise this power whether or not there is a current need to distribute principal or income under any standard provided in the terms of the original trust. The trustee's special power to appoint trust principal or income in further trust under this section includes the power to create the second trust. The second trust may be a trust created under the same trust instrument as the original trust or under a different trust instrument; however, the terms of the second trust are subject to certain limitations related to maintaining the beneficial interests set forth in the original trust, including: (1) only beneficiaries of the original trust may be beneficiaries of the second trust; (2) a future, vested or contingent interest in the original trust may not be accelerated in the second trust; (3) distributions of income and principal subject to an ascertainable standard in the original trust must be included in the second trust and must be exercisable in favor of the same current beneficiaries of the original trust; and (4) a power of appointment may be conferred upon a beneficiary to whom the trustee has the power to distribute principal or income of the original trust, subject to State's rule against perpetuities statute.

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, modification that would not affect the GST status of a grandfathered trust will similarly not affect the exempt status of such a trust.

In the instant case, Trust B does not expressly authorize the trustee to distribute principal from Trust B to Trust C. While State Statute authorizes the trustee to make such a distribution, to satisfy the requirement in § 26.2601-1(b)(4)(i)(A)(1)(i), the state law must be in effect at the time the exempt trust became irrevocable. In this case, State Statute was enacted subsequent to the execution of Trust B. Accordingly, the effect of the proposed distribution of Trust B principal to Trust C on the exempt status of the trusts will be evaluated under the rules in § 26.2601-1(b)(4)(i)(D).

Under the governing instrument of Trust C, the terms of the distribution of income and principal during Son 2's lifetime are identical to the terms in Trust B, except that under Trust C, an Independent Trustee has the discretionary authority to make such distributions. Under the governing instrument of Trust C, Son 2 maintains the testamentary limited power of appointment provided to Son 2 under Trust B, and has the power to appoint to the same class of permissible appointees. Under the governing instrument of Trust C, the contingent remainder beneficiaries in default of the exercise of Son 2's limited power of appointment remain the same as under Trust B. Trust C clarifies that Son 2, in exercising the limited power of appointment, may create new trusts for the benefit of permissible appointees and any trust created by the exercise of the power is subject to the same termination date as applicable to trusts created under Trust B. With respect to these Trust C provisions, the distribution of principal from Trust B to Trust C will not cause a shift of a beneficial interest to a lower generation beneficiary nor extend the time for vesting of any beneficial interest beyond the period provided for in the original trust.

Trust C differs from Trust B by providing for the creation of Article V Trusts (1) where Son 2 exercises his limited power of appointment but fails to specify whether the appointed property shall be distributed to the designated appointees outright or in further trust, and (2) to the extent Son 2 does not exercise his limited power of appointment and the remaining trust property is apportioned among living issue of Son 2 or Settlor. Under the governing instrument of Trust C, the beneficiary of each Article V Trust is the sole lifetime beneficiary of the trust and is granted a testamentary general power of appointment over the principal of such trust. The grant of a testamentary general power of appointment to the sole lifetime beneficiary of a trust is viewed as functionally equivalent to granting outright ownership. See Restatement (Second) of Property § 19.4 (1986). For transfer tax purposes, the grant of the power will cause the value of the beneficiary's Article V Trust to be includible in the gross estate of the beneficiary at his or her death under § 2041(a)(2) and the beneficiary to be

treated as the transferor of the Article V Trust for GST tax purposes under § 2652(a)(1). Therefore, with respect to these Trust C provisions, the distribution of principal from Trust B to Trust C will not cause a shift of a beneficial interest to a lower generation beneficiary nor extend the time for vesting of any beneficial interest beyond the period provided for in the original trust.

Trust C additionally differs from Trust B by modifying the provisions relating to the administration of trust, including provisions for (1) the appointment of an Independent Trustee, who will have the authority to make discretionary distribution decisions, (2) the appointment of a Family Trustee, whose authority will be limited to investment and administrative decisions, and (3) the future appointment of a trust Protector, who will have the authority to remove and replace trustees. Trust C provides that certain individuals and classes of individuals are prohibited from serving as Independent Trustee and trust Protector. Pursuant to § 26.2601-1(b)(4)(i)(D)(2), modifications that are administrative in nature that only indirectly increase the amount transferred will not be considered to shift a beneficial interest in the trust. See *Example 10* of § 26.2601-1(b)(4)(i)(E). Therefore, with respect to these Trust C administrative provisions, the distribution of principal from Trust B to Trust C will not cause a shift of a beneficial interest to a lower generation beneficiary nor extend the time for vesting of any beneficial interest beyond the period provided for in the original trust.

Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed distribution of assets from Trust B to Trust C satisfies the requirements of § 26.2601-1(b)(4)(i)(D) and will not cause Trust B or Trust C to lose their exempt status for GST tax purposes.

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 or the occurrence of any subsequent transaction or action that may be permissible under the governing instrument of Trust C.

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.

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.

Sincerely,

*Karlene M. Lesho*

Karlene M. Lesho  
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Enclosures (2)

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