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April 17, 2018

Legend

Decedent  
Trust  
GST Residuary  
Trust  
Spouse  
Son  
Daughter  
Date 1  
Date 2  
Date 3  
Date 4  
Date 5  
Court  
a  
b  
State

Dear :

This letter responds to your personal representative's letter of November 10, 2017, and subsequent correspondence, requesting rulings regarding the generation-skipping transfer tax (GST) consequences of a proposed judicial modification of a trust.

The facts and representations submitted are summarized as follows:

Decedent established Trust, a revocable trust, on Date 1 (a date after September 25, 1985). Trust was restated on Date 2, and later amended two times prior to Decedent's death.

Trust provides that when Decedent dies, the trustees are to divide Trust into a Marital Trust, a GST Marital Trust, and a GST Residuary Trust. These trusts provide income to Spouse during her lifetime. Upon Spouse's death, any remaining portion of these trusts are to be added to the GST Trusts, which are separate trusts to benefit each child of Decedent or the descendants of a deceased child of Decedent.

Article II, Paragraph E of Trust contains provisions that will govern the GST Trusts. Paragraph E provides that the trustee shall divide the trust estate of the GST Trusts into equal shares – one share for each living child of Decedent and one share for each deceased child of Decedent who has one or more descendants then living (Primary Beneficiary). If Decedent has no living descendants, the trust estate shall be distributed pursuant to Article III (distributes trust estate to a charity). Paragraphs E(1) and (2) provide for discretionary distributions of income and principal to any one or more of the group consisting of the Primary Beneficiary and the Primary Beneficiary's descendants as necessary for health, education, maintenance or support. Any net income not distributed is added to principal.

Article II, Paragraph E(4) provides that upon the death of the Primary Beneficiary, the trust estate shall be distributed as follows:

- (a) Pursuant to the Primary Beneficiary's general testamentary power to appoint a portion of the trust to his/her creditors in a situation where, upon the Primary Beneficiary's death, a portion of the trust estate is subject to GST taxes.
- (b) Except as provided in (a), the remaining principal and accumulated income shall be divided into shares for the Primary Beneficiary's descendants; if none, in equal shares for the Primary Beneficiary's siblings who is a descendant of Decedent, with the share for any deceased sibling being created only if he or she has one or more living descendants; if none, in shares for the descendants of the Primary Beneficiary's nearest ancestor who is a descendant of Decedent and has descendants then living; if none, for Decedent's descendants. Each share created under this paragraph shall be held as (or added to) the trust estate of a separate GST Trusts for such beneficiary. If Decedent has no living descendants, the trust estate shall be distributed pursuant to Article III.

Article IV, Paragraph F provides that notwithstanding any other provision of Trust, unless earlier terminated by the terms of Trust, the termination date of each trust created under Trust shall be twenty-one years after the death of all the descendants of the parents of Decedent and Decedent's Spouse who were living at the time of Decedent's death, or if later, the date before the term of the trust must cease under applicable state law.

Article V contains the Trustee provisions. In the event that Decedent shall fail or cease to act as Trustee of any trust, for any reason, Spouse, Son, and Daughter shall become the successor co-trustees of Trust. After the death of Spouse, Son and Daughter may become the sole individual Trustee of any separate GST Trust and Family Trust created for his or her benefit at any time after reaching age a by removing the other individual Trustee(s) then serving as to such trust.

Article VII, Paragraph L provides that a beneficiary may exercise his/her power of appointment to appoint outright or in trust. No beneficiary may exercise a limited power of appointment so as to create another power of appointment which can be validly exercised to postpone vesting of a trust or suspend absolute ownership or power of alienation for a period ascertainable without regard to Decedent's date of death. No limited power of appointment may be exercised to cause a trust to be included in the beneficiary's gross estate.

Article XI contains Special Trustee provisions. Under Paragraph A(1), following Decedent's death, a trustee may appoint one or more of Decedent's advisors as a Special Trustee. Special Trustee has the right to appoint his/her successor. Paragraph B(1) provides that Special Trustee has the express power to amend any provision of Trust if Special Trustee deems it necessary to adjust to situational changes, undesirable tax consequences, or provide clarity. Special Trustee has the authority to change the distributions standards; create, limit or delete powers of appointment (either general or limited) in one or more beneficiaries even if the creation of the power of appointment would cause trust assets to be included in the beneficiary's gross estate; and alter the timing of distributions. However, Special Trustee does not have a general power of appointment to appoint trust assets to him or herself. Special Trustee has the authority to release any of his/her powers.

Decedent died on Date 3, survived by his spouse, Spouse, two children, Son and Daughter, and six grandchildren. Trust became irrevocable upon Decedent's death. Trust is governed under the law of State. After Decedent's death, Decedent's remaining GST exemption was allocated to GST Residuary Trust resulting in a zero inclusion ratio. It is represented that an amount of Spouse's remaining GST exemption, if any, equal to the value of the assets transferred to the GST Trusts from the Marital Trust upon the death of Spouse, if any, will also be allocated to the GST Trusts, resulting in a zero inclusion ratio for such assets.

On Date 4, Spouse, Son, and Daughter entered into a non-judicial settlement agreement to modify Article V of Trust in order to provide an orderly succession of Trustees. The modified Article V provides, in relevant part, that in the event that Decedent shall fail or cease to act as Trustee of any trust, for any reason, Spouse, Son, and Daughter shall become the successor co-trustees of Trust. If Son shall fail or cease to act as Trustee of any trust, for any reason, Son's wife shall serve as successor co-trustee. If Daughter shall fail or cease to act as Trustee of any trust, for any reason, Daughter's husband shall serve as successor co-trustee. In the event any named

individual co-trustees should fail or cease to act as trustee of any trust, for any reason, the one or more remaining named individuals shall continue to act as the Trustees of such trust. After the death of Spouse, Son and Daughter shall become the sole individual Trustee of any separate GST Trust and Family Trust created for his or her benefit. If Son is then deceased, or is then living but thereafter fails for any reason to act as Trustee of any such GST Trust or Family Trust, Son's wife shall become the sole individual Trustee of any separate GST Trust and Family Trust created for the benefit of Son or his descendants. If Daughter is then deceased, or is then living but thereafter fails for any reason to act as Trustee of any such GST Trust or Family Trust, Daughter's husband shall become the sole individual Trustee of any separate GST Trust and Family Trust created for the benefit of Daughter or her descendants. Notwithstanding the above, each of the descendants of a deceased child of Grantor may become the sole individual Trustee of any separate GST Trust or Family Trust created for his or her benefit at any time after reaching age 21 by removing the other individual Trustee(s) then serving as to such trust.

Trustees and Special Trustee petitioned Court to modify Trust to grant the Primary Beneficiary a testamentary limited power of appointment to appoint his/her GST Trust estate to his/her spouse, his/her descendants, the spouse of his/her descendants, and/or charities. This limited power of appointment is exercisable over the portion of the GST Trust that is remaining after any exercise of a Primary Beneficiary's general power to appoint to his/her creditors is exercised. All of the dispositive provisions in Article II, Paragraph E(4)(b) remain, without modification. Accordingly, in default of the limited power of appointment, the GST Trust assets would go in further trust to the Primary Beneficiary's descendants, if none, siblings, if none, Decedent's descendants, if none, a charity. The modification to Article II, Paragraph E(4)(b) also includes the following language:

Notwithstanding any contrary provision of this Trust agreement, no exercise of a power of appointment granted in this paragraph (b) shall result in a termination date for a GST Trust or a share thereunder or created pursuant to such power of appointment which is later than the termination date set forth in Article IV, Paragraph F of the Trust Agreement as such provision existed on the Decedent's date of death, and such power of appointment may not be exercised in favor of any beneficiary in which the exercise would result in shifting a beneficial interest in the trust to any beneficiary, who occupies a lower generation (as defined in § 2651) than the person or persons who hold the beneficial interest in the absence of the exercise of the testamentary limited power of appointment.

On Date 5, Court issued an Order authorizing the modifications to the trust, subject to a favorable letter ruling from the Internal Revenue Service.

You have requested the following rulings:

1. The proposed judicial modification of the GST Trusts will not adversely affect the

exemption of the GST Trusts from GST tax for purposes of chapter 13.

2. The Date 4 modification of Trust by Non-Judicial Settlement Agreement will not adversely affect the exemption of the GST Residuary Trust or the resulting GST Trusts from GST tax for purposes of chapter 13.

## LAW AND ANALYSIS

### Rulings 1 and 2

Section 2601 of the Internal Revenue Code imposes a tax on each generation-skipping transfer made after October 26, 1986. A generation-skipping transfer is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term “taxable termination” means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that the term “taxable distribution” means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax of an interest in property to a skip person.

Section 2602 provides that the amount of tax imposed under § 2601 is determined by multiplying the taxable amount by the applicable rate. Under § 2641, the term “applicable rate” means the product of the maximum federal estate tax rate in the year that the GST occurs and the inclusion ratio. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a GST is one minus the applicable fraction. Under § 2642(a)(2), in general, the numerator of the applicable fraction is the amount of GST exemption allocated to the property transferred and the denominator is the value of the property transferred.

Under § 2631, every individual is allowed a GST exemption amount which may be allocated by the individual or the individual's executor to any property with respect to which the individual is the transferor.

Under § 1433(a) of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to any GST 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.

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) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, 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 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 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, 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 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.

No guidance has been issued concerning judicial modifications that may affect the status of trusts that are 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.

In the instant case, Trust became irrevocable after September 25, 1985. It is represented that sufficient GST exemption will be allocated to the GST Trusts so that the GST Trusts have an inclusion ratio of zero under § 2642. No guidance has been issued concerning changes that may affect the status of trusts that are 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 change that would not affect the GST status of a trust that was irrevocable on September 25, 1985, should similarly not affect the exempt status of such a trust.

The proposed judicial modification to Trust will grant the Primary Beneficiary of each GST Trust a testamentary limited power of appointment to appoint his/her GST Trust estate to his/her spouse, his/her descendants, the spouse of his/her descendants, and/or charities. This limited power of appointment is exercisable over the portion of the GST Trust that is remaining after any springing general power of appointment is exercised. Further, despite the proposed judicial modification, the GST Trusts shall terminate no later than twenty-one years after the death of all the descendants of the parents of Decedent and Decedent's Spouse who were living at the time of Decedent's death, or if later, the date before the term of the trust must cease under applicable state law.

Accordingly, based on the facts submitted and the representations made, we rule that the proposed judicial modification 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 proposed judicial modification. Further, the proposed judicial modification 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. Therefore, based upon the facts submitted and representations made, we conclude that the proposed judicial modification of the GST Trusts will not adversely affect the exemption of the GST Trusts from GST tax for purposes of chapter 13.

The Date 4 modifications to Article V only affect trustee succession. These modifications are administrative in nature and under § 26.2601-1(b)(4)(i)(D)(2), will not

be considered to shift a beneficial interest to a lower generation in the trust or extend the time for vesting of any beneficial interest in the trust beyond the period provided for in Trust. See Example 10 of § 26.2601-1(b)(4)(i)(E). Therefore, based upon the facts submitted and representations made, we conclude that the Date 4 modification of Trust by Non-Judicial Settlement Agreement will not adversely affect the exemption of the GST Residuary Trust or the resulting GST Trusts from GST tax for purposes of chapter 13.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Sincerely,

*Lorraine E. Gardner*

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

Enclosures

Copy for § 6110 purposes  
Copy of this letter

cc: