

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

Refer Reply To:
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Date:
May 13, 2019

Attn:

Re:

Legend

- Decedent =
- Trust =
- Beneficiary =
- Son =
- Grandson =
- Granddaughter =
- Court =
- Year 1 =
- Year 2 =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- Date 5 =

Dear :

This letter responds to your letter, dated November 6, 2018, submitted by your authorized representative, requesting generation-skipping transfer (GST) tax rulings with respect to a judicial construction and modification of Trust.

Decedent died testate on Date 1, a date prior to September 25, 1985. Under the terms of Decedent's last will and testament, a trust (Trust) was created for the primary benefit of Decedent's great-nephew, Beneficiary. Under the terms of Trust, all the trust income was to be distributed to Beneficiary for life, and upon Beneficiary's death to

Beneficiary's living issue, *per stirpes*. Distributions of principal were not permitted. Trust terminates upon the earlier of two dates: (1) the date that is 21 years after Beneficiary's death, or (2) the date that the youngest of Beneficiary's issue reach the age of 21. Upon Trust's termination, the trustee is to distribute the trust corpus to Beneficiary's then-living issue, *per stirpes*.

In Year 1, Beneficiary and the trustee of Trust petitioned Court to modify Trust. At that time, Beneficiary had one son (Son) and two grandchildren (Grandson and Granddaughter), all of whom were over the age of 21. Accordingly, under the terms of Trust as of Year 1, Trust was to terminate upon Beneficiary's death and the assets of Trust were to be distributed outright to Son if living.

Pursuant to a Court order dated Date 2, Trust was modified and any outright distribution to Son upon termination was instead to be held in further trust for Son's lifetime benefit. Under the new terms of Trust, the trustee had absolute discretion to pay income or corpus to or for the benefit of Son, and at the death of Son, distribute one half of the trust to Grandson, if living, in a separate trust, otherwise to his estate; and one half to Granddaughter, if living, in a separate trust, otherwise to her estate. Trust as modified also directed the trustee to consider, before making a distribution, whether a beneficiary was a substance abuser and if the trustee so suspects, to request that the beneficiary submit to testing and treatment. Any treatment costs are to be charged first against income and then principal.

Beneficiary died on Date 3, survived by Son. Son died on Date 4, survived by Grandson and Granddaughter.

In Year 2, the trustee petitioned Court to further construe Trust to clarify that Son has a general power of appointment over the assets in Trust. Such clarification ensures that the assets of Trust will be taxed as part of Son's gross estate and that there will be no extension of the time for vesting under the original terms of Trust. Pursuant to a Court order dated Date 5, Trust was clarified to state that Son has a general power of appointment over the assets of Trust. The order further provides that Trust is not required to file annual accounts or final accounts with the Court insofar as such accountings are no longer necessary.

It has been represented that no additions have been made to Trust after September 25, 1985.

You have requested a ruling that after the judicial construction and modifications to the administrative and dispositive provisions of Trust, Trust remains exempt from the application of the GST tax and that no distributions during the term of Trust or upon final termination will be subject to GST tax.

Law and Analysis

Section 2601 imposes a tax on every GST made after October 26, 1986. A GST 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.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). 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, if the settlor had died on September 25, 1985.

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 this paragraph 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)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener’s error will not cause an exempt trust to be subject to the GST provisions if: (1) the judicial action involves a bona fide issue; and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state.

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 § 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 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.

In § 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.

In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the

best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving “proper regard” to the state trial court’s determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

In this case, an examination of the documents together with state law confirms that Decedent intended to give Son a power of appointment and the Date 5 order clarified such right. Further, the court order providing that no annual accounts or final accounts were required is administrative in nature under § 26.2601-1(b)(4)(i)(D)(2), and will not be considered to shift a beneficial interest to a lower generation in the trust. See § 26.2601-1(b)(4)(i)(E), *Example 10*. Because the assets are to be included in Son’s gross estate, Son is now treated as the owner for GST purposes. Accordingly, after the judicial construction and modifications to the administrative and dispositive provisions of Trust, Trust remains exempt from the application of the GST tax and no distributions during the term of Trust or upon final termination will be subject to GST tax.

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, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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,

Leslie H. Finlow

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures