

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-134595-01

Date:

December 14, 2001

Re:

LEGEND:

Settlor =  
Spouse =  
Child A =  
Child B =  
Date =  
Trust =

Trust A =

First Corporate Trustee =  
Successor Corporate Trustee =

Dear :

This is in response to the June 13, 2001 letter requesting a ruling on the generation-skipping transfer tax consequences of the judicial reformation of Trust A. The facts submitted and representations are as follows.

Settlor died on Date, prior to September 26, 1985, survived by Spouse, Child A and Child B. Trust was created in Item VII of Settlor's will. Under Paragraphs (A) and (B) of item VII, during Spouse's lifetime, Trust was to be held for the benefit of Spouse and Settlor's living descendants. On Spouse's death, the Trust property was to be divided into separate equal shares to provide one share for each then living child of Settlor and one share for each then deceased child of Settlor who died leaving a spouse and/or issue.

Under Item VII, Paragraph (D), a share created for a child living at Spouse's death is to be held in further trust. Under Paragraph (D), subparagraphs 1 and 2, the income from the share is to be paid to or for the benefit of the child for life. The corporate trustee may also pay to or apply for the benefit of the child such sums of principal of the share as deemed necessary or desirable for medical care, comfortable

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maintenance and welfare, taking into consideration to the extent the corporate trustee deems advisable any other income or resources of the child known to the trustee. The terms of the trust provide that no individual trustee of the trust is to have any authority to make distributions under this provision. Under subparagraphs 3, 4, and 5, on the death of the child leaving issue, the trustee is to distribute outright to the child's issue per stirpes the undistributed balance of the share along with any accumulated but undistributed income. If the child leaves no issue but leaves a surviving spouse, the share will be retained in further trust with income payable for the spouse's benefit until the spouse's death or remarriage. On the spouse's death or remarriage, the principal is to pass for the benefit of Settlor's other child.

Under Item XIV, Paragraphs 1 and 2, Spouse and First Corporate Trustee were designated as the co-trustees. If Spouse ceased to act as trustee, Child A and Child B were to be the co-trustees along with the corporate trustee.

Trust was established on Settlor's death. Spouse has since died and, pursuant to Item VII, Paragraph (b), on Spouse's death, Trust was divided into equal shares. One such share, Trust A, was created for Child A. Successor Corporate Trustee and Child A are serving as the co-trustees of Trust A.

Successor Corporate Trustee has petitioned the local probate court to reform Trust A. Pursuant to the proposed reformation, Item VII, Paragraph (D), subparagraph 1, will provide that the trustee will pay, distribute, or disburse, to or for the benefit of the child (Child A), for life, in each calendar year, an amount equal to five percent of the average fair market value of the child's share (Trust A) as of the close of the last business day of the three previous calendar years, or the net income from the child's share for the calendar year, whichever is greater.

Under the proposed reformation, the corporate trustee will have the authority to petition the local probate court to change the five percent distribution rate, in appropriate circumstances. Any such change must be approved by the probate court. Further, no individual trustee shall have any authority to determine if the rate shall be changed.

Under Item VII, Paragraph (D), subparagraphs 2 and 3, all computations of fair market value will include accounting income and principal, but no accruals are required. If the trust includes assets for which there is not a ready market, the trustee will adopt a method of evaluation as the trustee deems reasonable in its discretion under the circumstances. The distribution amount is to be paid first from net accounting income, next from net realized short-term capital gains, then from net realized long-term capital gains and, as necessary, from principal.

In all other respects, the terms of the reformed Trust A will be identical to those of the original Trust A.

Requested ruling:

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You have asked us to rule that the reformation of Trust A as proposed will not cause Trust A to lose exempt status for generation-skipping transfer tax purposes.

Discussion:

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), the generation-skipping transfer (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) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after 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 generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains 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 will not cause an exempt trust to be subject to the GST tax 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. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer.

Section 26.2601-1(b)(4)(i)(E), Example 8, illustrates a situation where a trust that is otherwise exempt from the GST tax provides that trust income is payable to A for life and, upon A's death, the remainder is to pass to A's issue, per stirpes. In 2002, the appropriate local court approves a modification to the trust that converts A's income interest into the right to receive the greater of the entire income of the trust or a fixed percentage of the trust assets valued annually (unitrust interest) to be paid each year to A for life. The example concludes that the modification does not result in a shift in beneficial interest to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the

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modification. Rather, the modification can only operate to increase the amount distributable to A and decrease the amount distributable to A's issue. 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 modification will not subject the trust to the provisions of chapter 13.

In this case, the modification of Trust A to provide for the distribution to Child A of the greater of the Trust A income for the calendar year or an amount equal to five percent of the average fair market value of Trust A as of the close of the last business day of the three previous calendar years does not result in a shift of any beneficial interest in Trust A to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification. See § 26.2601-1(b)(4)(i)(E), Example 8. Further, the modification does not extend the time for vesting of any beneficial interest in Trust A beyond the period provided for in the original Trust.

Accordingly, based on the facts submitted and the representations made, the modification to Trust A, as proposed, will not cause Trust A to lose its exempt status for GST tax purposes.

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 the appropriate party. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations. We are specifically not ruling on the gift tax and income tax consequences of the transaction.

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.

Sincerely yours,  
George L. Masnik, Chief, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure  
copy for § 6110 purposes