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LEGEND

Date 1 =
Donor =
Children's Trust =
Niece and Nephew Trust =
Donor's Spouse =
State =
Trustee 1 =
Date 2 =
State Statute 1 =
State Statute 2 =
Religion =
Date 3 =
Date 4 =
Family Endowment Trust =
Trustee 2 =
Trustee 3 =
Year 1 =

Dear :

This responds to your letter dated July 30, 2008, submitted on your behalf by your authorized representative, concerning the estate and generation-skipping transfer (GST) tax consequences of the proposed modification of certain trusts.

FACTS

The facts and representations submitted are as follows.

On Date 1, a date after September 25, 1985, Donor established the Children's Trust for the primary benefit of his children. On the same date, Donor established the Niece and Nephew Trust for the primary benefit of the children of each brother of Donor's Spouse. Each trust is an irrevocable trust the terms of which are presently governed by the laws of State.

Trustee 1 is the trustee of the Children's Trust and is not related or subordinate to Donor. The Children's Trust provides for discretionary distributions of principal or income to any child of Donor until the oldest then-living child attains age 21. At that time, the remaining assets of the Children's Trust will be divided into equal separate shares, one for each then living child of Donor and one for each deceased child of Donor with then living issue. A separate share created for the issue of a deceased child of Donor shall be further divided into separate shares for each issue, by right of representation. Thereafter, the trustees may make discretionary distributions of principal and income to the child or issue of a deceased child of Donor for whom the separate share was created, with a mandatory distribution of 10 percent of the principal of the trust when the child or issue of a deceased child attains age 30 and a mandatory distribution of the remaining assets of the trust when the child or issue of a deceased child attains age 40. The trust further provides for the division and eventual distribution of assets to more remote issue in the event a child or issue of a deceased child of Donor, for whom a separate trust has been created, dies prior to final distribution of the assets of such separate trust. If, upon the death of a child or issue of a deceased child of Donor, the distribution of assets from the separate trust created for a beneficiary would result in the imposition of a generation-skipping transfer (GST) tax, that beneficiary has a testamentary power to appoint the assets of the trust of his or her separate share to any person, including such beneficiary's estate. The Children's Trust will terminate upon the final distribution of the assets pursuant to the terms of the trust, unless Donor's line of issue fails or earlier termination is required by operation of local law.

Trustee 1 also serves as the trustee of the Niece and Nephew Trust. The Niece and Nephew Trust provides for discretionary distributions of principal or income to the children of each brother of Donor's Spouse, subject to a maximum amount of distributions to each individual beneficiary. When the oldest then-living beneficiary attains age 30, the balance of the trust's assets will be divided into equal separate shares, one for each then living beneficiary of the trust (on a per capita and not on a per stirpes basis), and distributed outright and free of trust to such beneficiary. However, all previous distributions made to a beneficiary shall be charged, without interest, against the share to be distributed to such beneficiary. The trustees may withhold distributions to a beneficiary if the beneficiary does not demonstrate characteristics of industry, thrift, and intelligence as satisfy the trustees that the distribution of assets will be wisely used

or prudently invested by such beneficiary. Such determinations by the trustees, in their sole discretion, shall be conclusive and not subject to review.

The administrative provisions regarding trustees and the trust protector are substantially similar in the Children's Trust and the Niece and Nephew Trust as are the provisions outlining the trustees' powers. The Children's Trust and the Niece and Nephew Trust each appointed an initial trustee and a trust protector ("protector"). The Children's Trust and the Niece and Nephew Trust each provide that the purpose of appointing a protector was to protect the respective trust and its beneficiaries. Accordingly, the protector of each trust is authorized to receive and review any and all records and documents concerning the respective trust. The protector of each trust is prohibited from having any financial interest in any property of the respective trust or in the transaction of any business with such trust other than the payment of fair and reasonable compensation for the services of the protector. The protector of each trust may provide the consent necessary as to the transaction of any business by a trustee of the respective trust if the consent of an independent party, who is not related or subordinate to a trustee then serving, is necessary or advisable. The protector of each trust is authorized to add to the number of trustees of the respective trust.

The Children's Trust and the Niece and Nephew Trust each provide that in the event of the resignation, removal by the protector, death, or incapacity of the initial trustee or any successor trustee, the protector of the respective trust shall immediately appoint any bank or trust company, or a person other than the donor, a descendant of the donor, a person legally obligated to support any descendant of the donor, or a person who also would be disqualified from acting as the protector, as successor trustee of that trust.

The Children's Trust and the Niece and Nephew Trust each appoint an original protector and provide a mechanism for appointing successor protectors. The Children's Trust and the Niece and Nephew Trust further provide that in no event may the person named as protector be the donor or a person who has a beneficial interest in the trust or who is obligated for or chargeable with the support of any person who has a beneficial interest in the trust.

On Date 2, in the local court having jurisdiction over the trusts, Donor filed a petition, as authorized by State Statute 1, seeking to amend and supplement certain administrative provisions of the Children's Trust and the Niece and Nephew Trust. State Statute 1 generally provides that a donor may amend the trust agreement by written consent of the settlor and all beneficiaries of a trust or any part thereof. State Statute 2 further provides that if there are any legally incapacitated, unascertained, or unborn beneficiaries, consent may be given on their behalf by a court after a hearing in which the interests of such beneficiaries are represented by a guardian ad litem. In his petition, Donor requested the following modifications to the administrative provisions of the trusts:

1. To replace a current provision in the trusts limiting a trustee or protector's liability to those acts or omissions due to willful misconduct with a provision limiting liability only to those acts or failures to act when the trustee or protector acted in good faith.

2. To replace a current provision in the trusts providing that trustees shall be entitled to payment of their reasonable expenses and to reasonable compensation for their services and waiving any bond required of a trustee with a provision providing that the trustee and trust protector shall be entitled to payment of their reasonable expenses and to reasonable compensation for their services. The amended provision also provides that in determining reasonable compensation, compensation guidelines contained in Exhibit A shall be applied. The compensation guidelines set a maximum annual trustee's fee of 15 basis points times the fair market value of the trust assets and set the annual protector's fee at 8 basis points times the fair market value of the trust assets.

3. To add a provision requiring any trustee serving under the trust instrument to deliver to the protector a written authorization directing the release to the protector of individually identifiable health information and other medical information relevant to a determination of such trustee's ability to act as trustee ("HIPAA authorization"). A HIPAA authorization executed and delivered to the protector may be used by the protector solely for the purpose of determining a person's ability to act as trustee under this instrument. Similarly, this provision requires the protector to execute a HIPAA authorization for determining the protector's ability to act as protector under the trust instrument. The protector may select the person to whom such HIPAA authorization is granted.

4. To add a provision encouraging the trustees to establish guidelines for morally responsible investment of the assets of the trust, notwithstanding the provisions of the State's prudent investor act or any other rule of law. This provision further provides that no trustee nor any investment advisor or manager serving the trust shall incur any liability whatsoever on account of establishing or observing such guidelines for morally responsible investment of trust assets.

5. To add a provision requiring a majority of any individual trustees serving under the trust instrument to be members of Religion. This provision further provides that an individual shall be deemed to be a member of Religion if he or she identifies himself or herself as being a member of Religion.

6. To replace a current provision in the trusts defining the trustees' rights to invest the trust assets with a similar provision that defines the trustees' investment authority to accord with the provisions of the prudent investor act of State statutes, or any successor law as may be applicable to the administration of the trust.

7. To add a provision authorizing the trustees to delegate investment and management functions, in accordance with the provisions of the prudent investor act of State statutes.

8. To add a provision clarifying that no trustee or protector or any affiliate of a trustee or protector shall be retained by the trustee to provide, or be separately compensated for, investment management or advisory services, nor shall the trustee direct investment of trust assets to any private enterprise in which a trustee or protector or any affiliate of a trustee or protector has a financial interest. Such provision includes a de minimis exception for incidental investments in public entities.

A guardian ad litem was appointed to represent the respective minor and unborn beneficiaries of the Children's Trust and the Niece and Nephew Trust. Trustee 1, as the trustee of the Children's Trust and the Niece and Nephew Trust, filed an objection to Donor's petition to amend the trusts. After a hearing, in an order entered on Date 3, the court approved the amendments to the Children's Trust and the Niece and Nephew Trust. The order is effective upon the furnishing to the trustees of a favorable private letter ruling from the Internal Revenue Service ruling that the adoption of the amendments will not cause any of the property of the trusts to be included in the gross estate of the donor, the donor's spouse, or any beneficiary of the trusts for federal estate tax purposes.

On Date 4, a date after September 25, 1985, Donor and Donor's Spouse created the Family Endowment Trust for the primary benefit of the children and issue of Donor and Donor's Spouse. The trust is an irrevocable trust the terms of which are presently governed by the laws of State.

The Family Endowment Trust provides for distributions of income and principal to the children and other issue of Donor, in the discretion of the trustees. The trust instrument sets forth detailed distribution and loan guidelines and provisions. The trustees have broad discretion to make decisions and establish policies not inconsistent with the guidelines in order to carry out the donor's purposes of promoting education, hard work, achievement, integrity, high moral character, family unity, faith in God and religious philanthropy by the beneficiaries of the trust. The trust instrument sets a lifetime limit on the total amount that may be distributed by the trustees from the trust to a single beneficiary. The Family Endowment Trust will terminate only at such time as applicable law requires and the remaining assets of the trust shall be distributed to the donor's then living issue, by right of representation, or if none, to certain charitable organizations. However, certain circumstances may cause the trust to terminate at an earlier date.

The Family Endowment Trust provides for the appointment of three trustees, one from each category of trustees. The trustee from the first category must be a financial professional who is a registered investment advisor or certified financial planner and who has expertise with respect to the investment of trust assets. The trustee from the second category must be an attorney and/or a certified public accountant who has experience with respect to trust law and administration. The trustee from the third

category must be a priest of Religion or, alternatively, a member of the clergy of Religion, who has experience in youth or family counseling. The initial trustees of the first and second category are appointed in the trust instrument while the initial trustee of the third category is to be selected by the other trustees within one year of creation of the trust. Trustee 1, Trustee 2, and Trustee 3 are currently serving as the trustees of the Family Endowment Trust and none of the trustees are related or subordinate to Donor or Donor's Spouse.

A trustee of the Family Endowment Trust may be removed for cause by the written direction of the other two trustees or upon the petition of any beneficiary to a court having jurisdiction. The Family Endowment Trust provides a list of factors that establish cause for removal of a trustee, including incapacity, negligent or willful mismanagement of the trust assets or willful neglect of the trust provisions, a felony charge or a charge involving a serious misdemeanor, an act of stealing, dishonesty, embezzlement, or moral turpitude, the use of narcotics or excessive use of alcohol, and poor health to the point where the trustee is physically, mentally or emotionally unable to devote sufficient time to the administration of the trust. The trust further provides that the trustee in each category shall designate in writing a successor trustee for his or her category. Persons disqualified from serving as a trustee include Donor, Donor's Spouse, any beneficiary of the trust or any person legally obligated to support a beneficiary under the trust.

On Forms 709 (United States Gift (and Generation-Skipping Transfer) Tax Return) for Year 1, Donor and Donor's Spouse each consented to have the gifts made by the other considered as having been made one-half by each spouse under § 2513 of the Code. Donor and Donor's Spouse allocated their respective GST exemption in the amount of the gift tax value of the transfers as reported on Forms 709. It is represented that the Family Endowment Trust has an inclusion ratio of zero for GST tax purposes.

On Date 2, in the local court having jurisdiction over the trust, Donor and Donor's Spouse filed a petition, as authorized by State Statute 1, seeking to amend and supplement certain administrative provisions of the Family Endowment Trust. In their petition, Donor and Donor's Spouse requested the following modifications to the administrative provisions of the trust:

1. To replace a current provision in the trust limiting a trustee's liability to those acts or omissions due to willful misconduct with a provision limiting liability only to those acts or failures to act when the trustee acted in good faith.

2. To replace the current "Trustee Compensation Guidelines" that are applied in determining reasonable compensation of the trustees with new "Trustee Compensation Guidelines." The new compensation guidelines set a maximum annual trustees' fee of 30 basis points times the fair market value of the trust assets and require the trustees to annually determine by majority rule the allocation of trustees' fees among themselves.

3. To add a provision requiring each trustee and each successor trustee serving under the trust instrument to deliver to each co-trustee or successor trustee a written authorization directing the release to each co-trustee or successor trustee of individually identifiable health information and other medical information relevant to a determination of such trustee's ability to act as a trustee ("HIPAA authorization"). A HIPAA authorization executed and delivered as provided may be used by the co-trustee or successor trustee solely for the purpose of determining a person's ability to act as trustee under this instrument.

4. To add a provision that encourages the trustees to establish guidelines for morally responsible investment of the assets of the trust, notwithstanding the provisions of the State's prudent investor act or any other rule of law. This provision further provides that no trustee nor any investment advisor or manager serving the trust shall incur any liability whatsoever on account of establishing or observing such guidelines for morally responsible investment of trust assets.

5. To add a provision requiring at least one of the trustees from the first or second category of trustees to be a member of Religion. This provision further provides that an individual shall be deemed to be a member of Religion if he or she identifies himself or herself as being a member of Religion.

6. To replace a current provision in the trust defining the trustees' rights to invest the trust assets with a similar provision that defines the trustees' investment authority to accord with the provisions of the prudent investor act of State statutes, or any successor law as may be applicable to the administration of the trust.

7. To add a provision authorizing the trustees to delegate investment and management functions, in accordance with the provisions of the prudent investor act of State statutes.

8. To add a provision clarifying that no trustee or any affiliate of a trustee shall be retained by the trustee to provide, or be separately compensated for, investment management or advisory services, nor shall the trustee direct investment of trust assets to any private enterprise in which a trustee or any affiliate of a trustee has a financial interest. Such provision includes a de minimis exception for incidental investments in public entities.

9. To amend a current provision in the trust authorizing the release or renunciation of any power or interest granted under the trust instrument, whether in a beneficial or administrative capacity, by adding a sentence that provides that if a person acting in a fiduciary capacity releases or renounces any power granted under the trust instrument, the release or renunciation shall be binding not only on such person but also on all

successors to such person acting in the same fiduciary capacity, unless otherwise expressly stated in the release or renunciation.

A guardian ad litem was appointed to represent the minor and unborn beneficiaries of the Family Endowment Trust. Trustee 1 objected to the petition to amend the trust. After a hearing, in an order entered on Date 3, the court approved the amendment of the Family Endowment Trust. The order is effective upon the furnishing to the trustees of a favorable private letter ruling from the Internal Revenue Service ruling that the adoption of the amendments will not cause any of the property of the trusts to be included in the gross estate of the donor, the donor's spouse, or any beneficiary for federal estate tax purposes and will not cause the trust to lose its zero inclusion ratio for federal generation-skipping transfer tax purposes.

Donor and Donor's Spouse request the following rulings:

1. The amendments to the Children's Trust, the Niece and Nephew Trust, and the Family Endowment Trust will not cause any of the property of the trusts to be included in the gross estate of Donor, Donor's Spouse, or any beneficiary of the trust for federal estate tax purposes, except to the extent of property that is distributed to such person and remains in his or her estate at the date of his or her death.

2. The amendment of the Family Endowment Trust will not cause the trust to have an inclusion ratio, as defined in § 2642(a) of the Internal Revenue Code, greater than zero.

LAW AND ANALYSIS

Ruling 1

Section 2001 of the Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2035(a) provides that (1) if the decedent transferred an interest in property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of the property (or interest therein) would have been included in the gross estate under §§ 2036, 2037, 2038, or 2042 if the interest or power had been retained by the decedent on the date of death, then the value of the gross estate includes the value of any property (or interest therein) that would have been so included.

Section 2036(a) provides that the value of the gross estate shall include the value of all

property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period that does not in fact end before his death, (1) possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income from the property.

Section 2037(a) provides that the value of the gross estate includes the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate includes the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fine sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

Section 20.2038-1(a)(2) of the Estate Tax regulations provides that § 2038 does not apply if the decedent’s power could be exercised only with the consent of all parties having an interest (vested or contingent) in the transferred property, and if the power adds nothing to the rights of parties under local law.

In order for §§ 2035 through 2038 to apply, the decedent must have made a transfer of property or any interest therein (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. In the instant case, the modifications to the trusts are administrative in nature and do not change any beneficial interests in the trusts. Therefore, the proposed modifications will not cause Donor’s Spouse nor any beneficiary of a trust to be treated as making, or as having made, a transfer of trust property or an interest in any of the trust. Accordingly, the proposed modifications will not cause any portion of the trust property to be includible in the gross estate of the Donor’s Spouse or any trust beneficiary under §§ 2035 through 2038. As for Donor, on the creation of the trusts, Donor made a transfer of property to each trust but retained no interest in, or power over, the income

or corpus of the transferred property. Although Donor has exercised a power to amend the trusts, this power derived not from the trust instruments, but from a state statute that required the consent of all the respective trust beneficiaries and, in this case, a guardian ad litem to represent the minor and unborn trust beneficiaries. The requirements of State Statute 1 and State Statute 2 and applicable state law were satisfied and the modifications of the respective trusts were approved by the local court. The modifications will not cause any portion of the trust property to be includible in the gross estate of Donor.

Ruling 2

Section 2601 imposes a tax on every GST. 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.

Under § 2602, the amount of tax imposed under § 2601 is determined by multiplying the taxable amount (the amount involved in the GST transfer) 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 1 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.

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) 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 GST 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 of the governing instrument by judicial reformation or nonjudicial reformation that is valid under applicable state law 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 GST or the creation of a new GST.

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.

In the instant case, the Family Endowment Trust became irrevocable after September 25, 1985. It is represented that sufficient GST exemption was allocated to the Family Endowment Trust so that the trust has 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 grandfathered trust should similarly not affect the exempt status of such a trust.

The modifications to the Family Endowment Trust were effected in accordance with state law and are viewed as pertaining to the administration of the trust, comparable to the modification in Example 10 of § 26.2601-1(b)(4)(i)(E). We conclude that the modifications (i) will not result in a shift of any beneficial interest in the Family Endowment Trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons holding the beneficial interests prior to the division, and (ii) will not extend the time for vesting of any beneficial interest beyond the period provided for under the Family Endowment Trust.

Accordingly, based upon the facts submitted and the representations made, we rule that the modification of the Family Endowment Trust will not alter the inclusion ratio of the trust for GST tax purposes so that, after the modifications are effected, the trust will maintain an inclusion ratio of zero under § 2642.

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.

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.

Sincerely,

George L. Masnik
Chief, Branch 4
(Passthroughs & Special Industries)

cc: