Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
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Refer Reply To:
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In Re:

Legend:

Decedent	=
Spouse	=
Son	=
Daughter	=
Grandchild 1	=
Grandchild 2	=
Daughter's Spouse	=
Individual	=
Bank	=
Decedent's Will	=
Trust	=

Agreement =

Company =

x =

Year =

Date 1 =
Date 2 =

State =

State Statute =

State Statute 1 =
State Statute 2 =

State Trust Act 1 =

State Trust Act 2 =

Dear :

This letter responds to the March 6, 2009 letter and additional correspondence requesting rulings on the generation-skipping transfer (GST) tax consequences of the proposed modification of Trust.

Decedent died on Date 1, prior to September 25, 1985, survived by Spouse, Son, and Daughter. Article FIFTH of Decedent's Will establishes a residuary trust for the benefit of Decedent's Spouse, children, and grandchildren. Under the terms of the residuary trust, the trustee is to pay to Spouse and/or Decedent's children all or any portion of the net income or corpus as the trustee deems appropriate for their care, maintenance, health, recreation, travel and happiness. In addition, the trustee is to pay to Decedent's grandchildren all or any portion of the net income or principal the trustee in its sole discretion deems appropriate for their care maintenance health and education.

Under, Article FIFTH, paragraph 2., at Spouse's death, the trust will be divided into equal shares for each of Decedent's then living children. The share of a deceased child will be allocated to that child's then living issue. The share for Son is to be paid outright to him. The share for Daughter is to be held in trust by Bank (hereinafter referred to as "Trust").

Under the terms of Trust, the trustee will pay Daughter any or all of the net income and principal in monthly or other convenient installments for her care, maintenance, health, recreation, travel and happiness. After consulting with Daughter, the trustee may also pay any part of the net income to Daughter's issue. At Daughter's death, the principal will be distributed as Daughter appoints under a testamentary special power of appointment to or for the benefit of her lineal descendants. If Daughter does not exercise this power, the remaining principal of Trust will be divided into equal shares for each of Daughter's then living children.

The share of a deceased child will be allocated to that child's then living issue. Each share allocated at Daughter's death to a group of the then living issue of Daughter will be administered as follows: If no then living child of Daughter is under age 21, the share will be distributed outright to Daughter's then living issue by right of representation. If a then living child of Daughter is under age 21, the share will be retained as a separate trust for the benefit of Daughter's then living issue as a group, including those over age 21. The trustee, in the trustee's discretion, will pay to, or for the benefit of, the issue living from time to time as much of the net income and principal of the trust as the trustee deems necessary for a beneficiary's proper support, health, care, maintenance, and education. The trust will terminate when no living child of Daughter is under age 21. Upon termination, the remaining balance of the trust will be distributed outright to the then living issue of Daughter by right of representation; or, if none, to Decedent's heirs. Unless sooner terminated, each trust created under Decedent's Will terminates one day before 21 years after the date of death of the last survivor of Spouse and Decedent's issue living at his death. The remaining assets will be distributed to the beneficiaries in the proportions they are then entitled to receive income payments.

Article FIFTH, paragraph 1, designates Bank 1 and Son as the trustees of the residuary trust. In general, Son is prohibited from participating in any decision regarding his own interest in any income or corpus and regarding the payment or application of any income or corpus to any beneficiary whom he is under a legal obligation to support. Article FIFTH, paragraph 2.g. lists the powers of the trustees. The trustees are to have all the rights and powers authorized under State Trust Act 1, as well as additional powers listed in paragraph 2.g. Article FIFTH, paragraph 2.g. (v) provides, in part, that the trustees are authorized to invest and reinvest any trust property received or held in such stocks, bonds, and securities as may be permitted under the laws of State relating to the investment of trust property by fiduciaries. The trustees will be guided by the "so-called Prudent Man Rule as that term is defined by the laws of [State]."

Spouse died in Year, survived by Son and Daughter. At Spouse's death, pursuant to Article FIFTH, paragraph 2., Trust was established for the benefit of Daughter and her issue. Bank and Son have been serving as co-trustees of Trust since Trust was established, and prior to that time, Son and Bank served as co-trustees of the residuary trust. Trust holds x shares of stock in Company (Stock).

On Date 2, the parties identified below, pursuant to State Statute, executed Agreement to modify Trust. State Statute provides for a binding nonjudicial procedure to resolve matters pertaining to estates or trusts through a written agreement. The following parties executed Agreement: Bank and Son, as co-trustees; Daughter; Grandchild 1 and Grandchild 2 (Daughter's children); Daughter's Spouse; and Individual. Daughter, Grandchild 1, and Grandchild 2 executed the Agreement in their individual capacities as beneficiaries and as virtual representatives of their successors in interest or similar class members under State Statute 1.

Agreement modifies Trust to add provisions regarding the identity and selection of trustees. Under the terms of Trust, as modified by Agreement, Son may serve as co-trustee of Trust, and he may appoint individuals to serve as his successor co-trustee. However, neither, Daughter, Grandchild 1, or Grandchild 2 can be appointed as a successor co-trustee of Trust. A three member trustee selection committee is created solely to remove and replace the corporate trustee and to replace the individual trustee if none is then appointed. The committee is prohibited from appointing a corporate trustee that is related or subordinate to Son, Daughter, Grandchild 1, or Grandchild 2, within the meaning of § 672(c) of the Internal Revenue Code. The trustee selection committee will be comprised initially of Son, Daughter's Spouse, and Individual. Grandchild 2 is named as a successor to any individual who can no longer serve on the trustee selection committee. At any time that none of the named individuals can serve, a majority of the adult beneficiaries of Trust will select successor trustee selection committee members.

Agreement also modifies Trust with respect to the trustees' powers and duties as they pertain to Stock, in particular. Under Trust, as modified by Agreement, the trustees, including any individual co-trustee, will have all powers and duties provided by law, including those under State Trust Act 2, as now in effect and as amended in the future. Agreement lists as illustrations, but not by way of limitation, powers and duties of the individual co-trustee, including the power to direct the corporate trustee as to investment of Stock, including in any manner dealing in and with Stock, and the power to direct the corporate trustee with respect to voting Stock. In addition to the general grant of authority and specific authority and discretion provided elsewhere in Trust and in Agreement, in dealing with Stock the co-trustees will have the power to exercise any voting rights in Stock held by Trust. Further, Son, while serving as co-trustee, may also serve as an employee, officer, manager, or director of Company. The beneficiaries authorize Son to participate in the management of Trust with respect to Stock despite the fact this participation is a conflict of interest, and the beneficiaries affirmatively waive any right to object to such conflict of interest. The Agreement modifies Trust to specify that the trustees are under no obligation to diversify and that State Statute 2 and any common law relating to diversification do not apply to Trust regardless of whether there may be a compelling reason other than diversification to sell Stock. The trustees are to be held harmless for any loss resulting from the failure to sell Stock even where there may have been a compelling reason to do so. The trustees will not, under any circumstances, be liable to Daughter or any other beneficiaries for their actions in retaining Trust's investment in Stock without diversification.

Agreement will become effective upon issuance of a favorable private letter ruling by the Internal Revenue Service.

You have requested the following rulings:

1. The modifications to Trust as provided under Agreement, will not cause Trust to lose its status under § 1433 of the Tax Reform Act of 1986 as exempt from GST tax under chapter 13.

2. The modifications to Trust will not be treated as additions or constructive additions to Trust.

Law and analysis

Section 2601 provides that a tax is imposed on every generation-skipping transfer made by a "transferor" to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer (GST) Tax Regulations, 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 tax does not apply to a transfer 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. This rule does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12.

Section 26.2601-1(b)(1)(iv) provides that, if an addition is made after September 25, 1985, to an irrevocable trust, a proportionate amount of distributions from, and terminations of interests in, property held in the trust is subject to the provisions of chapter 13.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided under § 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post September

25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12.

Under § 26.2601-1(b)(1)(v)(B), the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) will not be treated as an addition to a trust if: (1) such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under § 26.2601-1(b)(1); and (2) in the case of an exercise, the power of appointment is not exercised 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 of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation.

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 will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are generally applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Unless the regulations specifically provide otherwise, 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 of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the 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 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. A modification that is administrative in nature that only indirectly increases the amount transferred 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.

In this case, Trust is exempt from the GST tax because it was irrevocable on or before September 25, 1985, and no actual or constructive additions have been made to Trust since that date.

The modifications to Trust pursuant to Agreement are authorized under State law. We conclude that the modifications: (i) will not result in a shift of any beneficial interest in 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 Trust. Further, the modifications do not cause the exercise, release, or lapse of any powers of appointment with respect to Trust, nor do they cause any actual additions to Trust.

Accordingly, based upon the facts submitted and the representations made, we rule as follows:

1. The modifications to Trust under Agreement will not cause Trust to lose its status under § 1433 of the Tax Reform Act of 1986 as exempt from GST tax under chapter 13.

2. The modifications to Trust will not be treated as additions or constructive additions to Trust.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of provides that it may not be used or cited as precedent.

Sincerely yours,

George Masnik, Chief
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special
Industries)

Enclosure
Copy for section 6110 purposes