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Department of the Treasury
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Person To Contact:
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Telephone Number:

Refer Reply To:
CC:PT&E:B04
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Date:
June 10, 2025

Re:

Legend

Settlor =
Spouse =
Trust 1 =

Trust 2 =

Trust 3 =

Grandchild =
Great-Grandchild 1 =
Great-Grandchild 2 =
Great-Grandchild 3 =
Great-Grandchild 4 =
Great-Grandchild 5 =
Great-Grandchild 6 =
Individual =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Trust Company =
State =
State Court =
State Statute 1 =

State Statute 2 =
State Statute 3 =

Case 1 =
Case 2 =

Dear :

This letter responds to your authorized representative's letter dated November 15, 2024, and subsequent correspondence, requesting a ruling with respect to the federal generation-skipping transfer (GST) tax consequences of a state court construction and proposed modification to divide a trust.

The facts and representations submitted are summarized as follows:

On Date 1, a date prior to September 25, 1985, Settlor created an irrevocable trust, Trust 1, for the benefit of Spouse during Spouse's lifetime. Paragraph 2 of Trust 1 granted Spouse a testamentary power to appoint the balance of Trust 1 upon Spouse's death to or for the benefit of such persons, other than Spouse, Spouse's creditors, Spouse's estate or the creditors of Spouse's estate, as Spouse shall direct and appoint. Trust 1 is governed by the laws of State.

Spouse died testate on Date 2, also a date prior to September 25, 1985, survived by Grandchild and other descendants. Pursuant to Clause Third of Spouse's Will, including one codicil, Spouse exercised the power of appointment over Trust 1 by appointing a portion of the balance of Trust 1 to Trust 2 for the benefit of Grandchild.

Under the terms of Trust 2 as set forth in Clause Third of Spouse's Will, the trustee is to apply the net income of the trust for the use of Grandchild as the "beneficiary" during Grandchild's lifetime. The trustee has no authority to distribute principal. Trust 2 granted Grandchild a testamentary limited power of appointment to appoint Trust 2 upon Grandchild's death, on such lawful terms and conditions, in favor of one or more of Settlor's and Spouse's issue living at the death of Grandchild (excluding Grandchild), or the wife or widow of such issue. To the extent Grandchild's testamentary limited power of appointment is not effectively exercised, the trustee shall transfer, pay over and deliver the principal to the issue of Grandchild living at the expiration of the trust term, in equal shares, per stirpes.

Grandchild died testate on Date 3, a date after September 25, 1985, predeceased by Grandchild's spouse and survived by six children, Great-Grandchild 1, Great-Grandchild 2, Great-Grandchild 3, Great-Grandchild 4, Great-Grandchild 5, and Great-Grandchild 6 (singly, Great-Grandchild; collectively, Great-Grandchildren), and great-great grandchildren.

In Article Fourth of Grandchild's Will, as amended by the First Codicil (Grandchild's Will), Grandchild exercised multiple testamentary limited powers of appointment, including the testamentary limited power to appoint the property of Trust 2, as follows:

> I hereby exercise [the powers of appointment granted to Grandchild], by directing the trustee or trustees of such trusts which are administering such trusts at the time of my death, to continue to administer such trusts as provided herein for the benefit of my then living children and the issue, per stirpes, of any of my children who may then be deceased for the longest possible terms of such trusts as they are limited in the above described trust agreements or wills, as amended.

Under Article Fourteenth of Grandchild's Will, each trust created under Grandchild's Will, including a trust created by an exercise of Grandchild's power of appointment "shall terminate only upon the expiration of the maximum period permitted by applicable law of the jurisdiction governing such trust," unless otherwise sooner terminated.

Based on the above, Grandchild's exercise of the power of appointment caused the property of Trust 2 to be held in further trust, Trust 3, with the following terms. The trustee shall pay or apply all or so much of the income and the principal to or for Grandchild's children (Great-Grandchildren) and their issue, as the trustee, in its sole and absolute discretion shall determine to be in the best interests of the beneficiaries. Such distributions shall be made in proportionate shares (per stirpital shares in the case of issue of deceased children) unless the trustee has a compelling reason to make such distributions in disproportionate shares.

Termination Date

On Date 4, Trust Company, as the trustee of Trust 2 and Trust 3, filed a State Court petition seeking a construction of relevant provisions of Clause Third of Spouse's Will and Article Fourth and Article Fourteenth of Grandchild's Will that govern the termination of Trust 3. On Date 5, State Court issued a Decree construing the provisions of Clause Third of Spouse's Will and Article Fourth and Article Fourteenth of Grandchild's Will and determined that Trust 3 will terminate at the expiration of the permissible perpetuities period.

Under State Statute 1, the permissible period of the rule against perpetuities for a trust created by the exercise of a limited power of appointment over a trust begins at the time of the creation of the power of appointment. State Statute 2 provides that no estate in property shall be valid unless it must vest, if at all, not later than twenty-one years after one or more lives in being at the creation of the estate and any period of gestation involved.

In the Date 5 Decree, State Court determined that the beginning of the permissible perpetuities period for Trust 3 relates back to the Date 1 creation of the original limited

power of appointment granted by Settlor to Spouse. Because none of the beneficiaries of Trust 3 (Great-Grandchildren and their issue) were born prior to Date 1, Individual (the youngest issue of Settlor who was living on Date 1) is the measuring life. Thus, State Court concluded that Trust 3 terminates twenty-one years after the first to occur of the death of all of Grandchild's issue (as the beneficiaries of Trust 3), or the death of Individual.

Proposed Division and Modification of Trust 3

In the same petition filed on Date 4, Trust Company petitioned State Court for the modification and division of Trust 3 into six separate trusts along family lines.

State Statute 3 provides, in relevant part, that upon the petition of the trustee and upon notice to all such persons, the court having jurisdiction of an express trust, may direct the establishment of two or more separate trusts for any reason not directly contrary to the primary purpose of the trust.

Under the terms of Trust 3, after Grandchild's death on Date 3, all property of Trust 3 has continued to be held in one share for the benefit of Grandchild's issue. Because the Great-Grandchildren have different investment goals and distribution needs, Trust Company petitioned State Court to divide Trust 3 into six equal, separate trust shares for the benefit of each of the Great-Grandchildren and their respective issue (Resulting Trusts).

The petition states that if State Court construes the relevant provisions of Spouse's Will and Grandchild's Will, such that a favorable ruling is obtained, each Resulting Trust will be identical to the terms of Trust 3 with the following modifications: (1) each Resulting Trust shall terminate twenty-one years after the first to occur of the death of all of Grandchild's issue who are the beneficiaries of such Resulting Trust or the death of Individual; and (2) if a Great-Grandchild dies during the term of his or her Resulting Trust, the deceased Great-Grandchild's Resulting Trust shall continue to be held in trust for the benefit of such Great-Grandchild's per stirpital issue, and in default of any such issue, shall be divided equally among the remaining separate Resulting Trusts.

In the Date 5 Decree, State Court approved the division of Trust 3 into the Resulting Trusts and the modifications to Trust 3, contingent upon the receipt of a favorable ruling from the Internal Revenue Service.

It is represented that there have been no additions, constructive or actual, to Trust 2 or Trust 3 after September 25, 1985.

You have requested the following rulings:

1. State Court's construction will not cause Trust 3 or any Resulting Trust to lose its status as exempt from the application of GST tax imposed under § 2601.

2. State Court's modification and division of Trust 3 will not cause Trust 3 or any Resulting Trust to lose its status as exempt from the application of GST tax imposed under § 2601.

LAW AND ANALYSIS

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations provide that the GST tax shall not apply to any GST under a trust that was irrevocable on September 25, 1985, but shall apply to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

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) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its 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)(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)(E), *Example 3*, considers a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of A and B, or per capita among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee filed a construction suit with the appropriate local court to resolve the ambiguity. The court issued an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates. The court's construction resolves a bona fide issue regarding the proper interpretation of the instrument and is consistent with applicable state law as it would be

interpreted by the highest court of the state. Therefore, the trust will not be subject to the GST tax.

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.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 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. 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. However, 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 a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), *Example 5*, illustrates a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue.

The division of the trust into two trusts does not shift any 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 division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In this case, Grandchild's exercise of the power of appointment under Article Fourth of Grandchild's Will created a bona fide issue regarding the termination date and final distribution of Trust 3. State Court's construction of the relevant provisions in Clause Third of Spouse's Will and Article Fourth and Article Fourteenth of Grandchild's Will is consistent with applicable state law that would be applied by the highest court of the state. *See Case 1; Case 2*. Accordingly, based on the facts submitted and the representations made, we conclude that State Court's construction will not cause Trust 3 or any Resulting Trust to lose its status as exempt from the application of GST tax under § 2601.

Further, the proposed modification and division of Trust 3 into Resulting Trusts will not result in a shift of any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification and division. The proposed modification and division of Trust 3 into Resulting Trusts will not extend the time for vesting of any beneficial interest beyond the period provided for in Trust 3, as construed by State Court Decree. Accordingly, based on the facts submitted and the representations made, we conclude that State Court's modification and division of Trust 3 will not cause Trust 3 or the Resulting Trusts to lose its status as exempt from the application of GST tax imposed under § 2601.

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 rulings contained in this letter are based upon information and representations submitted by the taxpayers accompanied by penalty of perjury statements executed by the appropriate parties. While this office has not verified 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 6100(k)(3) provides that it may not be used as precedent.

Sincerely,

Karlene M. Lesho

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Karlene M. Lesho
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure:
Copy for § 6110 purposes

cc:

cc: