

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09 / PLR-140033-02

Date:

November 19, 2002

Re:

**LEGEND**

- Decedent =
- Trust =
- Date 1 =
- Date 2 =
- Date 3 =
- Child 1 =
- Child 2 =
- Charity =
- Granddaughter =
- Great-granddaughter =
- Trustee =
- Date 4 =
- State Court =

Dear :

In a letter dated July 3, 2002, you requested rulings concerning the generation-skipping transfer (GST) tax consequences of a judicial modification of an irrevocable trust. This letter responds to your request.

The facts submitted and representations made are as follows: Decedent created Trust, a revocable living trust, on Date 1. On Date 2, Decedent amended and restated Trust in its entirety. Trust became irrevocable upon Decedent's death on Date 3.

Article I, Paragraph 5 of Trust provides that upon Decedent's death, the trustee shall divide the trust estate into equal shares for Child 1 and Child 2.

Article I, Paragraphs 6 and 12 provide that the net income of each share held for the benefit of a living child shall be distributed in monthly or other convenient installments or to the benefit of the child for whom the share was set aside during the remainder of his life. In addition, if the income to which either child is entitled is insufficient in the trustee's discretion to provide for the reasonable support, care, comfort and education of each such child, the trustee may pay to such child so much of the principal as the trustee deems necessary for such purposes.

Article I, Paragraph 7 provides that upon the death of Child 1 or Child 2, such child's share shall be held in further trust for such child's then living issue. If either Child 1 or Child 2 dies and is not survived by then living issue, such child's share shall be divided into equal shares, with one share for each then living child of the survivor of Child 1 and Child 2, and one share for the then living issue of each deceased child of the survivor of Child 1 and Child 2.

Article I, Paragraph 8(c) provides that upon the death of a grandchild for whose benefit a part or share is held, such part or share shall be distributed to the lawful issue of such grandchild, on the principle of representation.

Article I, Paragraph 9 provides that any of the trust estate not otherwise disposed of shall be distributed to Charity.

The current beneficiaries of Trust are Child 1, Child 2, Granddaughter and Great-granddaughter. The contingent beneficiary is Charity.

Under Article I, Paragraph 8(c), Trust will terminate at the death of the survivor of Child 1, Child 2, and Granddaughter. Great-granddaughter, if she survives the other beneficiaries, will receive the corpus of the trust outright. Great-granddaughter, however, has a history of having difficulty managing money. Accordingly, Trustee and the beneficiaries, including Great-granddaughter, have determined that the amount that would otherwise be distributed outright to Great-granddaughter should be preserved for her benefit.

On Date 4, Trustee petitioned State Court for an order approving a modification to the terms of Trust. The proposed modification provides that upon the deaths of Child 1, Child 2, and Granddaughter, any assets that would otherwise be distributed outright to Great-granddaughter will instead be retained in a lifetime trust for Great-granddaughter. All of the income of the trust will be distributed outright to Great-granddaughter and Trustee and/or a special power holder will have the power to make distributions of principal to or for Great-granddaughter's benefit. In addition, Great-

granddaughter will be given a general power to appoint the corpus of the trust to anyone, including her estate.

All of the current and contingent beneficiaries of Trust, including Great-granddaughter, executed written consents to the proposed modification. These consents were attached to the petition filed with State Court.

Subsequently, State Court issued an order approving the proposed modification of Trust. The order is contingent upon receipt of a favorable private letter ruling from the Internal Revenue Service. Trustee now requests a ruling that the modification of Trust, as approved by State Court, complies with the provisions of § 26.2601-1(b)(4)(i)(D)(1) and will not cause Trust to be subject to the tax on generation-skipping transfers under chapter 13 of the Code.

### LAW AND ANALYSIS

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping transfer tax shall not apply to any generation-skipping 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).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, Trust is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(4) 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)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its 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)(1) 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) of this section) 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 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.

In the present case, the proposed modification to Trust provides that Great-granddaughter's share will be held in trust for the exclusive benefit of Great-granddaughter during her lifetime. In addition, Great-granddaughter will have a general power of appointment over the trust corpus. Accordingly, the assets of the continuing trust for the benefit of Great-granddaughter will be included in Great-granddaughter's gross estate for estate tax purposes under § 2041(a)(2). Further, Great-granddaughter will be treated as the transferor of the trust corpus for GST tax purposes under § 2652(a)(1).

Under these circumstances and based on the facts submitted and the representations made, we conclude that the proposed modification complies with the provisions of § 26.2601-1(b)(4)(i)(D)(1) and will not cause Trust to be subject to the tax on generation-skipping transfers under chapter 13 of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 the taxpayer.

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,

James F. Hogan

James F. Hogan  
Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

Copy for 6110 purposes