

Internal Revenue Service

Number: **200214019**

Release Date: 4/5/2002

Index Number: 2601.00-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-137135-01

Date:

December 27, 2001

Re:

Legend:

Trust =

Trustee =

Decedent =

Date 1 =

Date 2 =

Date 3 =

Court =

State =

Dear :

This is in response to your letter dated June 28, 2001 in which a ruling was requested concerning the generation-skipping transfer tax consequences of a proposed reformation of Trust.

Decedent died testate on Date 1. Under Item VI of Decedent's will, Decedent established Trust for the primary benefit of Decedent's wife, Decedent's four children, and their issue.¹ Under Item VI(2) of the will, the Trustee is required to distribute one-half of the Trust net income to Decedent's wife for life. The balance of the Trust net income is to be divided into four shares with one share payable to each living child of Decedent, and if a child is not living, to the deceased child's issue, per stirpes. Upon the death of the Decedent's wife, all the Trust net income is to be divided into four equal

¹ A small monthly payment was to be made to Decedent's sister for the life-time support of Decedent's brother. If the sister predeceased the brother, the monthly payment was to be paid to the brother.

parts and distributed to the Decedent's children, or their surviving issue, as the case may be. Under Item VII of the will, the Trustee has discretion to distribute to each Trust beneficiary that beneficiary's respective portion of corpus to meet any emergency produced by sickness, accident or similar cause. Item XII(m) of the will provides, "[i]t is intended that only the cash dividends and actual distribution of income from the businesses represented by the securities or holdings that are part of the trust estate shall be treated by the Trustee as income distributable to the beneficiaries. Any stock dividends or other extraordinary distributions shall be deemed to be a part of and added to the corpus of the trust estate. The Trustees are authorized to determine whether or not a distribution shall be regarded as income or as corpus and the reasonable determination of the Trustees shall be binding and conclusive upon all parties."

Under Item VI(5) of the will, the Trust will terminate 21 years after the death of the last survivor of Decedent's wife and Decedent's four children. At the time of termination, the Trustee is to distribute the principal of the Trust estate in equal shares to the Decedent's living grandchildren, with a share for the child, children or descendants thereof of any deceased grandchild to be divided among such child, children, or descendants thereof, per stirpes.

The last survivor of Decedent's wife and children died Date 2 and, accordingly, the Trust will terminate on Date 3. The Trust's portfolio has been weighted heavily in low-basis, highly appreciated equities and produces a low annual return. One or more beneficiaries of Trust expressed a wish to receive greater income from Trust, raising a controversy as to the actions by the Trustee in connection with distributions to the beneficiaries. The Trustee petitioned the appropriate State Court for Construction, Direction and Declaratory Judgment. The petition asks the Court to construe the provisions of the will and State law to determine whether the Trustee is authorized under the will and State law to allocate a portion of capital appreciation to income and then to adopt and implement a "total return" policy. Under this policy, the Trustee could allocate a portion of capital appreciation to income so that the amount distributable annually to the current beneficiaries equals the greater of (1) three and one-half percent (3 ½ %) of the market value of the Trust per annum, or (2) all net income. Under State law, Court, upon petition, may construe the will, settle uncertainties with regard to the rights of beneficiaries, and authorize the Trustee to adopt a total return policy.

In the present case, Trust was irrevocable on September 25, 1985. It is represented that no additions or contributions have been made to Trust after that date.

You have requested a ruling that if the Court construes the will to authorize the Trust to provide for a 3 ½ % total return policy, as outlined above, the implementation by the Trustee of the Court's ruling will not cause the Trust to lose its exempt status for purposes of the generation-skipping transfer tax under § 2601 of the Internal Revenue Code.

Section 2601 imposes a tax on every generation-skipping transfer made by a transferor to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22,

1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, 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. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died on 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 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 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) and (2) provides that a modification 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 will not result in the shift of a beneficial interest to a lower generation beneficiary if the modification does not result in an increase in the amount of a GST transfer or the creation of a new GST transfer.

In the present case, the proposed reformation of the method of distribution under Trust to provide for the distribution of the greater of Trust's annual net income or 3 ½ % of Trust's total value as determined on an annual basis will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the reformation. See § 26.2601-1(b)(4)(i)(E), Example 8. Further, the proposed reformation will not extend the time for vesting of any beneficial interest in the Trust beyond the period provided for in Trust. Accordingly, based on the facts submitted and the representations made, the proposed reformation will not cause Trust to lose its exempt status for purposes of the generation-skipping transfer tax under § 2601.

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

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. We are specifically not ruling on the gift tax and income tax consequences of the reformation.

The 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,
Lorraine E. Gardner
Assistant to the Branch Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes

cc: