

Internal Revenue Service

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Department of Treasury

P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

Person to Contact:

Telephone Number

Refer Reply to:

CC:DOM:P&SI:4/PLR-113640-98

Date: November 13, 1998

Re:

Legend:

Trust =

Donor =

X =

Spouse =

Y =

Marital Trust =

Family Trust =

Daughter 1 =

Daughter 2 =

Z =

Court =

Court Order =

Dear :

This is in response to a letter dated May 6, 1997, and subsequent correspondence from your authorized representative, in which a ruling was requested concerning the federal generation-skipping transfer tax consequences of a Court Order construing Trust.

Facts:

Trust was established by Donor as a revocable inter vivos trust and became irrevocable at Donor's death on date X.

Under the terms of Trust, at Donor's death, the trust estate was divided into a Marital Trust, provided under Article Three, and a Family Trust, provided under Article Four. Under paragraph A.1. of Article Three, during her life, Spouse was to receive all of the net income of the Marital Trust and any amount of principal she requested in writing. Under paragraph A.3. of Article Three, Spouse was granted a testamentary general power of appointment over the Marital Trust. That paragraph further provides that to the extent Spouse fails to appoint the trust property it will be added to the Family Trust.

Paragraph 1 of Article Four provides with respect to administration of the Family Trust:

During the life of the Donor's wife, [Spouse], and thereafter so long as one or more of the Donor's grandchildren are living and under twenty-one (21) years old, the Trustee shall pay and/or apply the net income and principal, or either, of [Family Trust] in such amounts, proportions and manner as the Trustee shall in the Trustee's sole discretion determine to be advisable for the care, comfort, support and/or advancement of any one or more of the Donor's wife and his issue from time to time living; provided that in no event shall the Trustee distribute amounts of principal which will equal, in the aggregate, more than twenty per cent (20%) of the Trust principal at the time any principal amount is distributed.

Paragraph 2 of Article Four provides:

Notwithstanding the foregoing authorization to the Trustee to pay and/or apply the net income and principal of [Family Trust] among the Donor's wife and all of the Donor's issue, it is the Donor's intent that first priority be given by the Trustee to payments to the Donor's wife, [Spouse], for her care, comfort, support and /or advancement and thereafter to the Donor's daughters [Daughter 1] and [Daughter 2] for their care, comfort, support and/or advancement.

Under paragraph 3 of Article Four, after the death of Spouse and Donor's children, the remainder of Family Trust will be divided into equal shares to be distributed outright to Donor's then living grandchildren or held in trust for the issue of any deceased grandchildren of Donor.

It is represented that Spouse requested distribution to her of all of the assets of the Marital Trust during her life. Spouse died testate on date Y. It is further represented that Daughters 1 and 2 are still living and that currently all of Donor's grandchildren are over age 21.

The beneficiaries and Trustee of Trust believe paragraph 1 of Article Four is unclear as to whether income or principal can be distributed to any of Donor's issue while either of Donor's children is living, if Spouse is deceased and all of Donor's grandchildren are over age 21.

Z, an institution, is Trustee of Trust. Z filed a petition with Court requesting Court to interpret paragraph 1 of Article Four and to authorize the Trustee accordingly. Court issued Court Order. The Court Order concluded that it was Donor's intent that during the lifetime of his wife and thereafter, so long as either one of the Donor's children is living, the net income and principal, or either, of Family Trust is to be paid in such amounts, proportions and manner as the Trustee shall in the Trustees' sole discretion determine to be advisable for the care, comfort, support and/or advancement of any one or more of the Donor's wife and issue from time to time living; provided that in no event shall the Trustee distribute amounts of principal which will equal, in the aggregate, more than twenty per cent (20%) of the Trust principal at the time any principal amount is distributed.

The Court Order authorizes Trustee to make distributions to Donor's issue of income and/or principal from Family Trust consistent with the Court's interpretation.

You have requested a ruling that the Court Order construing paragraph 1, as noted above, will not constitute an addition to Trust under § 26.2601-1 of the Generation-Skipping Transfer Tax Regulations or otherwise cause Trust to lose exempt status for generation-skipping transfer tax purposes.

Law and Analysis:

Section 2601 of the Code imposes a tax on each generation-skipping transfer.

Section 2611 of the Code defines the term "generation skipping transfer" to mean (1) a taxable distribution, (2) a taxable termination, or (3) a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax (GSTT) 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.

In general, any modification or reformation of a trust that was irrevocable on September 25, 1985, that changes the quality, value or timing of any beneficial interest under the trust, will cause the trust to lose exempt status for GSTT purposes.

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.

In the instant case, the trust instrument provides no direction regarding either distribution or accumulation of trust income and principal after Spouse's death and after all of Donor's grandchildren attain age 21. The Court construed the instrument and determined that it was Donor's intent under paragraphs 1 and 2 of Article Four that, after Spouse's death, while either of Donor's children is living and all of Donor's grandchildren are over age 21, income or principal can be distributed among Donor's issue in the Trustee's discretion under the standards and in the amounts provided under paragraphs 1 and 2. We believe this construction of this instrument is consistent with applicable state law.

Accordingly, based on an analysis of the facts submitted and the representations made, we conclude that the Court Order construing paragraph 1 as discussed above, will not constitute an addition to Trust under § 26.2601-1 of the Generation-Skipping Transfer Tax Regulations or a modification of Trust that changes the quality, value or timing of any beneficial interest provided

for under the trust. Therefore, neither the Court Order, nor the distribution of Trust income or principal made pursuant to the Court Order, will cause Trust to lose exempt status for GSTT purposes.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Except as we have specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Chief, Branch 4

Enclosure:

Copy for section 6110 purposes