

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

**Telephone Number:**

**Refer Reply To:**  
CC:PSI:4 - PLR-110092-02  
**Date:** August 19, 2002

Re:

**LEGEND:**

Trust =  
N =  
P =  
Q =  
R =  
S =  
T =  
V =  
State 1 =  
State 2 =  
County =  
Date 1 =

Dear :

This is in response to your letter dated January 15, 2002, requesting rulings on the generation-skipping transfer tax (GSTT) consequences under § 2601 of the Internal Revenue Code to Trust and the federal estate tax consequences under §§ 2036 and 2038 to the Grantor of a proposed modification and division of Trust.

The facts and representations submitted are as follows:

On Date 1, N created Trust, an irrevocable trust, with N's wife, P, and N's eldest two sons, Q and R, and an unrelated individual, V, as trustees. Date 1 is prior to September 25, 1985. Pursuant to Article Eighth of the Trust Agreement, Trust is governed by the laws of State 1. Presently, T has replaced V as a trustee and N's youngest son, S, has been added as a trustee of Trust.

Article Second of Trust provides that until the "time of division", the trustees shall, from time to time, pay to, or apply for the benefit of, any one of more of the issue of N who are living, so much of the net income and principal of the trust, and in such amounts and proportions, as the trustees in their sole and absolute discretion shall determine.

Under Article Second of Trust, the "time of division" is defined as the date of the first to occur of three events: (1) the death of N; (2) the death of N's wife P; and (3) the death of the last surviving issue of N. (1) If the death of N is the time of division, the trustees are to dispose of any and all accumulated and accrued ordinary and capital gain income to or for the benefit of the then living issue of N, as provided in Article Fourth of the Trust (Article Fourth Trust) and the trustees are to dispose of the balance of the principal of the Trust in accordance with Article Third (Article Third Trust). (2) If P's death is the time of division, the trustees are to dispose of the principal of Trust then remaining together with any and all accumulated and accrued ordinary and capital gain income to or for the benefit of the then living issue of N, as provided under the terms of Article Fourth. (3) If the time of division of Trust is the death of the last surviving issue of N, the remaining accumulated and accrued income is to be paid, in such amount and proportions, to such persons an organizations and upon such terms, conditions and trusts, if any, as the last surviving child of N, by provision in his will expressly referring to the power in the Article Fourth Trust, validly nominates, directs and appoints. However, in no event shall the power be exercisable in favor of such child, the estate of such child, his creditors or the creditors of his estate. If the last surviving child of N fails to expressly and validly appoint the remaining accumulated and accrued income, the income is to be disposed in accordance with the descent and distribution laws governing intestate succession. Further, the trustees are to dispose of the principal of the trust for the benefit of P in accordance with Article Third.

Article Fifth of Trust provides that each trust established under Trust is to terminate, and each interest arising under a trust is to vest twenty-one years after the death of the last survivor of the group consisting of N, P, Q, R, and S.

Article Tenth of Trust provides that Trust is irrevocable and that N acknowledges that he has no right or power, either alone or in conjunction with any other person or persons, in whatever capacity, to alter, amend, or revoke the trusts, or any of the terms of the trusts, in whole or in part, or to designate the persons who shall possess or enjoy the property of, or the income from, the trusts.

The terms of Article Fourth

If N's issue and if either N or P survive the time of division, then the Trust property is to be held in further trust (Article Fourth Trust) for the benefit of the then living issue of N and the trustees are to pay or apply for the benefit of any one or more of N's issue who are then living so much of the net income and principal of the Article Fourth Trust, in such amounts and proportions, as the trustees in their sole and absolute discretion shall determine. Upon the death of the last surviving issue of N, during the lifetime of P or N, the trust is to terminate and the trustees are to dispose of the principal of the Article Fourth Trust, together with any and all accumulated and accrued income, in such amounts and proportions, to such persons and organizations and upon such terms, conditions and trust, if any, as the last surviving child of N, by a provision in the child's will expressly referring to Article Fourth, shall validly appoint. In no event may the power of appointment be exercisable in favor of the child, the estate of the child, his creditors or the creditors of his estate. If the child fails to validly appoint the Article Fourth property, the property is to be paid in accordance with the laws governing the distribution of personal property of residents of State 1 dying intestate, applied as if N had died intestate at the time of distribution.

Upon the death of the survivor of P or N during the lifetime of any issue of N, the trust shall terminate and Trustee is to divide the Article Fourth Trust property (principal and accumulated income) into a number of equal shares so that there will be one share for each child of N who survives the death of N and P, and one share for the issue surviving of each deceased child of N. Each share passing to a surviving child of N is to be held in a separate trust for each child for his lifetime, under the terms of Article Fourth, Section C. Each share passing to the issue of a deceased child of N is directed to be paid to such issue, per stirpes, outright and free of trust.

Until the child of N who is a beneficiary of a separate trust attains age twenty-five, the trustees are directed to pay or to apply for the benefit of such child so much or all of the income and principal as the trustees determine in their sole and absolute discretion. From the time that the child of N attains age twenty-five, the trustees are directed to pay to or apply for the benefit of such child, all of the net income of the separate trust for that child and, from time to time, pay to or apply for the benefit of the child such part or parts of the principal of the separate trust as the trustees in their sole discretion, determine to be necessary for the health, support, maintenance, education or welfare of such child or to enable him to enter into, invest in, or carry on any business venture.

Upon such child attaining the age of thirty-five, each child is granted the power to withdraw from his separate trust, such sum or sums as the child shall from time to time request in writing, the aggregate of which, in any one calendar year, may not exceed the greater of five thousand dollars (\$5,000) or five percent (5%) of the total value of the child's separate trust principal on the last day that year. Upon the death of such child, the trustees are directed to pay the balance of the principal of that child's separate trust

then remaining, together with any income accrued but uncollected, and income collected but not disposed of, in such amounts and proportions, to such person and organizations, other than such child, the estate of such child, his creditors or creditors of his estate, as such child, under his last will and testament may validly appoint. If the child fails to validly exercise the power of appointment, the remaining principal and income of the child's separate trust is to be paid, per stirpes, to the surviving issue of the child. If there are no surviving issue, then it shall be paid, per stirpes, to the surviving issue of N. Otherwise, such property is to be distributed according to the laws governing the distribution of personal property of residents of State 1 dying intestate, applied as if N had died intestate at the time of distribution.

#### The terms of Article Third

The principal of Trust shall be held in further trust (Article Third Trust) for the benefit of P. As long as P is alive, the trustees are to pay to, or apply for the benefit of any one or more of the group consisting of P and the issue of N who are then living, so much of the net income and/or principal as the trustees in their sole discretion shall determine. In addition, P may request and the trustees are to pay to P, an amount not to exceed the greater of five thousand dollars (\$5,000) or (5%) five percent of the total value of the principal on the last day of any such year that a request is made.

Upon the death of P, the trustees are to distribute the remaining principal, together with any income accrued but uncollected, and income collected but undisposed of in the Article Third Trust to the Article Fourth Trust to be disposed of under the terms thereof.

#### Proposed Modifications to Trust

N, P, Q, R, S, and T petitioned the State 1 Probate Court of County in order to obtain approval for a proposed modification of Trust. The purpose of the proposed modification and division is to facilitate the pursuit of the "divergent investment objectives and family goals" of N's three children, Q, R, and S, and their respective issue.

Under the proposed modification, Trust will be divided into three equal trusts, each having the same terms as Trust except that each of trust will benefit one child of N, rather than all three children and each child's siblings will no longer be serving as a trustee of each other's trusts. The trustees of each separate trust will be the child of N who is a beneficiary of the separate trust, P and T. Under the proposed modification, the phrase "time of division" will retain its meaning as defined under the original terms of Trust and each separate trust will be divided in accordance with the terms of Article Fourth and Article Third.

Accordingly, if N's death were the first to occur, each separate trust would be divided into an Article Third and an Article Fourth Trust. If P's death were the first to

occur, each separate trust's accumulated and accrued ordinary income and capital gain as well as the remaining principal would be held for each respective child of N in an Article Fourth Trust. Similarly, upon the death of the survivor of N and P, the remaining property of each separate trust would be held in an Article Fourth Trust.

If the death of the last surviving child of N during the life of N and P were the first to occur, this event would be applied separately to each separate trust. If all beneficiaries of one of the three separate trusts were to die (a child of N and of such child's issue), then such separate trust would terminate and the property of that trust would be paid in equal shares to the two remaining separate trusts. If the beneficiaries of one of the two remaining separate trusts were to die, then its assets would be paid to the sole remaining separate trust. Upon the death of the last surviving issue of N, all income of the separate trust would pass in such amounts and proportions to such persons and organizations as the last surviving child of N appoints in his last will, or in default of appointment, under the intestacy laws of State 1. At that time, if P is alive, all remaining principal would pass to an Article Third Trust for the benefit of P.

In any event, the separate trusts, as divided, are subject to the termination provisions under Article Fifth of Trust.

It is represented that there have been no additions to Trust since its creation, Date 1, which is prior to September 25, 1985.

The following rulings are requested:

(1) Consent by N to the Petition to modify Trust will not result in N having a power to alter, amend, revoke, or terminate Trust or result in N retaining a right with respect to Trust with the effect that would cause the Trust property to be includible in N's estate under § 2036 or 2038.

(2) The proposed modification and division of Trust will not shift a beneficial interest in Trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification, and will not extend the time for vesting of any beneficial interest beyond the period provided for in the Trust and, therefore, the proposed modification will not result in a loss of Trust's exemption from the generation-skipping transfer tax.

#### Ruling 1.

Section 2036 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death— (1) the possession or

enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 20.2036-1(b)(3) of the Estate Tax Regulations provides that the right to designate the persons who shall possess or enjoy the transferred property or the income therefrom includes the reservation by the decedent of the unrestricted power to remove or discharge a trustee at any time and appoint himself as trustee.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Section 20.2038-1(a)(2) provides that if a decedent's power could be exercised only with the consent of all parties having an interest (vested or contingent) in the transferred property, and if the power adds nothing to the rights of the parties under local law, then § 2038 does not apply to such power.

N's consent to the Petition to modify the Trust is not treated as a power to alter, revoke or amend Trust under § 2038 because N's consent to modify the Trust is only effective with the consent of all parties having a vested or contingent interest in the Trust, and the power to amend the Trust (with the consent of all the parties to the transaction) adds nothing to the rights of the parties under local law.

Accordingly, we conclude that the consent by N to the Petition to modify Trust will not result in N having a power to alter, amend, revoke, or terminate Trust or result in N retaining a right with respect to Trust with the effect that would cause the Trust property to be includible in N's estate under § 2036 or 2038.

## Ruling 2.

Section 2601 imposes a tax on every generation-skipping transfer (GST), 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), 1986-3 (Vol. 1) C.B. 1, and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping transfer tax does 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 was 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)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from chapter 13 by reason of § 26.2601-1(b)(1), a pro rata portion of subsequent 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)(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), (b)(2), or (b)(3), will not cause the trust to lose its exempt status. The rules of § 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. They 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 provisions of chapter 13, but only if—(1) 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 (2) 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 a 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.

Section 26.2601-1(b)(4)(i)(E), Example 5, illustrates a situation where a trust that is otherwise exempt from the GST tax is divided into two trusts. Under the facts presented, 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 interests prior to the division, and the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Accordingly, the two partitioned trusts will not be subject to the provisions of chapter 13.

In this case, Trust was irrevocable on September 25, 1985. It is represented that no additions to Trust have been made since September 25, 1985.

Based on the facts presented and the representations made, the division of Trust into three separate trusts, one for the benefit of each of Q, R, and S, and their respective issue 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 division. Further, the proposed division will not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for under the original Trust. Accordingly, we conclude that the proposed modification to Trust will not result in a loss of its exemption (or the exempt status of the three separate trusts) from GST tax, provided that there are no additions to Trust or the three separate trusts after September 25, 1985.

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

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

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Lorraine E. Gardner  
Senior Counsel  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:  
Copy for § 6110 purpose

cc: