

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04-PLR-118070-02

Date:

JULY 11, 2002

Re:

Legend:

Decedent =
Residuary Trust =

Spouse =
Daughter =
Son =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Grandchild 5 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
County Court =

State Statute =

Dear :

This is in response to your February 12, 2002 letter and other correspondence requesting a ruling concerning the generation-skipping transfer (GST) tax consequences of the legal settlement and termination of the Residuary Trust.

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You have requested a ruling that the legal settlement and termination of the Residuary Trust will not cause the Residuary Trust to lose GST tax exempt status under sections 1433(b)(2)(A) and 1433(b)(2)(B) of the Tax Reform Act of 1986.

The facts submitted are as follows:

Decedent died testate on Date 1, prior to September 25, 1985. Decedent's will provided that upon Decedent's death, the residue of Decedent's estate is to be divided equally into two trusts, the Marital Deduction Trust and the Residuary Trust. Decedent's surviving spouse (Spouse) is to receive all income from the Marital Deduction Trust. In addition, Spouse is granted a testamentary general power to appoint the corpus of the Marital Deduction Trust. Spouse is also to receive all income from the Residuary Trust and such amounts of principal the trustee deems necessary to provide for Spouse's reasonable support and maintenance, taking into account her other resources.

Decedent's will further provided that upon Spouse's death, the Residuary Trust is to be divided into equal shares for the children of Decedent, Son and Daughter. The net income from each of these shares is to be paid to the beneficiary in monthly or other convenient installments. Upon either child's death, the net income is to be paid to his or her children in equal shares with the issue of a deceased child taking under the principle of representation. Upon the death of the last survivor of Spouse, Son, and Daughter, the Residuary Trust is to terminate and all remaining assets are to be distributed to the grandchildren of Decedent in equal shares per capita, with the share of a deceased grandchild who died leaving issue to pass to his or her issue under the principle of representation.

Son died on Date 2 and Spouse died on Date 3, before September 25, 1985. Currently, Son's three children (Grandchild 1, Grandchild 2, and Grandchild 3) and Daughter are the income beneficiaries of the Residuary Trust. Daughter has two living children, Grandchild 4 and Grandchild 5. Daughter has been serving as trustee of the Residuary Trust since Date 4. It is represented that no additions to the Residuary Trust have been made since Date 1.

On Date 5, Grandchild 1 filed a petition for accounting in County Court against Daughter for breach of fiduciary duty, conflict of interest, and other charges in connection with her role as trustee of the Residuary Trust. The parties involved entered into a settlement agreement on Date 6, conditioned upon receipt of a favorable ruling from the Internal Revenue Service. The settlement provides for a termination of the trust and a current distribution of the assets to Daughter and Grandchildren 1 - 5. The amount distributed to each person will be an amount equal to the actuarial value of each person's interest, determined under section 7520 of the Code and based on the section 7520 interest rate in effect on the date this ruling is issued. Contingent interests of any issue of Grandchildren 1-5 are not being taken into account. The settlement was

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the result of negotiations between the parties and requires the consent of all the beneficiaries of the Residuary Trust. The settlement agreement has been submitted to County Court, for the court's approval.

State Statute provides that if all beneficiaries of an irrevocable trust consent, they may compel modification or termination of the trust upon petition to the court, unless the continuance of the trust is necessary to carry out a material purpose of the trust.

LAW AND ANALYSIS

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer, which is defined under section 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 and section 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) and section 26.2601-1(b)(1)(i), the tax does not apply to a 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)(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 section 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are only applicable for GST tax purposes. The rules do not apply, for example, in determining whether the transaction results in a gift for gift tax purposes, or the realization of gain for income tax purposes under section 1001.

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 section 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 section 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 generation-skipping transfer or the creation of a new generation-skipping transfer.

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Section 2651 provides, generally, that the generation to which any person (other than the transferor) belongs shall be determined in accordance with the rules in that section.

The GST tax would not generally apply to the Residuary Trust or distributions from the Residuary Trust because the Residuary Trust was irrevocable on September 25, 1985, and no additions (actual or constructive) have been made to the Residuary Trust since that date. The proposed settlement and termination of the Residuary Trust will not shift a beneficial interest in the Residuary Trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the proposed modification does not extend the time for vesting of any beneficial interest in the Trust beyond the period originally provided for in the Trust. Accordingly, based upon the facts submitted and the representations made, and pursuant to section 26.2601-1(b)(4)(i)(D), we conclude that the settlement agreement will not cause the Residuary Trust to lose exempt status for purposes of chapter 13. Therefore, distributions from the trust in accordance with the settlement agreement will not be subject to Chapter 13.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. No opinion is expressed regarding the gift tax consequences of the relinquishment of the unvested contingent remainder interests of Decedent's great-grandchildren.

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.

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

Sincerely yours,
George Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)