

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:04 – PLR-142135-04

Date: MAY 12, 2005

Re:

Legend

A =

B =

Trust 17 =

Trust 18 =

Trust 19 =

Trust 20 =

Trust 21 =

Trust 22 =

Trust 23 =

Trust 24 =

Trust 25 =

Trust 26 =

Trust 27 =

Trust 28 =

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Trust 29	=
Trust 30	=
Trust 31	=
Trust 32	=
Trust 33	=
Trust 34	=
Trust 35	=
Trust 36	=
Trust 37	=
Trust 38	=
Trust 39	=
Trust 40	=
Trust 41	=
Year 1	=
Year 2	=
Year 3	=
Date 1	=
Date 2	=
Company	=

Dear :

This is in response to your letter dated July 22, 2004, concerning the generation-skipping transfer (GST) status of Trusts 17-41 (collectively Trusts).

The facts and representations submitted are summarized as follows: Company was formed in Year 1 by brothers A and B. The shareholders of Company are all descendants (or their spouses) of A and B or trusts created for their benefit. The descendants and surviving spouses of the six children of A and B constitute six family groups.

Trusts 17-41 were created between Year 2 and Year 3, prior to September 25, 1985, and are not subject to the GST tax pursuant to section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act). It is represented that there have been no additions, constructive or otherwise, to any Trust after September 25, 1985.

It is represented that each Trust is either an electing small business trust (ESBT) or a qualified subchapter S trust (QSST) and owns shares in Company.

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Company and its shareholders filed an election to be taxed under subchapter S of the Code effective Date 1. As part of the decision to make the S election, the shareholders agreed in principle to negotiate and execute a shareholder agreement that addresses changes in the number of beneficial shareholders and prevents the ownership of stock by an ineligible shareholder for purposes of the S election. The trustees of Trusts 17-41 executed and entered into the Shareholder Agreement on behalf of Trusts 17-41. The Shareholder Agreement is not effective, however, until a letter ruling is issued by the Internal Revenue Service as specified in Section 13 of the Shareholder Agreement.

Section 2 of the Shareholder Agreement prohibits the shareholders from making, and the Company from recognizing, a transfer that would cause the S election to terminate. Such attempted transfers are void. Each shareholder agrees to provide notice to the Board if the shareholder contemplates taking any action that may jeopardize the S election. The shareholder agrees to follow any reasonable direction provided by the Board of Directors (Board) of Company to avoid termination of the S election; however, certain mandatory transfers under the terms of an irrevocable trust that is a shareholder are not generally subject to the restrictions in Section 2 of the Shareholder Agreement.

Section 3 specifies that upon the death of an individual shareholder, the personal representative must provide notice to the Board if the transfer of the deceased shareholder's Company stock causes, or will cause, the termination of the S election.

Section 4 requires a shareholder whose shares are subject to an event that causes a change in the number or the identity of persons deemed to be shareholders for purposes of subchapter S to provide notice to the Board. If the Board determines that this change will cause a termination of the S election, then the Board must provide notice to the shareholder of its determination.

Section 5 provides that upon the occurrence of any other event that causes or will cause the termination of the S election, the procedure in Section 6 commences.

Section 6 details the procedure to be followed in the event the Company has notice of an action or anticipated action that will cause the termination of the S election. First, the affected shareholder has a 45-day period to make alternative arrangements that do not otherwise violate the Shareholder Agreement or the Certificate of Incorporation, but which will alleviate the pending termination of the S election. If the shareholder makes such arrangements, then the procedure in Section 6 stops. If the shareholder does not make such arrangements, then the Company and the other shareholders will have the option to purchase the shares that are the source of the threatened (or potential) termination of the S election. The shares are offered to the

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following groups, in order, until one or more qualified shareholders and/or the Company purchase all of the affected shares: (i) the affected shareholder's family group, (ii) the Company, (iii) the affected shareholder's family group for a second time, (iv) the shareholders outside of the affected shareholder's family group, and (v) the Company for a second time. Together, these options are referred to as the "Purchase Options."

Several sections of the Shareholder Agreement detail the right to exercise an option with each step, other mechanical features of exercise, purchase price, and terms of effectiveness of the Shareholder Agreement.

Section 13 provides that the Shareholder Agreement is not effective or binding upon any shareholder until the later to occur of the following events: (i) agreement is executed by shareholders owning at least two-thirds of all outstanding shares, and (ii) the Company and/or the holders of at least two-thirds of all outstanding shares shall have received one or more letter rulings from the Internal Revenue Service, acceptable to the applicants, to the effect that the effectiveness of the Shareholder Agreement would not constitute a modification of the shareholder's governing trust instrument that would adversely affect the status of the shareholding trust as exempt from the GST tax under chapter 13 of the Code and the associated regulations.

The Shareholder Agreement will expire upon the earlier of Date 2, consent of shareholders owning not less than two-thirds of the outstanding shares, dissolution, or bankruptcy of the Company. The Shareholder Agreement is subject to four consecutive four-year extension terms, on an affirmative vote of the holders of not less than two-thirds of the outstanding shares.

You have requested a ruling that neither the execution and effectiveness of the Shareholder Agreement nor the exercise of any Purchase Option will constitute an addition to any of Trusts 17-41 or cause a change in the substance of any of Trusts 17-41 that will cause any of Trusts 17-41 to lose its GST exempt status under section 26.2601-1(b)(1)(i) so that future distributions from such Trust will not be subject to the GST tax under section 2601, provided that no additions (actual or constructive) are made to the Trust.

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) the Act 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) of the Act and section 26.2601-1(b)(1)(i), the tax does not apply to a transfer from a

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trust, if the trust was irrevocable on September 25, 1985. The rule does not apply to the extent additions (actual or constructive) were made to the trust after that date.

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)(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 section 26.2601-1(b)(4) are, except as otherwise noted, applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not generally 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 section 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 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 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. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

In this case, Trusts 17-41 were irrevocable on September 25, 1985. It is represented that no additions have been made to Trusts 17-41 after that date. The proposed actions of the trustees of Trusts 17-41 in executing the Shareholder Agreement on behalf of Trusts 17-41 are administrative actions. Accordingly, based on the facts submitted and the representations made, we conclude that neither the execution and effectiveness of the Shareholder Agreement nor the exercise of any Purchase Option will constitute an addition to any of Trusts 17-41 or cause a change in the substance of any of Trusts 17-41 that will cause any of Trusts 17-41 to lose its exempt status under section 26.2601-1(b)(1)(i) so that future distributions from Trusts 17-41 will not be subject to the GST tax under section 2601, provided that no additions (actual or constructive) are made to Trusts 17-41.

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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. Further, we express no opinion as to whether Company was or is an S corporation. Additionally, we express no opinion as to whether the Trusts are qualified shareholders.

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

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to the taxpayers.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

Copy for section 6110 purposes

Copy of this letter

cc: