

## Internal Revenue Service

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May 30, 2008

RE:

### Legend

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

State 1 =

State 2 =

State Court =

Date 1 =

Date 2 =

Date 3 =

Grantor =

Individual 1 =

Individual 2 =

Company =

Niece =

a =

b =

Dear :

This is in response to your May 29, 2007 letter and other correspondence requesting gift and generation-skipping transfer (GST) tax rulings concerning the modification of Trust.

The facts submitted are as follows:

On Date 1, Grantor established Trust, an irrevocable trust for the benefit of Niece, Grantor's niece and her descendants. On the same day, Grantor transferred \$a in cash to the trustee of Trust. Grantor appointed Individual 1 as the Selector of Trust. No additional contributions have been made to Trust since the initial funding. No distributions have been made from Trust since Date 1.

Grantor timely filed a Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return for the transfer of cash to Trust and allocated \$a in GST tax exemption to Trust. As a result of the allocation, Trust had an inclusion ratio of zero at the date of the transfer.

Article II, Paragraph A of Trust provides that during Niece's lifetime, the trustee may pay to, or apply for the benefit of, Niece or a child of Niece, first from trust income and then from trust principal, an amount as the trustee determines in the trustee's discretion is essential for Niece's or Niece's child's support or for medical, dental, hospital, and nursing expenses when, in the trustee's discretion, those requisites are not otherwise being provided to Niece or Niece's child by any other source. The aggregate annual distribution to Niece and her children as a group, shall not exceed 1 percent of the value of the Trust estate determined on the first day of the taxable year of Trust.

Article II, Paragraph B provides that the trustee shall pay to or apply for the benefit of a grandchild (or a more remote descendant) under the age of 25 of Niece first from trust income and then from trust principal such amount as the trustee determines in the trustee's discretion is reasonably necessary for such descendant's comfort and support in the descendant's accustomed manner of living, or for medical, dental, hospital and nursing expenses, or for educational expenses, including private elementary and secondary school, vocational school, college, graduate, and post-graduate school. At any time that Niece has one or more grandchildren (or more remote descendants) over age 25, the trustee shall distribute to each grandchild (or more remote descendant) age 25 or older annually a share of 3 percent of the value of the Trust estate determined on the first day of the taxable year of the Trust.

Article II, Paragraph D provides, in relevant part, that upon the death of Niece, any part of the trust estate not appointed by the Selector under Article IX shall be distributed, subject to the provisions of Article III to Niece's then living descendants. If

Niece has no living descendant, the remaining trust estate not appointed by the Selector under Article IX shall be distributed in equal shares to each of the following: Trust 2, Trust 3, Trust 4, and Trust 5.

Article III, Paragraph F provides, in relevant part, that the Trust shall be perpetual to the fullest extent permitted by State 1 law.

Article V, Paragraph B, provides, in relevant part, that a corporation qualified to do trust business, with not less than \$b of assets under management in a jurisdiction that will permit the perpetual existence (e.g. not less than 300 years for personal property held in trust) of this Trust and the Trusts by the Trust agreement, shall act as Trustee or a co-Trustee.

Article IX, Paragraph B, provides, in relevant part, Grantor the power during Grantor's lifetime at any time and from time to time, acting in a nonfiduciary capacity, without the approval or consent of any person, including the trustees, to acquire the assets of any trust created by the Trust agreement by substituting property of equivalent value. Paragraph B also provides that this power is not assignable and any attempted assignment will make this power void.

Article X, Paragraph G, provides that the validity, construction, and effect of the provisions of the Trust agreement in all respects shall be governed and regulated according to and by the laws of State 1.

Article X, Paragraph H, provides, in relevant part, that the original situs of the trusts created by the Trust agreement shall be State 1. The situs of any trust created may be maintained in any jurisdiction (including outside the United States), as the trustees, in the exercise of sole and absolute discretion, may determine, and thereafter transferred at any time or times to any jurisdiction selected by the trustees.

On Date 2, the trustee made the following administrative modifications as permitted by the Trust agreement and state statutes:

1. Moved the situs of the Trust from State 1 to State 2;
2. Appointed Company as the corporate trustee;
3. Appointed Individual 2 as Trust Selector;

Due to ambiguities contained in the Trust agreement, Grantor agrees that the Trust should be restated and reformed to insure that the original intentions of Grantor be carried out in perpetuity. The proposed modifications to the Trust are summarized as follows:

1. An increase of discretionary distributions of trust assets to Niece and the children of Niece, as a group, with no limitation on the amount of discretionary distributions; and
2. An increase in the number of trustees so that the trust powers can be segregated to provide a clear delineation of responsibility between the Investment Trustee, the Benefits Trustee, and the Administrative Trustee.

On Date 3, the trustee and beneficiary filed a petition in State Court requesting that Trust be reformed in a manner consistent with the changes described above. The reformation, however, was conditioned upon a favorable ruling from the Internal Revenue Service. The modifications are permitted under the state statutes of State 2.

You have requested the following rulings:

1. The proposed modification of Trust as to the upper limit of discretionary distributions will not cause the Trust to have a non-zero inclusion ratio or distributions from the Trust to be subject to the GST tax.
2. Change in trust situs from State 1 to State 2 will not cause Trust to have a non-zero inclusion ratio.
3. The proposed modification of Trust as to the administration of Trust, to increase the number of trustees and to segregate the responsibilities of trustees, will not cause Trust to have a non-zero inclusion ratio.

## LAW AND ANALYSIS

### Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every 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 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the GST tax shall not apply to any GST 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)(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 (because the trust was irrevocable on September 25, 1985)

will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, these rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Unless specifically noted, 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) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 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 § 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.

Section 26.2601-1(b)(4)(i)(D)(2) provides that 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 GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or person who held the beneficial interest prior to the modification. 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.

Section 26.2601-1(b)(4)(i)(E), Example 7, illustrates a modification that does not shift an interest to a lower generation. In the example, Grantor established an irrevocable trust in 1980 for the benefit of Grantor's grandchildren, A, B, and C. The trust provides that income is to be paid to A, B, and C, in equal shares for life. The trust further provides that, upon the death of the first grandchild to die, one-third of the principal is to be distributed to that grandchild's issue, per stirpes. Upon the death of the second grandchild to die, one-half of the remaining trust principal is to be distributed to that grandchild's issue, per stirpes, and upon the death of the last grandchild to die, the remaining principal is to be distributed to that grandchild's issue, per stirpes. In 2002, A became disabled. Subsequently, the trustee, with the consent of B and C, petitioned the appropriate local court and the court approved a modification of the trust

that increased A's share of trust income. The modification does not shift a beneficial interest to a lower generation beneficiary because the modification does not increase the amount of a GST transfer under the original trust or create the possibility that new GST transfers not contemplated in the original trust may be made. In this case, the modification will increase the amount payable to A, who is a member of the same generation as B and C. In addition, 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. Therefore, the trust as modified will not be subject to the provisions of chapter 13.

No guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a change that would not affect the GST status of a trust that was irrevocable on September 25, 1985, should similarly not affect the exempt status of such a trust.

In this case, the proposed modification to remove the 1 percent limitation on discretionary distributions that can be made to Niece and to the children of Niece, as a group, will not shift a beneficial interest in Trust to any beneficiary who occupies a lower generation than the person who held the beneficial interest prior to the modification. Further, the proposed modification will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. Therefore, based on the facts presented and the representations made we conclude that the proposed modification of Trust as to the upper limit of discretionary distributions will not cause the Trust to have a non-zero inclusion ratio or distributions from the Trust to be subject to the GST tax.

## Ruling 2

Section 26.2601-1(b)(4)(i)(E), Example 4, illustrates the tax effect of changing the situs of a trust. In that case, Grantor, who was domiciled in State X, executed an irrevocable trust in 1980 for the benefit of Grantor's issue, naming a State X bank as trustee. Under the terms of the trust, the trust is to terminate no later than 21 years after the death of the last to die of certain designated individuals living at the time the trust was executed. The provisions of the trust do not specify that any particular state law is to govern the administration and construction of the trust. In State X, the common law rule against perpetuities applies to trusts. In 2002, a State Y bank is named as sole trustee. The effect of changing trustees is that the situs of the trust changes to State Y, and the laws of State Y govern the administration and construction of the trust. State Y law contains no rule against perpetuities. In this case, however, in view of the terms of the trust instrument, the trust will terminate at the same time before and after the change in situs. Accordingly, the change in situs does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as

defined in § 2651) than the person(s) who held the beneficial interest prior to the transfer. Furthermore, the change in situs does not extend the time for vesting of any beneficial interest in the trust beyond that provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13 of the Internal Revenue Code. If as a result of the change in situs, State Y law governed such that the time for vesting was extended beyond the period prescribed under the terms of the original trust instrument, the trust would not retain exempt status.

In this case, Trust will terminate at the same time before and after the change in situs under the terms of the modification. Changing the situs from State 1 to State 2 does not extend the time for vesting of any beneficial interest provided in the original trust agreement, does not increase the amount of any GST transfer, nor creates any new GST transfer. Neither state has a rule against perpetuities. Therefore, based on the facts presented and the representations made we conclude that the change in trust situs from State 1 to State 2 will not cause Trust to have a non-zero inclusion ratio.

### Ruling 3

Section 26.2601-1(b)(4)(i)(E), Example 10, considers a situation where the appropriate local court approves a modification of a trust that decreases the number of trustees. The modification pertains to the administration of the trust and 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 it does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the example concludes, the trust will retain its exempt status.

In this case, the proposed modification to increase the number of trustees is administrative in nature and does not cause Trust to be subject to GST tax. The proposed modification to increase the number of trustees is intended to segregate the responsibilities and powers between the Investment Trustee, the Benefits Trustee, and the Administrative Trustee. Increasing the number of trustees does not shift any beneficial interest to a lower generation nor does it extend the time for vesting of any beneficial interest in the Trust beyond the period provided for in the original trust. Therefore, based on the facts presented and the representations made we conclude that increase the number of trustees and to segregate the responsibilities of trustees, will not cause Trust to have a non-zero inclusion ratio.

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

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. In particular, no opinion is expressed or implied concerning the gift tax consequences of this proposed modification.

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 requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

James F. Hogan  
Senior Technician Reviewer, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures

Copy for § 6110 purposes

Copy of this letter

cc: