

Internal Revenue Service
Index No.: 2601.00-00,
2501.00-00, 2041.00-00,
2514.00-00
Number: **199945022**
Release Date: 11/12/1999

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:4 - PLR-115984-98

Date:

August 12, 1999

Re:

LEGEND:

Decedent =
 P =
 Q =
 R =
 S =
State 1 =
State 2 =
Trust 1 =
Trust 2 =
Trust 3 =
 Bank =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =

This is in response to your authorized representative's letter dated June 22, 1999, and previous correspondence requesting rulings on the estate, gift, and generation-skipping transfer tax (GSTT) consequences of a proposed modification of three trusts established under the will of Decedent.

According to the facts submitted, Decedent died on Date 1, domiciled in State 1. Decedent's will was executed on Date 2, and amended by three codicils dated Date 3, Date 4, and Date 5.

Under the terms of Article Eighth of Decedent's will, upon Decedent's death, a separate trust was established for the benefit of each of Decedent's grandchildren. Trust 1 was created for the benefit of Decedent's grandson, Q, and Q's lawful issue; Trust 2 for the benefit of decedent's grandson, R, and R's lawful issue; and Trust 3 for the benefit of Decedent's granddaughter, S, and S's lawful issue. It is represented that there have been

no additions, constructive or otherwise, to the trusts since September 25, 1985.

The original trustees of the trusts were Bank and an individual. Pursuant to the terms of Decedent's will, each of her grandsons, Q and R, became a trustee at the age of 25. At the present time, the co-trustees of the three trusts are Bank, Q, and R.

Each trust is required to make certain payments unrelated to the issues under consideration. The provisions of the trusts require that one-half of the net income remaining in each trust after these payments is to be distributed at least quarterly to its designated beneficiary for life. The remaining income may be distributed to the designated beneficiary or to his or her issue in such amounts as the trustees, other than Decedent's grandsons, in their sole discretion, shall deem to be for his, her, or their best interests. Any income not distributed is to be accumulated and added to the corpus of the specific trust.

If the net income of a grandchild's trust, when considered together with the income available to him or her from all other sources of which the trustees have knowledge, is insufficient, in the opinion of the trustees, other than Decedent's grandsons, to provide for his or her "proper support, maintenance, education, comfort and medical care of his or her lawful issue," then such amounts of corpus as deemed necessary or desirable for such purposes may be distributed to him, her, or them. In addition, the trustees, other than Decedent's grandsons, may distribute corpus from Trust 1, Trust 2, and Trust 3 to Q, R, and S, respectively, "for his or her best interests, to enable him or her to maintain the standard of living to which he or she has been accustomed."

Under Article Eighth, Paragraph 6, of the will, the trustees, other than Decedent's grandsons, in their discretion, may also pay over to a grandson after he attains age 30, such sums from the corpus of the respective grandson's trust as the respective grandson requests in writing to assist him in any business enterprise in which he has been engaged or financially interested for at least one year; provided that such payments in any calendar year shall not exceed 10 percent of the fair market value of such grandson's trust determined as of December 31st of the preceding calendar year and provided that the aggregate of all such payments of corpus will not exceed more than 50 percent of the fair market value of the grandson's respective trust determined as of the time of the first withdrawal.

Under Article Eighth, Paragraph 7, upon the death of Q, R, and S, the trustees are to pay the corpus and undistributed income of his or her trust estate to his or her surviving spouse, lawful issue, brothers, sister, nieces and nephews, or to any one or more of them in such proportions and upon such terms and conditions and trusts as such grandchild shall appoint in his or her will. However, a grandchild may not appoint corpus to a surviving spouse, and the amount of income appointed to a surviving spouse may not exceed a certain amount and may not be payable beyond the surviving spouse's lifetime.

In default of the exercise of a grandchild's power of appointment, in whole or in part, the unappointed part of the deceased grandchild's trust property will vest in and be distributed to the respective grandchild's lawful issue, per stirpes. In the event of the death of a grandchild leaving no lawful issue surviving, the unappointed part of his or her trust estate is to pass to the then surviving lawful issue of Decedent's son, P, or to the trust provided under Decedent's will for such lawful issue of P.

Article Eighth provides that if a grandson of Decedent becomes a successor trustee of any trusts created under Decedent's will, such grandson shall not exercise any discretionary powers with respect to any such trust.

Article Fourteenth, Paragraph 1, provides that any trustee may resign at any time by delivering written notice thereof to the corporate trustee or other trustee, as the case may be. Each of Q and R, in the event of his death, resignation, inability or refusal to act as trustee, will have the right to designate his successor individual trustee by his will or by an instrument in writing delivered to the corporate trustee, and such successor individual trustee will have the power to appoint his successor trustee. The individual trustees are to exercise no discretion as to distributions of income or corpus from any of the trusts created under the Decedent's will.

Under Article Fourteenth, Paragraph 2, in the event the corporate trustee fails to act for any reason, the individual beneficiaries from time to time entitled to receive or to have the benefit of three-fourths of the income from the aggregate of the Trust 1, Trust 2, and Trust 3 will have the power and authority to designate a successor corporate trustee to administer the three trusts. The designation is to be made by an instrument in writing delivered to the then acting corporate trustee and to the corporate trustee so designated.

Article Fourteenth, Paragraph 4 provides that with the consent of the persons who are making the appointment, any successor corporate trustee may accept the account rendered and

the assets and property delivered to it by the predecessor trustee, and shall incur no liability nor responsibility to any beneficiary by reason of so doing.

The principal assets of the trusts are held in equal undivided interests as follows: (i) an undivided interest in a ranch located in State 2; (ii) an undivided interest in oil and gas properties located in State 2; (iii) working interests in oil and gas properties owned through a State 2 limited liability company; and, (iv) portfolio securities maintained at Bank in State 1.

The trusts have been administered according to the provisions of Decedent's will since their inception. Bank now wishes to resign as corporate trustee of the three trusts. In connection with Bank's resignation, all parties in interest propose to do the following:

(1) The parties will apply to the district court of County, State 2, for a judicial modification of certain trust provisions relating to the trusteeship of the trusts;

(2) After the modification, an independent trustee, either an individual or a corporation, will be appointed as the sole trustee of the three trusts with the power and authority to make discretionary distributions of income and/or corpus. This will be the only function of the independent trustee, who will have no other power or authority over the administration of the trusts; and

(3) S will be appointed as an individual trustee, along with Q and R, of the three trusts.

The proposed modifications can be summarized as follows:

First, as provided under Article Eighth of Decedent's will, discretionary distributions of income and corpus can only be made in the discretion of "the Trustees, other than my grandsons." Where the quoted words, or words to such effect and meaning appear in Article Eighth, they will be replaced by "the Trustees, other than my grandchildren or their issue," or words to such effect and meaning.

Second, under the modification, the provisions regarding a "corporate trustee" in Article Fourteenth of Decedent's will will refer to an "Independent Trustee." The Independent Trustee may be a corporation or an individual who is neither related to nor subservient to any beneficiary of the trusts. The Independent Trustee shall have as its sole duty the exercise of the discretionary distribution powers provided for under Article Eighth.

Third, the modification will allow Q and R to appoint S as an "Individual Trustee" of the trusts and, following the modification and the resignation of Bank, Q and R will, in fact, appoint S as an Individual Trustee. The Individual Trustees may not make any discretionary distributions of income or corpus from the trusts to any beneficiaries of the trusts.

Fourth, any trustee may resign at any time. An Individual Trustee (i.e., Q, R, and S) shall have the right to designate his or her successor, and the successor shall have the right to designate his or her successor. In the event the Independent Trustee shall resign or for any reason fail to act, then the individual beneficiaries from time to time entitled to receive or to have the benefit of three-fourths of the income from the aggregate of the three trusts shall have the power and authority to designate a successor Independent Trustee.

The following rulings are requested:

The judicial modification of the trusts and the appointment of S as an Individual Trustee will not:

(1) Cause the trusts to lose their exemption under § 1433(b)(2)(A) of the Tax Reform Act of 1986 ("the Act") and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax (GSTT) Regulations from the Generation-Skipping Transfer (GST) tax under § 2601;

(2) Constitute additions to the trusts under § 26.2601-1(b)(1)(iv);

(3) Cause the trusts and/or the co-trustees to be subject to the GST tax under § 2601;

(4) Cause future distributions to skip persons from the trusts to be subject to the GST tax under § 2601; and/or

(5) result in adverse gift and/or estate tax consequences for the respective co-trustees/beneficiaries of Trust 1, Trust 2, or Trust 3 under §§ 2041, 2511 and/or 2514 of the Code.

Rulings # 1-4.

Section 2601 provides that a tax is imposed on every generation-skipping transfer. Section 2611 defines the term "generation-skipping transfer" to mean (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(b) defines the term "taxable distribution" to mean any distribution from a trust to a skip person (other than a taxable termination or a direct skip). Section 2612(a)(1)(A)

provides, in essence, that a taxable termination occurs when an interest in a trust terminates, such as by death and, thereafter, only skip persons have an interest in the trust property.

Section 2613(a)(1) defines the term "skip person" as including a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor.

In this case, Trust 1, Trust 2, and Trust 3 are generation-skipping trusts because each provides for distributions to persons that are two or more generations below the Decedent's generation. Thus, unless Trust 1, Trust 2, and Trust 3 are excepted from the generation-skipping transfer tax provisions by reason of § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1) of the regulations, the trusts would be subject to the tax

Section 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the regulations provide that the generation-skipping transfer tax shall 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 is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

A modification of a generation-skipping trust that is otherwise exempt under the Act and the GSTT regulations will generally result in a loss of its exempt or "grandfathered" status if the modification changes the quality, value, or timing of any powers, beneficial interests, rights, or expectancies originally provided for under the terms of the trust.

In the present case, the trusts were irrevocable before September 25, 1985. It is represented that no additions, constructive or otherwise, have been made to the trusts since September 25, 1985. Also, we conclude that the proposed modifications to the trusts relate exclusively to the administration of Trust 1, Trust 2, and Trust 3, and do not confer additional powers or beneficial interests upon any current or new trustee or upon any of the trust beneficiaries. These modifications will not create any additional generation-skipping transfers or increase the amount of any generation-skipping transfers. The number of younger generations provided for will remain the same.

Based on the facts submitted and the representations made, we conclude that Trust 1, Trust 2, and Trust 3 are exempt from the generation-skipping transfer tax. We also conclude that the proposed transactions will not cause the trusts to lose exempt status with respect to the generation-skipping transfer tax under § 26.2601-1. Provided there are no additions, constructive or

otherwise, to the trusts, distributions to skip persons will not be subject to generation-skipping transfer tax.

Ruling #4.

Section 2501 imposes a tax on an individual's transfer of property by gift. Section 2511 provides, in part, that the gift tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(b) provides, in part, that where property is transferred for less than adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing the power.

Section 2041 provides that the value of the gross estate shall include the value of all property with respect to which the decedent has at the time of his death a general power of appointment, or with respect to which the decedent has at any time released such power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 through 2038.

Section 2041(b) provides, in part, that a general power of appointment is a power which is exercisable in favor of the decedent, his estate, his creditors or the creditors of his estate.

The proposed modification of the trusteeship provisions, the modification permitting S to be appointed as an Individual Trustee, the appointment of S as an Individual Trustee, and the modification requiring that discretionary distributions from Trust 1, Trust 2, and Trust 3 be determined solely by the Independent Trustee will not cause the respective individual trustees/beneficiaries of Trust 1, Trust 2, and Trust 3 to be deemed to possess a general power of appointment under either §2514 or § 2041 with respect to any of the three trusts. In addition, since the proposed modifications are administrative in nature and do not result in any change in the quality, value, or timing of any of the powers, beneficial interests, rights, or expectancies originally provided, the proposed modification of the trusts and the appointment of S as an Individual Trustee will not result in the making by Q, R, or S of a taxable gift under §

2501 and will not cause the corpus of Trust 1, Trust 2, or Trust 3 to be includible in the gross estates of either in Q, R, or S under §2041.

This ruling is based on the facts and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

Further, except as we have specifically ruled herein, we express no opinion as to the consequences of the proposed transactions under the cited provisions or under any other provisions of the Code.

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

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

Sincerely yours,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
Katherine A. Mellody
Senior Technician Reviewer
Branch 4

Enclosure
Copy for section 6110 purposes
