

## Internal Revenue Service

Number: **200520009**

Release Date: 5/20/2005

Index Number: 2601.03-01, 2041.11-00,  
2514.04-01

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-144148-04

Date: FEBRUARY 10, 2005

In Re:

### LEGEND:

Settlor =  
Daughter =  
Trust =  
State 1 =  
State 2 =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Date 5 =  
Court =

X =

Dear :

This is in response to your August 13, 2004 letter and other correspondence requesting a ruling concerning the gift and generation-skipping transfer (GST) tax consequences of the proposed modification of a trust.

You have requested the following rulings:

1. The modification of the Trust and the implementation of the Court's order modifying the Trust will not result in a transfer by any beneficiary of the Trust that is subject to the gift tax under section 2501.
2. The modification of the Trust and the implementation of the Court's order modifying the Trust will not cause the Trust to lose its GST tax exempt status under section 26.2601-1 of the Generation-Skipping Transfer Tax Regulations.

The facts submitted are as follows:

Settlor executed Trust under the laws of State 1 on Date 1. Trust became irrevocable upon Settlor's death on Date 2 (before September 25, 1985). On Date 3, the trustee elected, under the terms of Trust, to have the laws of State 2 govern the administration of Trust.

Article First provides that Trust is to be for the use and benefit of Daughter and for Daughter's children.

Article Second(A) provides that during the lifetime of Daughter, the net income of the Trust is to be paid over and distributed annually or at more frequent intervals, to or for the benefit of Daughter.

Article Third(A) provides that Daughter is to have the discretionary lifetime special power of appointment, exercisable by her at any time during her life, to direct the trustee to pay over and distribute any portion of trust principal from Trust to or for the benefit of any or all of her children or grandchildren.

Article Third(B) provides that Daughter is to have the right during her lifetime to direct the trustee to pay to or apply for her benefit such amounts from the principal of Trust as she may designate, up to but not exceeding the sum or value of \$5,000 or 5 percent of the trust principal, whichever is larger, in any one calendar year. The right to make withdrawals is non-cumulative.

Article Third(C) provides that if in the opinion of the trustee, the income from all sources of which the trustee has knowledge is not sufficient to suitably support, maintain, and provide for the comfort of Daughter or any of the other beneficiaries in the manner to which they are accustomed, or in the event of an emergency such as illness, accident, or other distress, the trustee is authorized to use and expend such part of the principal of the Trust as the trustee may deem necessary or desirable to make up such deficiencies.

Article Third(D) provides that upon the death of Daughter, the entire principal of Trust, and any undistributed income, is to be paid over and distributed by the trustee to the children and/or grandchildren of Daughter, in such amounts or proportions as Daughter may direct by her will.

Article Fourth(A) provides that if Daughter fails to exercise her special power of appointment, upon Daughter's death, the entire principal in Trust and undistributed income, if any, is to be divided into equal shares and held in further trust for the benefit of Daughter's children. If any child of Daughter predeceases Daughter and has children surviving, then the share of Trust which would have been set aside for the benefit of the

deceased child is to be divided and set aside and held in trust for the benefit of the deceased child's surviving children.

Article Fourth(B) provides that the net income from the respective portions of the trust estate set aside for the beneficiaries are to be paid out and distributed annually or at more frequent intervals to or for the benefit of the respective beneficiary.

Article Fourth(C) provides that if prior to the full distribution of any portion of the trust estate set aside for the benefit of any beneficiary, the income beneficiary of such portion dies with children surviving, then the net income from that portion of the trust estate is to be paid out and distributed annually or at more frequent intervals to or for the benefit of the children in proportion to which the children are entitled to receive eventual distribution of the trust principal under Trust, provided, however, that the interest in income of any such child to whom a share of the principal may be distributed is to cease upon the distribution to him or her of his or her share of principal or upon his or her earlier death.

Article Fourth(D) provides that if prior to the full distribution of the portion of the trust estate set aside for the benefit of any beneficiary, the beneficiary and all his or her children, if any, shall die, then any undistributed net income of the portion of the trust set aside for the deceased beneficiary is to be added to and become a part of the principal of the portion of the trust set aside for the beneficiary.

Article Fourth(E) provides that when a beneficiary for whose benefit a portion of the trust estate has been set aside attains the age of 35 years, he or she is to receive outright and free from trust one-third of either the then value of the portion of the trust estate set aside for his or her benefit or an undivided one-third interest in the then assets in said portion. Upon attaining the age of 40 years, he or she is to receive one-half of the then value of the remainder of the portion set aside for him or her (or an undivided one-half interest in such portion) and upon attaining the age of 45, he or she is to receive the balance of the properties in the portion set aside for him or her free and discharged from all trusts.

Article Fourth(F) provides that if prior to the full distribution of the portion of the trust estate set aside for the benefit of any beneficiary, the beneficiary dies and is survived by children, then the principal and any undistributed income in said portion of the trust estate is to be paid out and distributed to or for the benefit of the then living children of the deceased beneficiary, provided, however, that if any such children are then under 21 years of age, the trustee is to retain such child's share in trust and shall use so much or all of such child's share and the income therefrom as the trustee, in its sole discretion, deems desirable for the best interests of the child and his or her education, comfort, and support. When each child attains the age of 21, or upon the date 21 years after the death of the survivor of the children and grandchildren of Settlor who were living at the time of Settlor's death, whichever is earlier, the trustee is to pay

over and distribute to the respective beneficiary the portion of trust principal, including any undistributed income, which was retained for his or her benefit.

Article Fourth(G) provides that if, prior to complete distribution of any portion of the trust estate set aside for the benefit of a beneficiary, such beneficiary and all his or her children (if any) die, then the entire principal and any undistributed income of the respective portion of the trust estate created for the beneficiary are to be distributed among the surviving children and grandchildren of Daughter, per stirpes on the principle of representation.

Article Fifteenth provides, in part, that all trusts created by Trust are to terminate at the expiration of 21 years after the death of the last to die among Settlor, her children, and her grandchildren living at the time of Settlor's death. At the termination the principal and all undistributed income is to vest and be distributed, absolutely and free and clear of all trusts, to the beneficiaries entitled to take.

The trustee represents that Daughter has never exercised her limited power of withdrawal and that she never intends to exercise the power.

The trustee proposes to modify Trust to limit the time during which Daughter may exercise her limited power of withdrawal (pursuant to Article Third(B)) to the first 15 days of the month of x during each calendar year. The trustees believe the modification is warranted because it will reduce the likelihood that 5 percent of Trust assets would be treated as an asset of Daughter's for estate tax purposes. On Date 4, the trustee submitted a petition to Court seeking judicial approval of the modification. On Date 5, Court issued a ruling approving the proposed modification, conditioned on the receipt of a favorable letter ruling from the Internal Revenue Service. All living beneficiaries of Trust have consented to the proposed modification. Under State 2 law, minors and unborn beneficiaries may be represented and bound by individuals having substantially identical interests with respect to a particular issue. The parents of each of these minor children have interests in Trust which are substantially identical to their respective children's interests in Trust, in that they are all remote contingent remainder beneficiaries.

The trustee represents that Trust was irrevocable on September 25, 1985. No person has contributed assets to the Trust since that date. There have been no additions (actual or constructive) to Trust since September 25, 1985.

## LAW AND ANALYSIS

### Ruling 1

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual, resident or nonresident.

Section 2511(a) provides that the tax imposed by section 2501 applies 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(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an 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 is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

Under section 2514(b), the exercise or release of a general power of appointment created after October 21, 1942, is deemed the transfer of property by the individual possessing such power.

Section 2514(c) defines a "general power of appointment" as a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or creditors of his estate.

Under section 25.2514-3(c)(4), the failure to exercise a general power of appointment created after October 21, 1942, within a specified time so that the power lapses, constitutes a release of the power. However, under section 2514(e), a lapse during any calendar year is considered as a release for gift tax purposes only to the extent that the property which could have been appointed exceeds in value the greater of (1) \$ 5,000, or (2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied.

In this case, after the proposed modification, each beneficiary will have the same interest in Trust assets as each beneficiary had before the modification. Because the beneficial interests, rights, and expectancies of the beneficiaries of Trust are substantially similar both before and after the proposed modification, no transfer of property for less than adequate and full consideration in money or money's worth will occur as a result of the proposed modification. Accordingly, based on the facts submitted and representations made, we conclude that the modification of the Trust and the implementation of the Court's order modifying the Trust will not result in a transfer by any beneficiary of the Trust.

## Ruling 2

Section 2601 imposes a tax on every generation-skipping transfer. The term "generation-skipping transfer" is defined in section 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (Act) and section 26.2601-1(a) of the Generation-Skipping Transfer (GST) 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 GST 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)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under section 2038 or section 2042, if the settlor had died on September 25, 1985.

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 generation-skipping transfer tax will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. 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 section 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 GST tax 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. A modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust.

In this case, Trust is exempt from the GST tax imposed by section 2601 because the Trust became irrevocable on or before September 25, 1985, and no additions (actual or constructive) have been made to the Trust since that date. After the proposed modification, Daughter will continue to have a noncumulative power to withdraw the greater of \$5,000 or 5 percent of Trust. However, Daughter's right of withdrawal will be limited to the first 15 days of the month of x during each calendar year. The proposed modification of Trust 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 modification. Further, the modification of Trust will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. Accordingly, based on the facts submitted and representations made, we conclude that the modification of the Trust and the implementation of the Court's order modifying the Trust will not cause the Trust to lose its GST tax exempt status under section 26.2601-1.

In accordance with the Power of Attorney on file with this office, copies of this letter are 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.

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) of provides that it may not be used or cited as precedent.

Sincerely yours,

---

Lorraine Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes