

## Internal Revenue Service

## Department of the Treasury

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Person To Contact:

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Date:

November 04, 2011

In Re:

### Legend

Settlor	=
Trust	=
Trust 1	=
Trust 2	=
Trust 3	=
Child 1	=
Child 2	=
Child 3	=
Date 1	=
State 1	=
State 2	=
Court	=

Spouse/Trustee	=
Individual 1	=
Individual 2	=
Company	=
Corporation	=
Foundation	=

Dear :

This letter responds to the April 29, 2011 letter and subsequent correspondence from your authorized representative, requesting gift and generation-skipping transfer (GST) tax rulings with respect to the proposed modifications and restatement of Trust.

The facts and representations submitted are summarized as follows:

On Date 1, a date after September 25, 1985, Settlor established Trust, an irrevocable trust, to benefit his three children, Child 1, Child 2, and Child 3 and their issue. Prior to this ruling request, Trustee divided Trust into three separate and equal trusts: Trust 1 to benefit Child 1 and Child 1's issue, Trust 2 to benefit Child 2 and Child 2's issue, and Trust 3 to benefit Child 3 and Child 3's issue. Settlor's spouse, Spouse, is a trustee, Trustee, of Trust. Currently, Trustee serves as co-trustee of Trust, with Individual 1 and Individual 2. This letter ruling pertains to Trust 1.

When Trust was created, Settlor and Spouse resided in State 1. Currently, Settlor and Spouse reside in State 2. The corpus of Trust consists entirely of intangible investment assets. It is represented that Settlor allocated sufficient GST exemption to Trust to cause Trust and trusts created thereunder to have an inclusion ratio of zero. Trust 1 is currently administered under the laws of State 1.

Individual 1, in her capacity as a co-trustee of Trust, proposes to petition Court for a Court order to change the situs of Trust 1 to State 2 and to modify Trust as follows.

Trust will be modified to identify Child 1, Child 2, and Child 3 as the "named child" of his or her respective trust and references to State 1 will be changed to State 2 throughout Trust.

Part One of Trust contains the dispositive provisions. The trustees propose to modify this part to clarify that the provisions of Trust apply to Trusts 1, 2, and 3. This part provides that Trusts 1, 2, and 3 will terminate on the earlier of: (i) the date which is twenty-one (21) years after the death of the survivor of those beneficiaries who are living on the date of the execution of Trust; or (ii) the end of the latest time permitted by any rule against perpetuities or remote vesting, or any other law, applicable to such trust. This provision will be modified by inserting Date 1 in place of "on the date of execution." This part will also be modified to reflect that both Settlor and Spouse have irrevocably waived and released any powers that would cause the trusts to be treated as grantor trusts.

Under Part One, the beneficiaries are entitled to distributions equal to a maintenance allowance, which is defined as such sums of money as shall be necessary to provide maintenance, support and education in the manner to which the beneficiary has been accustomed. The beneficiaries are also entitled to distributions that exceed this allowance. The current instrument allows any trustee to make distributions that exceed the maintenance allowance. The proposed modification gives only the Independent Trustee the power to make these distributions.

Part Two contains the administrative provisions. Article I, 2.1.2 provides that Spouse has the right during her lifetime to remove or appoint any trustee, including a corporate trustee. Spouse may only remove or appoint a trustee with the prior approval of Settlor. This provision will be modified as follows:

Spouse, during her lifetime, has the power to remove or appoint any trustee of any trust created hereunder, including a corporate trustee. Spouse may only remove a trustee of a trust if at least one-half of the remaining trustees of the trust are Independent Trustees and may only appoint a trustee who is an Independent Trustee.

Article I, 2.1.4 provides that at such time as Spouse ceases to serve as a trustee of a particular trust, each child of Settlor who is then a current income beneficiary of such trust shall automatically become a co-trustee of such trust upon attaining the age of eighteen (18) years. The proposed modifications are as follows:

After the deaths or incapacities of both Settlor and Spouse, or at such time during the life of Spouse as she ceases to serve as a trustee of a particular trust created thereunder and no successor trustee appointed by Settlor or Spouse is serving with respect to such trust, all children of Settlor who are then living shall automatically become co-trustees of each such trust. The trustee who is the named child, together with any trustees appointed by the named child or who succeed to the named child's position as trustee, shall collectively have two votes with respect to all matters to be decided by the trustees of such trust, and each of the other two children of Settlor shall have, in his or her capacity as a trustee, one vote. Upon the deaths, resignations, or ceasing to serve of both children of Settlor who are not named children, the named child shall serve as sole trustee of such trust. The named child may, at any time and from time to time, name any person to serve in the named child's place as trustee or to serve as co-trustee with such named child, and may remove any person so appointed, but all such trustees so appointed by the child shall collectively share the votes or votes allotted to the trustee who is the named child, and such appointments shall not increase such vote or votes; provided, at such time as no child of Settlor who is not the named child is serving as trustee of the named child's trust, the named child may only appoint or remove the trustees of such trust in a manner which results in at least one-half of the trustees being Independent Trustees.

Article I, 2.1.5 provides that after the death or incapacity of Settlor and Spouse, any current income beneficiary over the age of twenty-five (25) years (or if there be at any time more than one under any separate trust, a majority of them) may, with respect to his separate trust(s), remove or appoint any trustee or co-trustee, including such current income beneficiary; provided, following such removal and appointment, at least one-half (1/2) of all trustees of the affected trust shall be Independent Trustees. The proposed modifications are as follows:

Upon the death of any current income beneficiary of a trust, his or her surviving spouse shall then serve as a co-trustee of any trust of which all succeeding current income beneficiaries are then under the age of twenty-five (25) years. If such surviving spouse would at any time be a sole trustee of such trust, no action shall be taken by the trust until Foundation appoints a co-trustee who shall serve with the surviving spouse as the sole trustees of the trust, with each having a single vote. At such time as any descendant of the named child reaches age 25 and is a current income beneficiary of a trust (Adult Descendant), such Adult Descendant shall automatically become a trustee or co-trustee of the trust in place of (i) children of Settlor who are then serving as one or more co-trustees or (ii) the trustee appointed by Foundation. Such Adult Descendants shall have the right to serve as the sole trustee or trustees of such trust. A majority of Adult Descendants who are then serving as trustees of such trust may appoint or remove the trustees of such trust in a manner which results in at least one-half of the remaining trustees being Independent Trustees. A trustee appointed by Foundation shall serve as sole trustee in the absence of both a surviving spouse trustee and an Adult Descendant trustee.

Article I, 2.1.6 provides that any individual trustee may resign as trustee and appoint a successor or he may appoint a successor by will. He may remove any trustee by him named and appointed and resume the office, or name and appoint another, including a corporate trustee. Notwithstanding the foregoing, any Independent Trustee who resigns, or is removed by a trustee who is also a beneficiary of such trust or a descendant of Settlor, shall be replaced by another Independent Trustee; provided further, no trustee who is a beneficiary of a trust or descendant of Settlor shall remove or appoint a trustee of such trust unless immediately following such removal or appointment at least one-half of all trustees of the affected trust are Independent Trustees. The proposed modification replaces this provision with the following provision.

If at any time a trustee is prohibited by this instrument from acting because that trustee is not an Independent Trustee, such trustee may appoint an Independent Trustee to act in his or her place and exercise such vote as the trustee otherwise would have been able to exercise.

Article II, 2.2.16 gives the trustees the authority to do or perform any act with respect to the trust properties which may be done pursuant to State 1 law and to make any election permitted under the Code, in their sole discretion. Any investment in corporate stock or bonds, or any business association, will not be deemed improper for the reason that any trustee may own stock or bonds of the same corporation, or have any interests in the business association, or be employed in any capacity by such

corporation or business association. The proposed modifications add the following language:

The trustees will have no liability with respect to any investment they make, with Settlor's consent, in any corporation, partnership, general or limited, limited liability company, or other entity that is controlled, directly or indirectly, by a group consisting of Settlor and his descendants so long as the purchase price is the fair market value of the stock, partnership interest, membership interest or other securities (the "family securities") being acquired, determined on the basis of either (i) a qualified independent appraisal or (ii) a written purchase and sale agreement between the trust and the seller that provides for adjustment of an agreed purchase price or quantity of the family securities based upon a final agreement with the Internal Revenue Service or a final and non-appealable determination of value by a court of appropriate jurisdiction, nor shall they have any duty to sell, for reasons of diversification or otherwise, the family securities.

Article II, 2.2.16(k) provides that the trustees are authorized to take out and maintain on the life of any beneficiary under Trust, any trustee, and Settlor and Spouse, life insurance or any other kind of insurance, for the benefit of the beneficiary or beneficiaries, or the trust estate, in such amount as the trustees in their uncontrolled discretion shall deem advisable. The proposed modification provides that this provision is subject to the restrictions in Trust regarding payment of premiums and that this power is further limited by Settlor's intent that Trust not be includable in Settlor's gross estate.

Article II, 2.2.24 provides that under State 1 law, trustees are relieved from all of the duties, restrictions and liabilities imposed by State 1 law. The proposed modification replaces this provision in its entirety with the following:

To the fullest extent permitted under State 2 law, which states that the provisions of the trust agreement generally govern the duties imposed on trustees, with certain exceptions, a corporate trustee may lend funds to a corporate trustee or affiliate of the corporate trustee, purchase assets from or sell assets to a trustee or an affiliate of the trustee, purchase and sell assets between two trusts of which the corporate trustee is the trustee, and purchase or sell shares, securities, or other financial instruments of a corporate trustee or affiliate.

Article II, 2.2.25 give the trustees special directions regarding shares held by Trust and refers specifically to Company. This reference is replaced by "Corporation."

Article IV, 2.4.2 will be modified to provide that Trusts 1, 2, and 3 and trusts created thereunder will be governed, construed, and administered according to State 2 law.

Article VI, 3.6.1 provides that each trust created hereby or pursuant hereto shall be irrevocable and Settlor shall have no power to alter, revoke or terminate this trust agreement. This provision will be modified to add that: "Notwithstanding the foregoing, the Independent Trustees of any trust created hereunder shall have the power, exercisable in their sole discretion, to make such modifications as are reasonably necessary to ensure that such trust continues to qualify as a GST Exemption Trust."

Spouse, as co-trustee of Trusts 1, 2, and 3, requests the following rulings:

1. The change in situs of Trust 1 from State 1 to State 2 will not cause Trust 1 to lose its exempt status from GST tax.
2. The proposed modifications and restatement of Trust will not cause any distribution from or termination of any interests in Trust 1 to be subject to the GST tax.
3. The proposed modifications and restatement of Trust will not cause any beneficiary of Trust 1 to have made a gift for gift tax purposes.

## LAW AND ANALYSIS

### Rulings 1 and 2

Section 2601 of the Internal Revenue Code imposes a tax on every GST made after October 26, 1986. A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term "taxable termination" means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that the term "taxable distribution" means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax of an interest in property to a skip person.

Section 2631(a), as in effect for applicable years of the trust, provides that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 (adjusted for inflation) which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is defined as the excess (if any) of 1 over the applicable fraction. The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of the GST exemption allocated to the trust, and the denominator of which is the value of the property transferred to the trust or involved in the direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 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). Under § 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 § 2038 or 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 GST tax under paragraph (b)(1), (2), or (3) of this section (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus (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 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 paragraph (b)(4)(i)(A), (B), or (C) of this section) 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 for purposes of this section, 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 persons 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 4 provides as follows. In 1980, Grantor, who was domiciled in State X, executed an irrevocable trust 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, in all events, 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 or persons 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. If, in this example, 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.

Section 26.2601-1(b)(4)(i)(E), Example 10, considers the following situation. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. 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 § 2651) than the person or persons who held the beneficial interest prior to the modification. 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 will not be subject to the provisions of chapter 13.

No guidance has been issued concerning judicial modifications 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 modification that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of such a trust.

In this case, Trust provides that State 1 law governs the trust and all trusts created thereunder. When Settlor executed Trust, Settlor and Spouse resided in State 1. Currently, they reside in State 2. The proposed modification provides that Trust will be governed, construed, and administered according to State 2 law. The proposed change in situs and governing law will not change the termination date of any trust created under Trust. Thus, the proposed change in situs will not shift any beneficial interest in Trust 1 and will not extend the time for vesting of any beneficial interest in Trust 1. Accordingly, based upon the facts submitted and representations made, and assuming Court issues an order modifying Trust, as described above, we conclude that the change in situs of Trust 1 from State 1 to State 2 will not cause Trust 1 to lose its exempt status from GST tax.

The other proposed modifications of Trust are administrative in nature and under § 26.2601-1(b)(4)(i)(D)(2), will not be considered to shift a beneficial interest to a lower generation in the trust. See Example 10 of § 26.2601-1(b)(4)(i)(E). Further, as discussed above, the proposed modifications will not change the termination date of Trust 1. Accordingly, based upon the facts submitted and the representation made, and assuming Court issues an order modifying Trust, as described above, we conclude that the proposed modifications and restatement of Trust will not cause Trust 1 to lose its exempt status from GST tax.

### Ruling 3

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

Section 2511(a) provides that the gift tax 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 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.

In this case, the beneficiaries of Trust 1 will have the same interests after the proposed modifications that they had prior to the modifications. Because the beneficial interests of the beneficiaries are substantially the same, no transfer of property will be deemed to occur as a result of the modifications. Accordingly, based on the facts submitted and the representations made, and assuming that Court issues an order modifying Trust, as described above, we conclude that the proposed modifications and restatement of Trust will not cause any beneficiary of Trust 1 to have made a gift for gift tax purposes.

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. The § 2601 rulings are based upon a representation that Settlor allocated sufficient GST exemption to Trust to cause Trust and trusts created thereunder to have an inclusion ratio of zero. This office has not verified whether Trust has an inclusion ratio of zero. The proposed modifications will not cause the inclusion ratio of Trust to change, whether the inclusion ratio is zero or between one and zero. However, Trust will be subject to GST tax on distributions and termination if the inclusion ratio is not zero. No opinion is express or implied concerning the estate tax consequences of the taxpayers requesting the rulings 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.

The rulings in this letter pertaining to the federal estate and/or generation-skipping transfer tax apply only to the extent that the relevant sections of the Internal Revenue Code are in effect during the period at issue.

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,

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

Enclosures

Copy for § 6110 purposes  
Copy of this letter

cc: