

Internal Revenue Service

Department of the Treasury

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Date:

July 21. 1999

LEGEND:

a =

Grantor =

Trust =

Daughter =

A =

B =

b =

c =

d =

Granddaughter =

Trust 1 =

e =

f =

State Law =

Trust 2 =

g =

Dear Sir:

In a letter dated, July 28, 1998, you requested rulings concerning the estate, gift and generation-skipping transfer (GST) tax consequences of the proposed distribution of assets from Trust 1 to a newly created trust the terms of which are identical to Trust 1 except for the spendthrift provision. This letter responds to your request.

The information submitted and representations made are summarized as follows: On a, Grantor created the Trust for the benefit of Daughter and her descendants. Section I(1) of the Trust directs the trustee to pay over to Daughter all or any part of the net income as the Committee directs. Any net income that is not distributed to Daughter may be paid to the one or more of Grantor's other children and/or to Grantor's wife and/or to Daughter's husband as the Committee may from time to time direct. The Committee may also, if it deems advisable, direct that some or all of the net income is to be paid to A and/or B. If the Committee fails to give any direction with respect to the net income, or any part thereof, the net income or part thereof is to be paid to Daughter until contrary directions are received from the Committee.

Section I(2) of the Trust provides that on Daughter's death, the trustee is to divide the principal of the Trust into as many equal parts as may be necessary so that there is one part set aside for each lawful child of Daughter then living and one part set aside for the then living descendants, collectively, of each lawful child of Daughter who has previously died leaving a lawful descendant or descendants living at the time of Daughter's death. Each part so set aside for the then living lawful descendants collectively of any deceased child is to be subdivided *per stirpes* into subparts so that there shall be one subpart for each descendant who is taken into account in making the division.

Section I(2)(a) of the Trust provides that the trustee is to hold each share as a separate trust and the trust with reference to each share is to constitute a separate and distinct trust, but for the purposes of investment and administration the trustee may treat the aggregate of the shares as a single fund except as actual payments are made therefrom to the respective beneficiaries of parts of the principal. Unless the Trust is sooner terminated, each share is to be held in trust during the life of the beneficiary thereof, provided however, that the share of any beneficiary who was not in being at the date of the Trust Indenture is, unless the Trust is sooner terminated, to be held in trust only during the life of the youngest of Grantor's lawful descendants who are living at the time of Daughter's death, and who have attained the age of b years and who were in being at the date of the Trust Indenture; and provided further, however, that any share of any beneficiary who was not in being at the date of the Trust Indenture is to be

conveyed, transferred, and paid over absolutely to the beneficiary in the event that at the time of Daughter's death, there are not then living any lawful descendant of Grantor who has attained the age of b and who was in being at the date of the Trust Indenture.

Section I(2)(a) of the Trust further provides that the trustee is to collect and receive the income of each share and is to pay over the net income to the beneficiary of the share and/or to the one or more of Daughter's lawful descendants and/or A and/or B as the Committee from time to time directs. If the Committee fails to give any direction with respect to the net income, or any part thereof, the net income or part thereof is to be paid to the beneficiary until contrary directions are received from the Committee.

Section I(2)(b) of the Trust provides that after the beneficiary of any share has arrived at the age of c, but not before, the trustee is to pay the beneficiary, to be his or her own property free from any trust, the portion or all of the principal of his or her share, as the Committee may at any time or from time to time direct.

Section I(2)(c) of the Trust provides that on the death of a beneficiary, who was in being on the date of the Trust instrument or, in the case of a beneficiary not in being on the date of the Trust instrument, either on the death of the person on whose life the trust of the beneficiary's share is limited or on the death of the beneficiary, whichever occurs first, the trustee is to convey, transfer, and pay over the principal of the share or so much of the principal as then remains to the beneficiary of the share if he or she is living, or, if he or she is not living, absolutely to his or her lawful descendant or descendants then living, *per stirpes*, or in default of such descendant or descendants of Daughter, to Grantor's then living lawful descendant or descendants, in equal shares *per stirpes*, or in default of such descendant or descendants of Grantor to A.

Section III(3) of the Trust grants the trustee full power and authority, in its discretion, subject, however, to the provisions of subdivisions (4) and (5) of Section VI, to establish any trust fund and to make distribution to any person entitled to a part or all of the principal of any trust fund in any securities or other property held by it.

Section VI of the Trust provides for a Trust Committee (the Committee) that is to consist of b named individuals. Section VI(4) provides that the Committee is to have the power to direct the trustee to take or refrain from taking any action that the Committee deems advisable for the trustee to take or refrain from taking under and pursuant to any of the powers conferred upon the trustee by Section II and/or by Section III of the Trust and the trustee is to refrain from taking any such action as is directed by the Committee.

Section VI(5) provides that the Committee is have control in the manner and to the extent hereinafter provided over the exercise by the trustee of any of the powers conferred upon the trustee by Section III. The trustee is not to take any action under

and pursuant to any of the powers conferred upon it by Section III unless directed by the Committee or until it has notified the Committee in writing of the action it contemplates taking and requested the Committee's approval thereof and it is the duty of the trustee, whenever it deems advisable that any action should be taken pursuant to any of such powers and it has received no directions from the Committee with respect thereto, to seek approval from the Committee. If the Committee notifies the trustee that it does not approve of the contemplated action, the trustee is not to take the action so contemplated. If the Committee notifies the trustee that the Committee is prepared to leave the question of the taking or not taking of the contemplated action to the judgment and discretion of the trustee or if no approval or refusal to approve is received from the Committee by the trustee within g days after the mailing by the trustee of the notice of the action it contemplates taking, the trustee is at liberty in the exercise of its sole and unrestricted discretion to take or not take the contemplated action.

The Committee presently consist of b individuals who are the successors to the original members of the Committee and who are independent of the trustee and unrelated to Grantor or any of Grantor's descendants.

Section XII of the Trust provides as follows:

Whenever, pursuant to the provisions of the instrument, the trustee is directed or authorized to pay over the income of any fund in its hands to any person, such payment shall be made to his or her actual, personal and beneficial use, and if the person to whom such income is payable is a married woman such income shall be separate and apart from and free from the debts, control or interference of any husband she may at any time have; and no disposition, charge or incumbrance of such income or any part thereof by way of anticipation by the person to whom such income is payable shall be of any validity, or be in any wise regarded by the trustee, nor shall such income or any part thereof be in any wise liable to any claim of any creditor of the person to whom such income is payable.

Pursuant to the terms of the Trust, on Daughter's death in d , separate trusts were created for each of Daughter's children, one of whom is Granddaughter. Trust 1 is for the benefit of Granddaughter. Granddaughter was born on e, and was therefore in being on the date of the creation of the Trust. Accordingly, the principal of Trust 1 will be distributed and Trust 1 will terminate on Granddaughter's death, unless terminated sooner, and the remainder will be distributed outright to her descendants, *per stirpes*. Granddaughter has f children who are currently living and are the presumptive remaindermen of Trust 1.

It is represented that there have been no additions (actual or constructive) to Trust since September 25, 1985, that the trustee continues to serve as trustee of the Trust, and that the Trust has been administered under the laws of State.

Section 10-6.6(b)(2) of the State Law provides that unless the terms of the instrument expressly provide otherwise, the court having jurisdiction of a trust created under a testamentary instrument or an irrevocable inter vivos trust agreement, upon the petition of the trustee and upon notice to all persons interested in the trust, may direct a trustee, who has the absolute discretion, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to invade the principal of the trust for the benefit of the income beneficiary or income beneficiaries, to exercise such discretion by appointing so much or all of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument, provided, however, that (A) the exercise of such discretion does not reduce any fixed income interest of any income beneficiary of the trust, (B) the exercise of such discretion is in favor of the beneficiaries of the trust, and (C) does not violate the limitations of § 11-1.7, which prohibits waivers of liability.

Section 10-6.6(f) of State Law provides that the exercise of the power to invade the principal of the trust under paragraph (b) of this section shall be considered the exercise of a special power of appointment as defined in § 10-3.2 and shall be subject to the provisions of §§10-8.1 and 10-8.2 covering the time at which the permissible period of the rule against perpetuities begins and the law which determines the permissible period of the rule against perpetuities.

The trustee, subject to approval by the Committee and the appropriate court proposes to transfer the corpus of Trust 1 to a new trust, Trust 2. The terms of Trust 2 will be identical in all respects to the terms of Trust 1 except for one change. The existing spendthrift provision contained in Section XII of the Trust will be modified to apply to the principal as well as the income of Trust 1.

Section XII, with the modification underlined, will provide as follows:

Whenever, pursuant to the provisions of this instrument, the trustee is directed or authorized to pay over the income or principal of any fund in its hands to any person, such payment shall be made to his or her actual, person and beneficial use, and if the person to whom such income or principal is or may become payable is a married woman such income or principal shall be separate and apart from and free from the debts, control or interference of any husband she may at any time have; and no disposition, charge or incumbrance of such income or principal or any part thereof by way of anticipation by the person to whom such income or principal is or may become payable shall be of any validity, or be in any wise regarded by the trustee, nor shall such income or principal or any part thereof be in any wise liable to any claim of any creditor of

the person to whom such income is or may become payable.

It is represented that Trust 2 will be administered under the laws of State and subject to State's jurisdiction. It is asserted that the creation of Trust 2 and the transfer of Trust 1 corpus to new Trust 2, is authorized under §10-6.6(b)(2) of State law and Section III(3) of the Trust.

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 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that the provisions of chapter 13 will not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. This rule does not apply to a portion of any generation-skipping transfer under an irrevocable trust where additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) provides that where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse of the power of appointment over that portion of the trust is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed will be treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12. In the latter case, the transferor for purposes of chapter 11 or chapter 12 is the transferor for purposes of chapter 13.

Section 26.2601-1(b)(1)(v)(B) provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) will not be treated as an addition to a trust if--

(1) the power of appointment was created in an irrevocable trust that is not subject to chapter 13 under § 26.2601-1(b)(1), and

(2) in the case of an exercise, the power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years.

Under §§ 2041(b)(1) and 2514(c), a "general power of appointment" is defined

as a power that is exercisable in favor of the possessor of the power, his estate, his creditors, or the creditors of his estate.

With respect to the transfer of Trust 1 corpus to Trust 2, a modification of a trust that is otherwise exempt for purposes of chapter 13 and the applicable regulations, will generally result in a loss of its exempt 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 this case, Trust and Trust 1 were irrevocable on September 25, 1985, no additions (actual or constructive) have been made to them since that date. The substantive and dispositive provisions of new Trust 2 are identical to those of Trust 1. In addition, it is represented that Trust 2 will be administered and regulated in accordance with the laws of State.

We express no opinion on whether the proposed transaction is authorized under Section III.3 of the Trust. Further, regarding the creation of Trust 2 and the transfer of Trust 1 corpus to Trust 2 pursuant to State law, § 26.2601-1(b)(v)(1)(B), which discusses whether the exercise of certain special powers of appointment will cause a trust to lose exempt status, does not address the situation presented in the instant case where a trustee is exercising an invasion power pursuant to a state statute requiring participation or concurrence by the court and/or trust beneficiaries.

However, because Trust 2 will be identical in every respect to Trust 1 (other than with respect to the modification of the spendthrift clause discussed above), we conclude that the proposed transfer of Trust 1 corpus to Trust 2 will not change the quality, value or timing of any power, beneficial interest, right or expectancy originally provided for under the terms of the Trust. In this regard, the modification to the spendthrift clause does not effect the trustee's/Committee's continued authority to pay trust corpus to the beneficiaries in accordance with the terms of the trust. Accordingly, this modification does not affect the quality, value or timing of any beneficial interest originally provided for under the terms of Trust 1.

We conclude that the proposed transaction will not cause Trust 1 or Trust 2 to be subject to the provisions of chapter 13.

We conclude also that the proposed transaction will not cause the Trust, Trust 1, or any beneficiary thereof to be deemed to have made a gift or to be subject to federal gift tax. Further, the proposed transaction will not cause the inclusion of any portion of Trust 1 or new Trust 2 in the estate of any individual beneficiary for federal estate tax purposes.

This ruling is based on the facts presented and the applicable law in effect on the date of the 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.

We express or imply no opinion concerning whether the proposed transaction is authorized under Section III(3) of the Trust.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code.

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

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to Taxpayer.

Sincerely yours,

Christine E. Ellison
Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)