

Internal Revenue Service

Department of the Treasury

Number: **200123012**
Release Date: 6/8/2001
Index Number: 2601.03-01

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4/PLR-110512-00

Date:

March 2, 2001

In Re:

Legend:

- Grantors -
- Daughter -
- Trust #3 -
- Trustee -
- Foundation -
- Date 1 -
- Date 2 -
- Date 3 -
- Date 4 -
- Date 5 -
- \$x -

Dear :

This is in reference to your October 10, 2000 correspondence, and prior submissions, requesting rulings regarding the effect of the proposed judicial modification of the trust instrument for federal generation-skipping transfer tax purposes.

The facts submitted are as follows:

On Date 1, Grantors created and funded Trust #3, an irrevocable trust governed by the law of State X, primarily for the benefit of the issue of Daughter, their child. Trustee, an independent corporation, is the trustee of Trust #3.

Under the terms of Trust #3, Trustee will distribute \$x from net income and, to the extent that income is not sufficient, from principal to Foundation annually for a term of 35 years. The annuity period for the payments commenced on Date 2 and will terminate on Date 3. In the event that there is excess income in any year, the amount of any excess (not to exceed the percentage of \$x by which the Wholesale Price Index, or other equivalent substitutes, for that year exceeds the Wholesale Price Index for Date 4) is to be paid to Foundation. Trustee has the discretion to pay any income in excess of the amounts required to be paid to Foundation, to the issue of Daughter or, if

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there is no such issue, to other issue of the Grantors. Any income not so distributed, will be retained in principal and may be distributed in subsequent years as excess income.

Article FIRST(d) of Trust #3 provides that the trust will terminate 21 years after the death of the survivor of Grantors, Daughter, Daughter's spouse, two other children of Grantors and their spouses, and named issue of Grantors' children. Article FIRST(d)(i) provides that, in the event that the trust terminates before Date 3, Foundation will be paid an amount equivalent to the present value at the date of termination of the remaining payments of \$x per year payable on the payment date and any remaining principal will be distributed pursuant to Article FIRST(d)(ii). Article FIRST(d)(ii) provides that, if Trust #3 terminates on or after Date 3, the remainder will be distributed to such of the Grantors' issue (other than Daughter, her estate, or the creditors of either) and their spouses as Daughter may appoint, either by testamentary or inter vivos appointment. In the event that Daughter does not exercise the power of appointment, the principal will be distributed in equal shares to the issue of Daughter, per stirpes, or, if none, in equal shares to the issue of Grantors, per stirpes. In the event that there are no issue of Grantors living at the termination date, the principal will be distributed to Foundation.

Daughter, who is no longer living, exercised her limited power of appointment over the assets of Trust #3 on Date 5 in favor of her children who may be living on Date 3 and the issue of any child of hers who is deceased on Date 3, by right of representation. Currently, Daughter has three children, all of whom are living.

The Trustee represents that there is an ambiguity in Trust #3 with respect to the termination date. Article FIRST(d) provides that Trust #3 will terminate 21 years after the death of Grantors, Daughter, Daughter's spouse, and other named individuals. Article FIRST(d)(i) indicates that Trust #3 could terminate at an earlier date. This section states that "[I]f such termination shall be prior to [Date 3]," In addition, Trust #3 does not include any provisions addressing distribution of income and/or principal after the expiration of the annuity period on Date 3.

To resolve this ambiguity, the children of Daughter filed a petition in the appropriate local court for a proper construction of the termination provisions of Trust #3. The court issued an order construing the terms of Trust #3. The order concluded that Trust #3 should terminate at the expiration of the annuity period on Date 3, if not earlier, and that the assets should be distributed pursuant to Article FIRST(d)(ii). The order is subject to the Internal Revenue Service issuing a private letter ruling that termination of Trust #3 at the expiration of the annuity period on Date 3 and distribution of the principal of Trust #3 pursuant to Article FIRST(d)(ii) of Trust #3 on that date will not subject Trust #3 to the generation-skipping transfer tax.

Trustee has represented that no additions have been made to Trust #3 after September 25, 1985.

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Trustee requests a ruling that the court order construing the termination date of Trust #3 will not affect the exempt status of Trust #3 for generation-skipping transfer tax purposes, and will not result in a transfer of property that will subject Trust #3, or distributions thereunder, to the generation-skipping transfer tax imposed under § 2601.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made after October 26, 1986.

A generation-skipping transfer 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 trust where the property passes to a skip person with respect to the transferor of the property. 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 made by a transferor to a skip person.

Under § 1431(a) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax does not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(iv) states that, if an addition is made after September 25, 1985, to a trust which was irrevocable on September 25, 1985, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the GST tax provisions. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to the GST tax and a portion subject to the GST tax.

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) is not treated as an addition to a trust if (1) the power was created in an irrevocable trust that is not subject to the GST tax because it was irrevocable on September 25, 1985, and (2) in the case of an exercise, the power was not exercised in such a way that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period beyond the rule against perpetuities measured from the creation of the trust.

A general power of appointment is defined in § 2514(c) as a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

The inter vivos and testamentary power held by Daughter to appoint the remainder of Trust #3 (after the expiration of the annuity period) to such of the Grantors' issue and their spouses was not a general power of appointment because Daughter

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could not exercise the power in favor of herself, her estate, or the creditors of either. The exercise by Daughter on Date 5 of the limited power of appointment in favor of her children who may be living on Date 3 and the issue of any child of hers who may have died before that date did not postpone or suspend the vesting or ownership of any interest in Trust #3 beyond the rule against perpetuities measured from the creation of Trust #3 on Date #1. Thus, pursuant to § 26.2601-1(b)(1)(v)(B), the exercise of the power by Daughter was not treated as an addition, constructive or otherwise, to Trust #3.

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.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct scrivener's error will not cause an exempt trust to lose its exempt status provided the judicial action involves a bona fide issue, and the construction is consistent with applicable state law that would be applied by the highest court of the state.

In the present case, Trust #3 was irrevocable on September 25, 1985. Trustee has represented that no additions, actual or constructive, have been made to the trust after that date.

The law of Minnesota provides, at Minn. Stat. Ann. § 501B.16(4) (West 1990), that:

A trustee of an express trust by will or other written instrument or a person interested in the trust, may petition the district court for an order to construe, interpret, or reform the terms of a trust, or authorize a deviation from the terms of a trust, including a proceeding involving [charitable trusts].

If there are ambiguities in the construction of the terms of an instrument, the court will adopt that construction that will result in sustaining the questioned provision to the end that the testator's intention will be carried out. Matter of Florance, 343 N.W.2d 297 (Minn. Ct. App. 1984), aff'd and rev'd in part on other grounds, 360 N.W.2d 626. The settlor's intention as expressed in language used in the trust must prevail if it is not inconsistent with the rules of law. In ascertaining the settlor's intention, the court will consider pertinent trust provisions as a whole. In re Butler's Trusts, 26 N.W.2d 204, 208 (Minn. 1947).

In this case, the court concluded that the terms of Trust #3 concerning the termination date were ambiguous and concluded that the settlor intended that the trust would terminate at the expiration of the annuity period. The court construed Trust #3 to require termination after expiration of the annuity period and, pursuant to that

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construction, amended Trust #3 to the effect that the assets of Trust #3 will be distributed upon termination on Date 3 pursuant to Article FIRST(d)(ii).

We conclude that the terms of Trust #3 present a bona fide issue regarding the termination of the trust. Further, we conclude that the court's construction of Trust #3 is consistent with applicable state law that would be applied by the highest court of the state. Accordingly, based on the facts submitted and the representations made, the court order construing Trust #3 will not affect the exempt status of Trust #3 for generation-skipping transfer tax purposes, and will not result in a transfer of property that will subject Trust #3, or distributions thereunder, to the generation-skipping transfer tax imposed under § 2601.

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

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 the 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. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

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.

Sincerely yours,
James Hogan
Assistant to Branch Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes