

Internal Revenue Service

Department of the Treasury

Number: **200217035**
Release Date: 4/26/2002
Index Numbers: 2601.03-01

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09-PLR-137112-01
Date:
January 23, 2002

In Re:

LEGEND:

Trustee =

Decedent =
Date 1 =
Spouse =
Son =
Daughter =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Trust =

Date 2 =
Date 3 =
Probate Court =

Dear :

This is in response to your letter dated June 28, 2001, submitted on behalf of Trustee, requesting a ruling regarding the generation-skipping transfer (GST) tax consequences of a proposed modification to a trust.

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The information submitted and representations made are summarized as follows. Decedent died testate on Date 1, several years prior to September 25, 1985, survived by Spouse, Son, Daughter, Grandchild 1, Grandchild 2, and Grandchild 3. Decedent's will provided for a number of specific bequests, a marital bequest, and established a residuary trust (Trust) for the benefit of Son, Daughter, and their issue. The Trustee represents that there have been no actual or constructive additions to the trust after September 25, 1985.

Item VII(d) of Decedent's will provides that Decedent devises and bequeaths the residue of his estate to Trust to be held in trust until twenty-one (21) years after the death of the last survivor among his children and grandchildren who are in being at the time of his death and, upon termination, the principal of Trust shall be divided among its income beneficiaries, per stirpes. The trustee shall divide the residue into two separate and equal trusts to be designated "Fund A" and "Fund B." Fund A will be maintained for the benefit of Daughter and her issue. Fund B will be maintained for the benefit of Son and his issue.

Item VII(d-1) provides that Fund A shall be held by Trustee for the benefit of Daughter and her issue. Daughter shall receive two-thirds of the net income so long as she may live, in monthly or quarterly installments as she may direct. The issue of Daughter, per stirpes, shall receive one-third of the net income so long as Daughter shall live, in monthly or quarterly installments as she may direct. If all of the issue of Daughter shall predecease her, Daughter shall thereafter receive the entire net income so long as she shall live. Upon the death of Daughter, Fund A shall be held for the benefit of the surviving issue of Daughter, per stirpes, and Daughter's issue shall receive the entire net income until the termination of this trust. If any issue of Daughter should die during the life of the trust, the share of income of the deceased issue shall be paid to the then living issue of Daughter, per stirpes. Upon the death of Daughter without issue surviving, or upon the death of Daughter's last surviving issue prior to termination, the entire assets of Fund A in the custody of the trustee shall be added to Fund B.

Item VII(d-2) provides that Fund B shall be held by Trustee for the benefit of Son and his issue. Son shall receive the entire net income until he shall have issue in being. Thereafter, he shall receive two-thirds of the net income so long as he may live, in monthly or quarterly installments as he may direct. The issue of Son, per stirpes, shall receive one-third of the net income so long as Son shall live, in monthly or quarterly installments as he may direct. Upon the death of Son or upon Decedent's death if he should predecease Decedent, Fund B shall be held for the benefit of the surviving issue of Son, per stirpes, and his issue shall receive the entire net income until the termination of this trust. If any issue of Son should die during the life of the trust, the share of income of the deceased issue shall be paid to the then living issue of Son, per stirpes. Upon the death of Son without issue surviving, or upon the death of his last surviving issue prior to termination, the entire assets of Fund B in the custody of the trustee shall be added to Fund A.

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Item IX provides the powers granted to the executor and also to the trustee, subject to the approval of the advisory committee.

Item X provides for an advisory committee consisting of Spouse, Son, and Daughter. Item X further provides that the fiduciaries shall consult with the advisory committee regarding all important matters affecting the trust established under the will and that the prior written consent and approval of two members of the advisory committee shall be deemed the consent of the committee. After the death of two members of the advisory committee, the surviving member shall constitute the advisory committee. After the death of all members of the advisory committee, the executors and trustees and their successors shall exercise their own powers and discretion. For all actions taken in accordance with the directions or consent of the advisory committee, the fiduciaries shall have "full and complete acquittance." No party dealing with the executor or trustee or their successors shall be required to ascertain whether the direction or consent of the committee shall have been obtained and all parties dealing with the fiduciaries may do so as though the fiduciaries were possessed of full, complete, and independent power and authority. Members of the advisory committee may receive from the executor or trustee or their successors, reasonable compensation for their services and reimbursement for their expenses incident to their services.

Son died on Date 2, prior to the funding of the trust and without children. Spouse died on Date 3. Due to the deaths of Son and Spouse, Daughter is currently the last surviving member of the advisory committee. After Daughter's death, the Trust does not provide for the continuation of the advisory committee.

The Trustee represents that Daughter, as the last surviving member of the advisory committee, desires to extend the life of the advisory committee beyond the life of Daughter and to retain an advisory committee for the remaining life of the trust. Trustee, Daughter, Grandchild 1, Grandchild 2, and Grandchild 3 (all of whom are current beneficiaries of the trust), and one of Daughter's grandchildren who has attained the age of legal majority (who, together with his siblings, are contingent beneficiaries of the trust) have executed an agreement which shall only be effective upon an order of the Probate Court.

The agreement provides, in part, as follows:

(1) Upon Daughter's death, Daughter's then living children, jointly, shall be allowed to function and serve as the substitute and successor advisory committee to the trust, with the same power and authority conferred upon the advisory committee in the Trust.

(2) At the death of Grandchild 1, if Grandchild 1 survives Daughter (or at Daughter's death, if Grandchild 1 predeceases Daughter), Grandchild 1's eldest then living child who has attained the age of legal majority shall automatically succeed Grandchild 1 as a member of the advisory committee. If Grandchild 1's eldest child who is then serving as a member of the advisory committee shall fail or cease to serve thereas, Grandchild

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1's next eldest child who has attained the age of legal majority shall automatically become a member of the advisory committee. For purposes of the agreement, if all of Grandchild 1's children living at the time any such vacancy arises are then minors, Grandchild 1's eldest child who is then a minor shall automatically become a member of the advisory committee upon later attaining the age of legal majority.

(3) At the death of the last survivor of Daughter and Daughter's children, Grandchild 1's then living children, jointly, shall be allowed to function and serve as the substitute and successor advisory committee to the trust with the same powers and authority conferred upon the advisory committee in the Trust. Any of Grandchild 1's children who are then minors shall become members of the advisory committee upon later attaining the age of legal majority.

A petition has been filed with the Probate Court seeking approval of the agreement. Trustee represents that the advisory committee has no power or authority to alter how, or to whom, the income or corpus of the trust is distributed.

The Trustee has requested a ruling that the proposed appointment of successor members of the advisory committee will not violate §1433(b)(2)(A) of the Tax Reform Act of 1986 and thus, the Trust will continue to be exempt from the GST tax.

LAW AND ANALYSIS:

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term "generation-skipping transfer" as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply if additions (actual or constructive) are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(ii)(B) or (C), which relates to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, Trust is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(4) 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 under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt

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status. The rules contained in § 26.2601-1(b)(4) 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 § 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 § 26.2601-1(b)(4)(i)(A), (B), or (C)) 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, in part, that a modification to a trust 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 10, illustrates the application of paragraph (b)(4) as follows:

Administrative change to terms of a trust. In 1980, Grantor executed 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 of the Internal Revenue Code.

In the present case, the Trust was created and became irrevocable on Date 1, and there have been no additions made to the Trust after September 25, 1985. Accordingly, the Trust is exempt from the GST tax under § 26.2601-1(b)(1).

Based on the facts submitted and the representations made, the proposed appointment of the successor advisory committee or advisory committee members effectuates an administrative change and will not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation, as defined in § 2651, than the person

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or persons who held the beneficial interest prior to the modification. The modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Provided that the Probate Court approves the proposed agreement, the modification will not violate § 1433(b)(2)(A) of the Tax Reform Act of 1986 and will not affect the exempt status of the Trust.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. 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. 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 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.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter should be attached to the federal estate tax return of the decedent. A copy is enclosed for that purpose.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to Trustee.

Sincerely yours,

James F. Hogan
Senior Technician Reviewer, Branch 9
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy for section 6110 purposes