

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-105348-02

Date:

DECEMBER 04, 2002

Re:

LEGEND:

- Grandparent A =
- Grandparent B =
- Child A =
- Child B =
- Grandchild A =
- Grandchild B =
- Grandchild C =
- Trust =
- Grandchild A Trust =
- Grandchild B Trust =
- Grandchild C Trust =
- Corporate Trustee =
- Individual Trustee A =
- Individual Trustee B =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- Date 5 =
- Court =
- First Order =
- Second Order =
- State Statute =

Dear :

This is in response to the August 9, 1999 letter and subsequent correspondence requesting a ruling regarding the generation-skipping transfer tax consequences of a judicial construction of Trust.

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Facts

The facts submitted and representations made are as follows.

Grandparent A died on Date 1, prior to September 25, 1985. His will provided for the creation of Trust and designated Grandparent B and Child A as trustees. Grandparent A died on Date 1, Grandparent B died on Date 2, and Child A died on Date 3, all before September 25, 1985. Child A had three children (“the grandchildren”): Grandchild A, Grandchild B, and Grandchild C, each of whom survived Grandparent B and Child A.

Under Article III, paragraph (a) of Trust, the trust is to be held for the benefit of Grandparent B during her life. Under Article III, paragraph (b), on Grandparent B’s death, Trust is to be divided into equal shares, one such share to be held for the benefit of each child of Child A then living (“the grandchildren”).

Under Article III, paragraph (d), until the complete distribution of a grandchild’s share, or until the grandchild’s prior death, so much of the net income is to be distributed to the grandchild as the trustees in their absolute discretion deem reasonably necessary for the grandchild’s comfortable support, education, and welfare. The remaining income may be distributed to any one or more of Grandparent A’s descendants (except Child A and Child B) and their spouses, as the trustees in their absolute discretion deem advisable. Any remaining income is to be added to the principal of the share.

Under Article III, paragraph (e), the trustees may distribute such principal of a grandchild’s share to the grandchild as, in their absolute discretion, they deem advisable. However, distributions of principal made after Child A’s death may not exceed one-third of the fair market value of such share at the time of its creation, until the grandchild attains age 33, nor two-thirds of the fair market value until the grandchild attains age 36.

Under Article III, paragraph (e), if a grandchild dies after Child A has died, the grandchild’s share is to be distributed to such of the grandchild’s then living descendants, in such proportions and subject to such trusts and conditions, as the grandchild directs by will. In default of the grandchild’s direction, the trustees are to distribute the grandchild’s share to the grandchild’s then living descendants, equally per stirpes or, if there are none, equally per stirpes to Grandparent A’s then living descendants (except Child B).

Under Article III, paragraph (b), at Child A’s death, the entire trust estate is to be distributed to such of Grandparent A’s then living descendants and their spouses in

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such proportions and subject to such trusts and conditions as Child A directs by will at his death, with power in Child A to exclude any one or more of such persons. In default of the exercise of the power, the trust is to continue as described above.

Under Article III, paragraph (n), the trustees have the full power and authority to determine whether and in what proportions any receipts or disbursements are to be credited or charged to or apportioned between principal and income.

Pursuant to the directive of Article III, paragraph (b), on Grandparent B's death, the trustees divided Trust into three shares: Grandchild A Trust, Grandchild B Trust, and Grandchild C Trust. Child A did not exercise the testamentary power to appoint the Trust property among Grandparent A's then living descendants and their spouses, and, therefore, Grandchild A Trust, Grandchild B Trust, and Grandchild C Trust have continued in effect under the provisions of Trust. The current trustees are Corporate Trustee, Individual Trustee A, and Individual Trustee B. It is represented that no additions, actual or constructive, have been made to Trust or Grandchild A Trust, Grandchild B Trust or Grandchild C Trust after September 25, 1985.

Under applicable local law governing the ascertainment of income and principal and the apportionment of receipts and expenses, a trust is to be administered with due regard to the respective interests of income beneficiaries and remaindermen. A trust is so administered with respect to the allocation of receipts and expenses if a receipt is credited or an expense is charged to income or principal or partly to each in accordance with the terms of the instrument. State Statute.

On Date 4, in response to the trustees' request for instructions relating to their authority to manage and invest the trust assets, Court issued First Order authorizing the trustees to: (1) invest the assets on a joint or pooled basis; and (2) retain professional investment managers having expertise in managing the type of investments appropriate to meet the investment objectives of a trust or joint investment fund, if the trustees deem it appropriate in accordance with the exercise of their fiduciary responsibility.

The trustees subsequently petitioned Court for instructions concerning the power to allocate expenses and receipts under Article III, paragraph (n). On Date 5, Court issued Second Order concluding that, pursuant to the express language of Trust, the trustees have the power and authority in the exercise of their fiduciary responsibilities to credit realized capital gains to income and to charge income expenses to principal.

Requested ruling

You have asked us to rule that the exercise of the trustee's discretion to allocate capital gain receipts to income and to charge certain income expenses to principal pursuant to Second Order does not adversely affect the trusts' status as exempt from the generation-skipping transfer tax.

Discussion

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (“the 1986 Act”) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping transfer tax shall not apply to any generation-skipping 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)(1)(ii) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in the grantor's gross estate under sections 2038 and 2042).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from the application of Chapter 13 by section 1433(b)(2)(A) of the 1986 Act, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of Chapter 13.

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.

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 will not cause an exempt trust to be subject to the provisions of chapter 13 if - (1) the judicial action involves a bona fide issue; and (2) the construction is consistent with a applicable state law that would be applied by the highest court of the state.

In the instant case, Trust and Grandchild A Trust, Grandchild B Trust and Grandchild C Trust were irrevocable on September 25, 1985, and no additions, actual or constructive, have been made to Trust or Grandchild A Trust, Grandchild B Trust or Grandchild C Trust after that date. The judicial construction of Article III, paragraph (n), that the trustees are authorized under the provision to allocate capital gain receipts to income and charge certain income expenses to corpus, is consistent with the language of the provision and applicable state law.

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Accordingly, based on the facts submitted and the representations made, we rule that the entry of the Second Order authorizing the trustees to allocate capital gain receipts to income and charge certain income expenses to corpus, and the trustees' exercise of discretion in accordance with the court order, will not adversely affect the status of Grandchild A Trust, Grandchild B Trust, and Grandchild C Trust as exempt from generation-skipping transfer tax. Section 26.2601-1(b)(4)(i)(C).

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the modification under the cited provisions or under any other provisions of the Code. Specifically, we express no opinion on the federal income and gift tax consequences of the modification.

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,

George L. Masnik
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes