

Internal Revenue Service

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Person To Contact:
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Date:
August 01, 2006

Legend

- Trust =
- Grantor =
- Date 1 =
- Daughter 1 =
- Grandchild 1 =
- Grandchild 2 =
- Grandchild 3 =
- Daughter 2 =
- Foundation =
- Court =

Dear :

This letter responds to your letter, dated January 6, 2006, requesting rulings relating to the income, gift, and generation-skipping transfer (GST) tax consequences of a proposed modification of Trust.

Grantor created Trust on Date 1 for the benefit of Daughter 1 and her descendants. Daughter 1 has three minor children: Grandchild 1, Grandchild 2, and Grandchild 3. Grantor created an identical trust on the same date for Daughter 2. Date 1 is before September 25, 1985.

Article Second of the Trust agreement provides that the trustee has the discretionary power to distribute income and principal to or for the benefit of any

member of the class consisting of Daughter 1, her lineal descendants, and the spouses of her lineal descendants.

Article Third of the Trust agreement provides that Trust will terminate upon the death of Daughter 1. Upon termination, the Trust principal will be distributed in equal shares, per capita, to Grantor's then living grandchildren and the living lineal descendants of any deceased grandchild of Grantor. The lineal descendants of a deceased grandchild will receive per stirpes distributions in the place of the deceased grandchild. If there are no living grandchildren or more remote descendants, the principal shall be distributed in equal shares, per capita, to Grantor's then living children. If there are no living children, the principal shall be distributed to Foundation. The trust set up for Daughter 2 similarly provides present interests for Daughter 2's family. The termination provision of Daughter 2's trust are the same as Daughter 1's Trust.

In order to be able to pursue customized investment strategies for each daughter's family, the trustee proposes to modify Trust. As modified, Trust will provide that, upon termination, the remaining Trust principal will be distributed to the then living descendants of Daughter 1, per stirpes. If there are none, then to the then living descendants of Daughter 2, per stirpes. If there are none, then to Daughter 2 if she is living. If Daughter 2 has predeceased Daughter 1, then the principal shall be distributed to a nonprofit corporation as the successor in interest to Foundation. The trust created for Daughter 2 will be modified in a similar manner.

Daughter 1 and Daughter 2 were born on different dates and have different life expectancies. The trustee has agreed to make a distribution between Trust and the trust created on behalf of Daughter 2 so the present value of the remainder interests in each trust are the same before and after the modification is implemented.

Court has issued a conditional order, approving the modification and providing that the modification will become effective if the Internal Revenue Service determines that it will not affect the Trust's status as exempt from the GST tax.

The trustee has requested the following rulings: (1) The modification of Trust will not result in a transfer by any beneficiary that is subject to the gift tax under § 2501; (2) Trust is exempt from the GST tax because it was irrevocable on September 25, 1985; (3) No beneficiary shall be considered a transferor with respect to any Trust property for GST purposes as a result of the proposed modification of Trust; and (4) The proposed modification of Trust will not cause Trust to lose its status as exempt from the GST tax.

Ruling 1

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

Section 2511 provides that, subject to certain limitations, the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations states that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

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, because of the distribution between Trust and the trust created for the benefit of Daughter 2, the Trust beneficiaries will have the same interests before and after the proposed modification. Accordingly, there is no direct transfer of assets and no transfer of property will be deemed to occur as a result of the proposed modification. Therefore, based on the facts submitted and the representations made, we conclude that the proposed modification of Trust does not constitute a transfer, direct or indirect, of property that will be subject to the gift tax consequences under § 2501.

Rulings 2, 3, and 4

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, but only to the extent that the 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)(A) provides that, except as provided in § 26.2601-11(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042.

Potential beneficiaries of Trust include individuals who are two or more generations below the grantor's generation, therefore, distributions from Trust may be subject to the generation-skipping transfer tax. In the present case, Trust is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies. The trustees represent that no additions have been made to Trust after September 25, 1985. Trust, therefore, is exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i).

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 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) 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 in the original trust. Furthermore, 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 a shift in a beneficial interest in a trust.

The proposed modification to Trust in conjunction with the modification to the trust for the benefit of Daughter 2 and the proposed distribution to equalize the interests does not shift a beneficial interest 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 proposed modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Based on the facts submitted and representations made, we conclude that the proposed modification of Trust will not affect Trust's status as exempt from the generation-skipping transfer tax. No beneficiary shall be considered a transferor with respect to any Trust property for GST purposes solely as a result of the proposed

modification. As a result, the proposed modification will not cause a distribution from, or termination of any interest in, Trust to be subject to the GST tax.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied regarding the income tax consequences of the Trust modification.

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.

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

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representatives.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

Enclosure

Copy for § 6110 purposes

cc: