

**Internal Revenue Service**

Department of the Treasury  
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Refer Reply To:  
CC:PSI:B04 – PLR-124568-16

Date:  
January 25, 2017

Re:

- Date 1 =
- Date 2 =
- Grantor =
- Daughter =
- Son 1 =
- Son 2 =
- Trust Agreement =
  
- Trust 1 =
  
- Trust 2 =
- State =
- Bank =
- Foundation =
- State Statute =

Dear \_\_\_\_\_ :

This letter responds to correspondence, dated July 27, 2016 requesting a ruling regarding the generation-skipping transfer (GST) tax consequences of a proposed transfer of assets from one trust to a successor trust and modifications to the successor trust.

The facts submitted and representations made are as follows. On Date 1, Grantor entered into Trust Agreement which established four separate irrevocable trusts, each for the benefit of one of his four children. Trust 1 benefits Grantor's

Daughter and her descendants. Date 1 is a date prior to September 25, 1985. This private letter ruling pertains to Trust 1 and its successor, Trust 2, described below.

Trust Agreement is governed by the laws of State. Daughter and Bank are the current trustees of Trust 1. Daughter, Son 1, Son 2, and two of Son 2's minor children, are the current beneficiaries of Trust 1.

Trust Agreement provides that the trustees of Trust 1 are authorized to pay to Daughter the net income during her life. Further, the trustees have the discretion to withhold from Daughter all or any part of the income which would properly be paid to Daughter, and to pay that amount to any of Daughter's descendants, or to accumulate it and add it to the principal of the trust. In addition, the trustees have the absolute discretion to distribute principal to Daughter and one or more of her descendants as necessary for maintenance, education, accident, illness, to build a home, start a business or for any other financial transaction the trustee deems to be in a beneficiary's best interest.

If at any time a descendant of the Grantor shall be in office as trustee of Trust 1, all powers granted to the trustees shall be vested exclusively in the trustees other than such descendants of Grantor. Currently, only Bank has the authority to make distributions to Daughter and her descendants.

Trust Agreement further provides that the distribution powers granted to a trustee shall be exercised with primary regard for the interests of Daughter and, to the extent the trustees shall deem appropriate, the current interests of Daughter's descendants rather than for remainder or other successor interests.

After Daughter's 35<sup>th</sup> birthday, the trustees will consider whether to distribute to Daughter all or a major portion of the trust principal of Trust 1. If the trustees do not make such distributions when Daughter attains age 35, then the trustees are required to periodically review the basis for their determination in order to determine whether to make such distributions at a later date.

Trust 1 provides that upon Daughter's death, the trustees shall distribute the then principal of the trust, in equal shares, *per stirpes*, to the descendants of such child who shall then be living or, in default of any such descendant, to the descendants of the Grantor who shall then be living; provided, however, that if any property shall become distributable, pursuant to the provisions of this sentence, to a child of the Grantor for whose primary benefit a trust shall then be in existence under this Article, such property shall not be distributed to such child but shall rather be added to, and thereafter dealt with as a part of the principal of the trust.

If the trustees are authorized to distribute any amount, whether income or principal, to a person, other than Daughter, who is under the age of 25, the trustees are authorized to retain all or any part of the amounts as a separate trust for the primary benefit of such person. The trustees have the absolute discretion to distribute such amounts to that person for that person's support and education. Such trust will terminate on the earliest to occur of: (a) the death of such person, (b) the attainment by such person of the age of 25, and (c) the 21<sup>st</sup> anniversary of the death of the last to die of the descendants of Grantor's father living on the date of the Agreement. On termination, the trustees shall distribute the principal to such person or, if such trust shall have terminated at his death, in equal shares to his children who shall then be living or, in default of any such child, in equal shares, *per stirpes*, to the then living descendants of his most immediate ancestor who shall have any descendant then living and who shall be, or shall have been, the Grantor or one of his descendants.

If, on the termination of Trust 1, the whole or some part of the principal of the trust shall not be effectively disposed of by or pursuant to the provisions in Trust Agreement, the Grantor directs that the property of Trust 1 be distributed as follows: one-half to Foundation and one-half, in equal shares, *per capita*, to the then living children of the Grantor's sisters, provided, however, that if any child of either of the Grantor's sisters shall have died leaving any descendants who shall then be living, the trustees shall distribute to the then living descendants of such child, in equal shares, *per stirpes*, the share to which such child would have been entitled under Trust 1 if he had survived the termination of the trust.

Trust 1 provides that any individual at any time in office as trustee may at any time resign as trustee. Further, any adult individual (other than Grantor) may at any time be appointed and removed as trustee of Trust 1. Trust 1 does not have any provisions governing the appointment, resignation, or removal of a corporate trustee.

Grantor died on Date 2, a date prior to September 25, 1985. Trust 1 received additional principal from Grantor's estate. It is represented that no additions have been made to Trust 1 after September 25, 1985.

Bank plans to resign as a trustee of Trust 1. Upon receipt of a favorable private letter ruling, the trustees, pursuant to State Statute, will appoint the assets of Trust 1 to Trust 2. Trust 2 will continue to be governed by the laws of State. Trust 2 will have the same beneficiaries and will not extend the time for vesting of any beneficial interest in the trust assets beyond the period provided in Trust 1, and will contain the same distribution and dispositive provisions of Trust 1. Further, Trust 2 authorizes only a Disinterested Trustee to make distributions from Trust 2 to the beneficiaries. A "Disinterested Trustee" is defined as a trustee who is (i) not a transferor of property to the trust; (ii) not a present or future beneficiary who is, or in the future may be, eligible to receive income or principal pursuant to the terms of the trust; and (iii) an individual or

corporation that is not related or subordinate to a person described in (i) or (iii), within the meaning of § 672(c).

Trust 2 will modify the provisions governing trustee resignation, removal and appointment of individual and corporate trustees as follows: (i) if Daughter ceases to serve as a trustee, her two sons will be successor trustees; (ii) The individual and any corporation acting as the trustees may at any time acting unanimously by written instrument appoint an individual or a corporation with fiduciary powers as successor trustee; (iii) if the office of trustee is vacant and no successor takes office pursuant to the above provisions, either an individual or a corporation with fiduciary powers may be appointed as trustee by a majority of Daughter's adult descendants then living and competent (or, if none, the guardian or similar fiduciary of the then-living eldest descendant of Daughter); (iv) The individual and any corporation acting as the trustees may at any time acting unanimously by written instrument appoint an individual or a corporation with fiduciary powers as a co-trustee; (v) if no person is serving as a Protector, described below, the individual trustee has the right to remove and replace any corporate trustee by unanimous consent.

Trust 2 also adds provisions governing the appointment and service of a trust protector. Trust 2 provides that Daughter and her two sons, shall serve together as the "Protector" of the trust. If Daughter ceases to serve as a Protector for any reason, the two sons shall continue to serve as Co-Protectors. Two Protectors shall act jointly and multiple Protectors shall act by majority. The Protector has the power to modify or amend the terms of the trust to achieve favorable tax status or to respond to changes in the Code, state law or the rulings and regulations implementing such changes; to take advantage of changes in laws governing restraints on alienation, or other state laws restricting the terms of the trust, the distribution of property, or the administration of the trust; provided, however, that such amendment or modification may not shift any beneficial interest in the trust assets to a beneficiary of a lower generation or extend the time for vesting of any beneficial interest in the trust assets beyond the time provided in Trust 2.

The Protector, by written unanimous consent, has the right to appoint one or more persons to be successor Protector, to remove any Disinterested Trustee of Trust 2, for any reason, to appoint an individual or corporation with fiduciary powers to replace the removed trustee, and to appoint an individual or corporation with fiduciary powers, whenever the office of Disinterested Trustee of the trust becomes vacant.

Trust 2 provides that no discretionary distributions shall be made from Trust 2 that would discharge or substitute for a legal obligation of any person serving as Protector even if such a distribution otherwise would be authorized under the terms of the trust.

The Protector shall not appoint as trustee an individual or corporation related or subordinate to the Protector, within the meaning of § 672(c) when the Protector is an Interested Trustee or would be an Interested Trustee if the Protector were serving as Trustee. An "Interested Trustee" is defined as a trustee who is (i) a transferor of property to the trust; (ii) a present or future beneficiary who is, or in the future may be, eligible to receive income or principal pursuant to the terms of the trust; or (iii) an individual or corporation that is related or subordinate to a person described in (i) or (ii), within the meaning of § 672(c).

You have requested a ruling that the proposed transfer to Trust 1 assets to a successor trust, Trust 2, and the modifications to Trust 2 will not cause Trust 1 or Trust 2 to lose their exempt status for purposes of the generation-skipping transfer tax.

Section 2601 of the Internal Revenue Code imposes a tax on every GST made after October 22, 1986. A GST 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 a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

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 of an interest in property to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the GST tax does not apply to a 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). Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died on September 25, 1985.

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 GST 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. In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus (unless specifically noted), 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 gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(A) provides that the distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new or continuing trust to be subject to the provisions of chapter 13, if either the terms of the governing instrument of the exempt trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; or at the time the exempt trust became irrevocable, state law authorized distributions to the new trust or retention of principal in the continuing trust, without the consent or approval of any beneficiary or court; and the terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust 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 the original trust became irrevocable, extending beyond any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation.

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 paragraph § 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 that for purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be

immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. 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 to shift a beneficial interest in the trust.

In § 26.2601-1(b)(4)(i)(E), *Example 10* considers the following situation. In 1980, Grantor established 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.

State Statute provides that an authorized trustee with unlimited discretion to invade trust principal may appoint part or all of such principal to a trustee of an appointed trust for, and only for the benefit of, one, more than one or all of the current beneficiaries of the invaded trust (to the exclusion of any one or more of such current beneficiaries). The successor and remainder beneficiaries of such appointed trust may be one, more than one or all of the successor and remainder beneficiaries of such invaded trust (to the exclusion of any one, more than one or all of such successor and remainder beneficiaries).

The proposed distribution of Trust 1 principal to Trust 2 does not satisfy the requirements of § 26.2601-1(b)(4)(i)(A). Trust Agreement does not authorize the trustee to distribute principal from Trust 1 to Trust 2. Further, while State Statute authorizes the trustee to make such a distribution for purposes of satisfying State law, the state law must be in effect at the time the exempt trust became irrevocable for purposes of satisfying § 26.2601-1(b)(4)(i)(A)(1)(i). In this case, State Statute was enacted subsequent to the execution of Trust Agreement.

However, if a transaction does not satisfy § 26.2601-1(b)(4)(i)(A), the regulations provide that the transaction may remain exempt from GST tax if the transaction satisfies § 26.2601-1(b)(4)(i)(D). In this case, the transfer of assets of Trust 1 to Trust 2 satisfies these requirements. The distributions from Trust 1 to Trust 2 will 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 distribution. In addition, the distribution does not extend the time for vesting of any

beneficial interest in the trust beyond the period provided for in the original trust. Accordingly, based upon the facts provided and the representations made, we conclude that the transfer of assets from Trust 1 to Trust 2 will not cause Trust 1 or Trust 2 to lose their exempt status from GST tax.

The proposed modifications to Trust 2 to modify the successor trustee provisions and add Protector provisions as described above, are administrative in nature under § 26.2601-1(b)(4)(i)(D)(2), and will not be considered to shift a beneficial interest to a lower generation in the trust. See *Example 10* of § 26.2601-1(b)(4)(i)(E). The changes will not result in a shift in any beneficial interest to a lower generation nor do the changes extend the time for vesting of any beneficial interest in Trust. Based upon the facts submitted and representations made, we conclude that the modifications to Trust 2 will not cause Trust 1 or Trust 2 to lose their exempt status under chapter 13.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Lorraine E. Gardner

Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy for section 6110 purposes  
Copy of this letter