

State =

State Statute 1 =

State Statute 2 =

Dear :

This responds to a letter from your authorized representative dated December 19, 2018, and subsequent correspondence, requesting a ruling on the gift, estate, and generation-skipping transfer (GST) tax consequences resulting from a proposed modification of Trust.

Facts

You represent the facts to be as follows. On Date 1, a date prior to September 25, 1985, Grantor created an irrevocable trust, Trust, for the primary benefit of his son, Son, and Son's issue. On Date 2, Article III of Trust was modified pursuant to State Statute 1 and, on Date 3, the Service issued Private Letter Ruling 201015025, in which the Service concluded that the modification would not cause Trust to be subject to the GST tax.

Article II, § 2.2(b) of Trust provides for mandatory distributions of net income to Son in quarterly payments. Article II, § 2.2(c) provides for specified distributions of principal to Son upon reaching certain age requirements.

Article II, § 2.2(e) provides the distributions that will occur on the death of Son when Son leaves issue surviving. Under this provision, the remaining trust assets are to remain in trust and will be divided into as many shares as may be necessary to allocate one share to each child of Son who is then living and one share to each deceased child of Son who has left issue then living. For each share, Article II, § 2.2(e) provides for mandatory distribution of net income in quarterly installments to the issue for whom the share was created. Upon such issue attaining the age of twenty-one, the share held for such issue is to be distributed to such issue free of any trust. If any of the surviving issue shall die prior to reaching the age of twenty-one, the trust or share of the trust held for such issue is distributed to the estate of such issue.

Article II, § 2.2(f) provides the distributions that will occur on the death of Son when Son leaves no issue surviving. Article II, § 2.2(k) provides that, unless sooner terminated by its terms, Trust will terminate twenty-one years after the death of the survivor of Grantor, Son, and Grantor's daughters, A and B.

Article III, § 3.5 (as amended on Date 2) designates persons empowered to appoint a successor trustee in the event that a trustee resigns or is removed and provides, in part, that any successor trustee must be a corporate trustee that is not a related or

subordinate party as defined in § 672 of the Internal Revenue Code (Code) with respect to Grantor or any then-living beneficiaries of Trust.

State Statute 1 generally provides that a settlor and all beneficiaries of a trust, without court approval, may modify a trust instrument. Pursuant to State Statute 1, Grantor and all of the current and contingent beneficiaries of Trust, including the children of Son, propose to modify Trust pursuant to State Statute 1 by executing an agreement signifying consent to modify Article II, § 2.2(e) and Article III, § 3.5 of Trust. In accordance with State Statute 2, all current and contingent beneficiaries of Trust, including unborn issue, will be properly represented.

Proposed Article II, § 2.2(e) continues to provide that upon the death of Son when Son leaves issue surviving, the remaining trust assets will be divided into as many shares as may be necessary to allocate one share to each child of Son who is then living and one share to each deceased child of Son who has left issue then living. Proposed Article II, § 2.2(e)(i) provides that each such share shall be referred to as a “child’s share.”

Proposed Article II, § 2.2(e)(ii)(A) provides that any share of a deceased child leaving issue surviving will be further divided into shares for the then-living issue of that deceased child on a per stirpes basis. Each child’s share and per stirpital share of a child’s share in the case of a deceased child leaving issue surviving shall be held in a separate trust and administered under Article II, § 2.2(e)(ii)(B).

Proposed Article II, § 2.2(e)(ii)(B)(1) directs the trustee to make lifetime distributions of income and principal from each separate trust to the beneficiary for whom the trust was created, for such beneficiary’s support, maintenance, health and education, in the absolute discretion of the trustee. Upon the death of the beneficiary for whom the trust was created, proposed Article II, § 2.2(e)(ii)(B)(2)(a) grants that beneficiary a testamentary general power to appoint the remaining trust property including undistributed trust income. To the extent not effectively appointed by such beneficiary, proposed Article II, § 2.2(e)(ii)(B)(2)(b) provides for the creation of per stirpital shares for the then-living issue of that beneficiary, and if none, the then-living issue of Son.

Proposed Article III, § 3.5 continues to contain provisions relating to the appointment of a successor trustee of Trust and continues to provide, in part, that any successor trustee appointed by Son or Son’s named successors must be a corporate trustee that is not a related or subordinate party as defined in § 672 of the Code with respect to Grantor or any then-living beneficiaries of Trust. In addition, with respect to any trust administered pursuant to proposed Article II, § 2.2(e)(ii)(B) (except a trust that may be created for Son’s child C), proposed Article III, § 3.5(c)(i) appoints Spouse as trustee, and A or Bank, in the order named, as successor trustee. Proposed Article III, § 3.5(c)(ii) provides that the beneficiary for whom such trust was created shall become the trustee of that trust upon attaining the age of forty-five. Finally, proposed Article § 3.5(d) appoints Bank as trustee of any separate trust created for C that is administered pursuant to Article II, § 2.2(e)(ii)(B).

You have represented that no additions, actual or constructive, have been made to Trust after Date 1.

Rulings Requested

1. The proposed modification will not cause Trust or any separate trust subsequently created under the terms of Trust to lose its exempt status for purposes of the GST tax.
2. The proposed modification will not result in the inclusion of the value of any Trust property in the gross estate of Grantor for federal estate tax purposes.
3. The proposed modification will not cause Grantor to have made a gift for gift tax purposes.
4. The proposed modification will not cause any beneficiary of Trust to have made a gift for gift tax purposes.

Law and Analysis

Ruling 1

Section 2601 imposes a tax on every GST made after October 26, 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 § 26.2601-1(b)(4) 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)(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 that for purposes of § 26.2601-1, 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.

In the present case, Trust is exempt from the GST tax because Trust was irrevocable on September 25, 1985. You have represented that no additions, actual or constructive, have been made to Trust after that date. Accordingly, pursuant to § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), Trust is not subject to the GST tax.

Under the proposed modification of Article II, § 2.2(e) of Trust, the Trust property is divided upon Son's death into the same trust shares as under the original governing instrument of Trust. Each share will be held in a separate trust for the lifetime benefit of the beneficiary for whom it is created and any remaining trust property including undistributed income will be subject to that beneficiary's general power of appointment

at his or her death. Therefore, the value of such property will be included in the beneficiary's gross estate under § 2041(a)(2) and the beneficiary will be treated as the transferor of such property for GST tax purposes under § 2652(a)(1). Under these circumstances, we conclude that the modification of Article II of § 2.2(e) of Trust will not shift a beneficial interest in Trust to any beneficiary occupying a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original governing instrument of Trust.

In addition, the proposed modification to Article III, § 3.5 of Trust designating the trustees of any trust created under Article II, § 2.2(c) of Trust will not change the beneficial interests of the beneficiaries, nor extend the time for vesting of any beneficial interest in Trust. Therefore, we conclude that the modification to Article III, § 3.5 will not shift a beneficial interest in Trust to any beneficiary occupying a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original governing instrument of Trust.

Accordingly, based on the facts submitted and representations made, we conclude that the modification of Trust will not cause Trust or any separate trust subsequently created under the terms of Trust to lose its status as exempt from GST tax under § 2601.

Ruling 2

Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 of the Code provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2035(a) provides that (1) if the decedent transferred an interest in property or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of the property (or interest therein) would have been included in the gross estate under §§ 2036, 2037, 2038, or 2042 if the interest or power had been retained by the decedent on the date of death, then the value of the gross estate includes the value of any property (or interest there) that would have been so included. Under § 2035(b), the gross estate shall be increased by the amount of any gift tax paid by the decedent or his estate on any gift made by the decedent or his spouse during the three year period ending on the date of decedent's death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds five percent of the value of such property.

Section 2038(a)(1) provides that the value of the decedent's gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person, to alter, amend, revoke, or terminate, or where any such power is relinquished during the three-year period on the date of the decedent's death. Section 20.2038-1(a)(2) of the Estate Tax Regulations provides that § 2038 does not apply if the decedent's retained power could be exercised only with the consent of all parties having an interest in the property and the power adds nothing to the rights of the parties under local law.

In order for §§ 2035 through 2038 to apply, a decedent must have made a transfer of property or any interest therein under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. Grantor retained no interest in or power over Trust property after Date 1. Accordingly, based on the facts submitted and representations made, we conclude that the proposed modification to Trust will not result in the inclusion of the value of any Trust property in the gross estate of Grantor for federal estate tax purposes.

Rulings 3 and 4

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

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations provides that the gift tax also applies to gifts indirectly made. Thus, 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.

In this case, the modification of Trust will not result in any change to the beneficial interests of any of the contingent or non-contingent beneficiaries of Trust. Accordingly, we conclude that the proposed modification of Trust will not result in a transfer subject to gift tax under § 2501 by Grantor or any of the beneficiaries of Trust.

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.

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.

Sincerely,

Karlene M. Lesho

Karlene M. Lesho
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Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter
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cc: