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Department of the Treasury

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Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-161674-01

Date: JANUARY 28, 2005

In Re:

Grantor =  
Child 1 =  
Child 2 =  
Child 3 =  
Trust 1 =  
  
Trust 2 =  
  
Trust 3 =  
  
Receiving Trust 1 =  
Receiving Trust 2 =  
Receiving Trust 3 =  
Date 1 =  
Date 2 =  
Date 3 =  
a =  
Corporation =  
State =  
State Court =

Dear :

This is in response to your October 11, 2001, letter and other correspondence requesting a ruling concerning the generation-skipping transfer (GST) tax consequences of the proposed distributions of a trust.

The facts submitted are as follows:

On Date 1 (before September 25, 1985), Grantor created Trust 1 for the benefit of Child 1, Trust 2 for the benefit of Child 2, and Trust 3 for the benefit of Child 3. Except as otherwise mentioned here, Trust 1, Trust 2, and Trust 3 contain identical provisions. Grantor transferred a shares of common stock in Corporation to each trust on Date 1. Each trust became irrevocable on Date 1 and no additions have been made to the trusts since Date 1.

Item IV(a) of Trust 1 provides that the trustee is to hold, invest, reinvest and use such part of the income and principal as is necessary for Child 1's health, maintenance, support, and education.

Item IV(b) provides that when Child 1 reaches the ages of 25, the trustee is directed to distribute one-third of the trust assets to Child 1. When Child 1 reaches the age of 30, the trustee is directed to distribute one-half of the remaining trust assets to Child 1. When Child 1 reaches the age of 35, the trustee is directed to distribute the remaining trust assets to Child 1.

Item IV(c) provides that the trustee is to have the absolute discretion to withhold the distribution of principal to the beneficiary, notwithstanding the provisions of Item IV(b). In such event, the trustee is to continue to use the income and principal of the withheld property for the health, maintenance, support, and education of the beneficiary. Thereafter, the trustee is to have absolute and sole discretion to distribute to the beneficiary principal, which was withheld, free of the trust, as the trustee deems advisable. Further, the trustee has the discretion to withhold all or any part of the principal for the rest of the life of the beneficiary.

Item IV(d) provides that if Child 1 should die before receiving all of the property of the trust, the property is to be distributed, free of the trust, to the beneficiary's living descendants, per stripes. In the event Child 1 does not have any descendants then living, the property is to be added equally to the two other trusts created on Date 1 by Grantor for the benefit of Grantor's other children, Child 2 and Child 3, to be held and distributed just as though such equal shares had originally been a part thereof. If such other trusts have terminated by distributions of the property thereof, the property added under paragraph (d) to such trusts is to be distributed to the beneficiaries of the trusts, determined as of the date of distribution from the trust.

Item V provides that whenever money or property under any provision of the will is required to be paid to a person who is less than 21 years of age, the trustees are authorized to hold the property for such person in trust until that person becomes 21 years of age.

Consistent with the above provisions, the trustee has opted under Item IV(c) to withhold distributions. In view of the current net worth of the trusts, the trustee believes

that it would be beneficial to retain the assets of Trust 1 in trust for Child 1's lifetime and to defer distribution to the Grantor's grandchildren until they reach age 45.

On Date 2, the trustee petitioned State Court to modify Trust 1, Trust 2, and Trust 3 so that the trustee can make an immediate distribution for the benefit of Child 1, Child 2, and Child 3 in further trust to Receiving Trust 1, Receiving Trust 2, and Receiving Trust 3, respectively. Except for identity of the beneficiary and the trustee, Receiving Trust 1, Receiving Trust 2, and Receiving Trust 3 contain identical provisions. On Date 3, State Court approved the order.

Paragraph 4.02 of Receiving Trust 1 provides that after deducting all necessary and proper expenses, and until the death of Child 1, the trustee is to be authorized from time to time to pay such part of the income and the principal of the Trust to Child 1, or use the same for his benefit, as the trustee in its sole discretion deems needed for Child 1's support, maintenance, education, and medical needs, in reasonable comfort, taking into consideration any other means of support he may have to the knowledge of the trustee. Any income not paid out or used currently is to be accumulated and added to the principal of the trust. The determination of the trustee as to distributions of income and principal is to be final and binding upon all persons then or thereafter interested in this trust.

Paragraph 4.03(A) provides that upon the death of Child 1, any property remaining in this trust is to be divided into as many separate and equal trusts as will allow the trustee to set apart one such trust for each of Child 1's then living children and one such trust, per stirpes, for the then living descendants of any deceased child of Child 1. One such trust is to be held for the benefit of the descendants then living of each deceased child of Child 1.

Paragraph 4.03(B) provides that with respect to each trust created under this Article for the primary benefit of a child of Child 1 then living, the trustee is to be authorized from time to time to pay such part of the income and the principal of such trust to said child who is the beneficiary thereof, or use the same for his or her benefit, in such manner as the trustee in its sole discretion deems needed for said child's support, maintenance, education, and medical needs, in reasonable comfort, taking into consideration any other means of support he or she may have to the knowledge of the trustee. Any income not paid out or used currently is to be accumulated and added to the principal of the trust.

Paragraph 4.03(C) provides that each trust created under this Article for the descendants of a deceased child of Child 1 is to be divided per stirpes into separate trusts for such descendants living at that time. The trustee is to pay to each such descendant such part of the income and the principal of the trust of such descendant, or use the same for his or her benefit, as the trustee in its sole discretion deems needed for his or her support, maintenance, education, and medical needs, in reasonable comfort, taking into consideration any other means of support such descendant may

have to the knowledge of the trustee. Any income not paid out or used currently is to be accumulated and added to the principal of the trust.

Paragraph 4.03(D) provides that the full amount of each trust so set apart for a child of Child 1 in Paragraph 4.03(B) or for a descendant of a deceased child of Child 1 in Paragraph 4.03(C) who is then age 45 or older is to be distributed and paid over to such beneficiary, or if such beneficiary is below the age of 45 at the time the trust is established, then such distribution is to be made upon such beneficiary subsequently attaining the age of 45; provided, however, that the trustee is to have the discretion to accelerate in whole or in part from time to time said terminal distribution to the beneficiary as the trustee determines in its sole discretion, unless sooner distributed pursuant to Paragraph 9.03.

Paragraph 4.03(E) provides that the trustee is to be authorized in its discretion to distribute to any beneficiary, before such beneficiary becomes 45 years of age, from the trusts described in Paragraphs 4.03(B) and (C) a portion of the principal of the trusts to enable such beneficiary to marry, to purchase a home, to enter into a trade, business, or profession or for similar purposes if the trustee deems such distribution for the best interests of such beneficiary.

Paragraph 4.03(F) provides, in relevant part, that upon the death of a beneficiary before final distribution of the applicable trusts established hereunder, the following provisions shall apply. Should Child 1 die without surviving descendants, then the property remaining in the trust is to be distributed after his death in equal shares, with one such equal share being apportioned to each of his siblings who survives Child 1, and with one such equal share being apportioned to the surviving descendants, per stirpes, of either of such siblings who predeceases Child 1; provided that if Grantor has created another trust for the same beneficiary, then such property is to be added to such other trust instead of being distributed to such beneficiary. If none of such siblings and their descendants should survive Child 1, and if Child 1 should die without surviving descendants of his own, then the property remaining in the trust is to be distributed to the heirs at law of Grantor; provided, however that neither Grantor nor his spouse nor the estate or creditors of either of them are to have any reversionary remainder or other interest in such trust.

Paragraph 4.03(F) further provides that should any child of Child 1, any descendant of a deceased child of Child 1, or any heir at law of Grantor for whom a trust was established herein die before the final distribution of such trust, then, unless the beneficiary's interest in the trust has previously vested pursuant to Paragraph 9.03, the trustee is to distribute the remaining property in such trust to the executors and administrators of the beneficiary's estate.

Paragraph 9.01 provides that no beneficiary of a trust is to alienate, encumber or hypothecate his or her interest in the principal or income of a trust in any manner; and, to the fullest extent of the law, the interests of any beneficiary are not to be subject to

the claims of his or her creditors or liable to attachment, execution or other process of law. Further, the interest of each beneficiary in the income and principal of the trust hereunder is to be free from the control or interference of any creditor of a beneficiary or any spouse of a married beneficiary and is not to be subject to attachment or susceptible of anticipation or alienation.

Paragraph 9.03 provides that unless sooner vested under the other provisions of this instrument, the interest of each beneficiary in any trust created hereunder is to vest in interest 21 years after the death of the last survivor of the designated beneficiaries hereunder who were living on the date of execution of Trust 1 unless a shorter perpetuities measuring period is applicable under the laws of State, in which event such vesting is to be accelerated consistent with such shorter period. All principal and undistributed income of any trust so vested in interest pursuant to this paragraph is to be immediately divided between the current permissible income beneficiaries of such trust in equal shares by right of representation, and is to continue to be held, administered, and distributed for the benefit of such beneficiary on the same terms; provided, however, that upon the subsequent death of the respective vested beneficiary, the property remaining in the trust, if not sooner distributed to the beneficiary, is to be distributed to the executors and administrators of the beneficiary's estate.

You have requested the following rulings:

1. The proposed distributions in further trust will not affect the GST exempt status of the assets so transferred to Receiving Trust 1.
2. In relation to Trust 1, a change in trustee of Receiving Trust 1 will not affect the GST exempt status of the assets so transferred to Receiving Trust 1.
3. In relation to Trust 1, the inclusion of a spendthrift clause in Paragraph 9.01 of Receiving Trust 1 will not affect the GST exempt status of the assets so transferred to Receiving Trust 1.
4. As a result of the proposed distributions in further trust, Child 1 has not made a gift for federal gift tax purposes.
5. The assets of Receiving Trust 1 will not be included in the future estate of Child 1 for federal estate tax purposes.

## LAW AND ANALYSIS

### Ruling 1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer, which is defined under section 2611 as a taxable

distribution, a taxable termination, or a direct skip.

Under section 1433 of the Tax Reform Act of 1986 (the Act), GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after 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 generation-skipping transfer tax under section 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains 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 section 1001.

Under section 26.2601-1(b)(4)(i)(A), the distribution of trust principal from an exempt trust to a new trust will not cause the new trust to be subject to the provisions of chapter 13, if the terms of the governing instrument of the exempt trust authorizes distributions to the new trust without the consent or approval of any beneficiary or court, and the terms of the governing instrument of the new 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)(E), Example 1, illustrates a situation in which Trust, that is otherwise exempt from the GST tax, authorizes the trustee to distribute income and principal, at the trustee's discretion, for the benefit of A, A's spouse, and A's issue. At the time Trust was established, A had two children, B and C. A corporate fiduciary is trustee and has the discretion to distribute all or part of the income to one or more of a group consisting of A, A's spouse or A's issue. The trustee is also authorized to distribute all or part of the principal to one or more trusts for the benefit of A, A's spouse, or A's issue. Any trust established must terminate 21 years after the death of the last child of A to die who was alive at the time the trust was executed. Trust will terminate on the death of A, at which time the remaining principal will be distributed to A's issue, per stirpes. The terms of Trust authorize the trustee to make the distribution to a new trust without the consent or approval of any beneficiary or court. In 2002, the trustee distributed part of Trust's principal to a new trust for the benefit of B and C and their issue. The new trust will terminate 21 years after the death of the survivor of B and C,

at which time the trust principal will be distributed to the issue of B and C per stirpes. The example concludes that, under the facts presented, the terms of the new trust do not extend the time for vesting of any beneficial interest in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of any interest in property for a period, measured from the date of creation of Trust, extending beyond any life in being at the date of creation of Trust plus a period of 21 years, plus, if necessary, a reasonable period of gestation. Therefore, neither Trust nor the new trust will be subject to the provisions of chapter 13.

Section 26.2601-1(b)(4)(i)(D)(i) provides that a modification will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 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 Trust 1.

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 section 2651) than the person or persons who held the beneficial interest prior to the modification.

In the present case, the proposed modification and distribution in further trust provides that upon the death of Child 1, Receiving Trust 1 will be divided into trusts for each of Child 1's living children and the living descendants of Child 1's deceased children. These trusts will be held for the exclusive benefit of the beneficiary (Child 1's child or living descendant of a deceased child of Child 1), until that beneficiary reaches the age of 45, whereupon the trust will terminate and the assets will be distributed to that beneficiary. If the beneficiary dies prior to reaching age 45, the trustee will distribute the remaining property in such trust to the executors and administrators of the beneficiary's estate. Accordingly, the assets of the trust for the benefit of the beneficiary will be included in the estate of the beneficiary.

Under the circumstances in this case, the proposed modification and distribution in further trust will not result in a shift of any beneficial interest in Trust 1 or Receiving Trust 1 to any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed modification and distribution in further trust will not extend the time for vesting of any beneficial interest in Receiving Trust 1 beyond the period provided for in Trust 1. Therefore, based on the facts submitted and the

representations made, we conclude that the proposed distribution complies with the provisions of section 26.2601-1(b)(4)(i)(A) and the proposed modification complies with the provisions of section 26.2601-1(b)(4)(i)(D)(1) and will not affect the GST exempt status of the assets transferred to Receiving Trust 1.

### Ruling 2

Section 26.2601-1(b)(4)(i)(E), Example 10, considers a situation where a trust is modified by decreasing the number of trustees. 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 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 Trust 1. Therefore, the modification will not subject the trust to the provisions of chapter 13.

In this case, the change in trustee is a change that pertains to the administration of the trust and will not result in a shift of any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the proposed modification. In addition, the proposed modification will not extend the time for vesting of any beneficial interest beyond the period provided for in the trust instrument. Therefore, based on the facts submitted and the representations made, we conclude that in relation to Trust 1, a change in trustee of Receiving Trust 1 will not affect the GST exempt status of the assets transferred to Receiving Trust 1.

### Ruling 3

In this case, the addition of a spendthrift clause in Paragraph 9.01 provides restrictions on the beneficiary's ability to alienate his interest in his trust. This change will not result in a shift of any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the proposed modification. In addition, the proposed modification will not extend the time for vesting of any beneficial interest beyond the period provided for in the trust instrument. Therefore, based on the facts submitted and the representations made, we conclude that in relation to Trust 1, the inclusion of a spendthrift clause in Paragraph 9.01 of Receiving Trust 1 will not affect the GST exempt status of the assets transferred to Receiving Trust 1.

### Rulings 4 and 5

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 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 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 the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent has retained for life the possession or enjoyment of, or the right to the income from the property, or the right to designate the persons who are to possess or enjoy the property or the income from the property.

Section 2037 provides that the value of the gross estate includes 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 the 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 5 percent of the value of such property.

Section 2038(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 the 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 death to any change through the exercise of a power by the decedent to alter, amend, revoke, or terminate the interest in the property or where the decedent relinquished such power within the three year period ending on the date of the decedent's death.

Sections 2036 through 2038 may apply only in circumstances where a decedent made a transfer of property or an interest therein.

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 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.

In this case, upon the distribution of assets in further trust to Receiving Trust 1, Child 1 will have the same beneficial interest as he had under Trust 1. Each beneficiary (living child of Child 1 or descendant of deceased child of Child 1) will have a substantially similar interest as he or she had under Trust 1. Trust 1 provided for outright distribution to the beneficiaries upon Child 1's death, while the proposed modification provides for distribution in further trust for the exclusive benefit of the named beneficiary and outright distribution to the beneficiary or the beneficiary's estate when the beneficiary dies or reaches the age of 45. No other beneficiary has a right to

the share of the named beneficiary, while the named beneficiary is alive. Because the beneficial interests of the beneficiaries are substantially the same both before and after the proposed transaction, no transfer of property will be deemed to occur as a result of the modification. Accordingly, we conclude that as a result of the proposed distribution in further trust, Child 1 has not made a gift for federal gift tax purposes. Likewise, Child 1 will not be considered to have made a transfer for estate tax purposes, and the proposed modification will not cause the assets of Receiving Trust 1 to be included in the future estate of Child 1 for federal estate tax purposes.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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.

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) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

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

Enclosure:

Copy of letter for section 6110 purposes