

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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PLR-115543-05
Date: DECEMBER 12, 2005

Re:

LEGEND

Decedent =
Spouse =
Daughter =
Grandchild 1 =
Grandchild 2 =
Trust =

Trustee =
Date 1 =
Date 2 =
State =
Court =
State Statute =

Dear _____ :

This responds to a letter from your authorized representative dated February 1, 2005, requesting a ruling on the generation-skipping transfer (GST) tax consequences resulting from the proposed modification to Trust.

You represent the facts to be as follows. Decedent died testate on Date 1, survived by Spouse. Pursuant to Article V of Decedent’s will, an amount equal to fifty percent of the adjusted gross estate (less nonprobate property passing to Spouse)

passed to a marital trust for the benefit of Spouse. The residue of the estate passed to a Residuary Trust (Trust), established under Article VI of the will.

Under the terms of the marital trust, Spouse was to receive all trust income for life, and on her death, the corpus was to pass pursuant to Spouse's exercise of a general power of appointment. In default of exercise, the trust corpus was to pass to Trust. Spouse disclaimed her entire interest in a portion of the marital trust. As a result, that portion passed to Trust. In addition, Spouse disclaimed her general power of appointment over a portion of the remaining balance of the marital trust. It is represented that Decedent's executor made a partial qualified terminable interest property (QTIP) election under § 2056(b)(7) with respect to the portion of the marital trust no longer subject to Spouse's general power.

It is represented that Decedent's GST exemption was allocated to Trust. Article VI(A) of Decedent's will provides that, during the lifetime of Spouse, the Trustee has the discretion to pay Trust income and corpus to Spouse, and Article VI(B) gives the Trustee the discretion to pay income and corpus to Decedent's grandchildren, Grandchild 1 and Grandchild 2. Article VI(C) provides that, upon Spouse's death, Trust is to be equally divided into as many shares as there are then living children of Daughter, and held in further trust. During their lives, fifty percent of the income is distributed to each grandchild in quarterly payments. The Trustee has the discretion to distribute principal for the benefit of a grandchild if deemed to be necessary and proper for maintenance, care, education or the general welfare of the grandchild. At the death of the first grandchild, one-half of Trust will be distributed, in equal shares, to his or her issue, and at the death of the survivor, the balance will be distributed, in equal shares, to the issue of that grandchild.

Spouse died on Date 2. On her death, the corpus of the marital trust passed to Trust. It is represented that Spouse's GST exemption was allocated such that Trust currently has an inclusion ratio of zero and therefore distributions are exempt from the GST tax. In accordance with Decedent's will, Trust is held as one trust with two separate shares, one each for the benefit of Grandchild 1 and Grandchild 2. To date, no distributions from principal have been made to either grandchild.

The Trustee, Grandchild 1, and Grandchild 2 petitioned Court, and Court has approved, a proposed reformation of the method of distribution under Trust. As reformed, Trust will provide for the distribution of the greater of the annual net income of Trust or five percent of the value of Trust as determined on the first working day of each calendar year to the income beneficiary. The Trustee will use the same valuation method for each taxable year for purposes of determining the amount to be paid to each grandchild from trust in each subsequent year. The modification is permitted under State Statute. No other provisions of Trust will be modified.

You have requested a ruling that the proposed reformation of Trust will not result in Trust losing exempt status for GST tax purposes.

LAW AND ANALYSIS

Section 2601 imposes a tax on every GST which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Section 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) provide that the GST tax shall not apply to any GST under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer was 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 irrevocable unless the settlor had a power that would have caused inclusion of the trust in settlor's gross estate under § 2038 or 2042 if the settlor had died on September 25, 1985.

Under § 2602, the amount of tax imposed under § 2601 is determined by multiplying the taxable amount by the applicable rate. The taxable amount of a taxable distribution is the amount received by the transferee (§ 2621), of a taxable termination is the amount of property with respect to which there was a taxable termination (§ 2622), and of a direct skip is the amount received by the transferee (§ 2623).

Under § 2641, the term "applicable rate" means the product of the maximum federal estate tax rate in the year that the generation-skipping transfer occurs and the inclusion ratio.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is 1 minus the applicable fraction. Under § 2642(a)(2), in general, the numerator of the applicable fraction is the GST exemption amount allocated to the property transferred and the denominator is the value of the property transferred.

Under § 2631, every individual is allowed a GST exemption amount which may be allocated by the individual or the individual's executor to any property with respect to which the individual is the transferor.

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 (because the trust was irrevocable on September 25, 1985) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, these rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. 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 capital gain for purposes of section 1001.

Section 26.2601-1(b)(4)(i)(D) 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 § 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. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer.

Section 26.2601-1(b)(4)(i)(E), Example 8, considers a situation where a trust that is otherwise exempt from the GST tax provides that trust income is payable to A for life and, upon A's death, the remainder is to pass to A's issue, per stirpes. In 2002, the appropriate local court approves a modification to the trust that converts A's income interest into the right to receive the greater of the entire income of the trust of a fixed percentage of the trust assets valued annually (unitrust interest) to be paid each year to A for life. The example concludes that the modification 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. Rather, the modification can only operate to increase the amount distributable to A and decrease the amount distributable to A's issue. 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 modification will not subject the trust to the provisions of chapter 13.

No guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a change that would not affect the GST status of a trust that was irrevocable on September 25, 1985, should similarly not affect the exempt status of such a trust.

In this case, as in Example 8, the modification described above changing the method for determining the amount distributable can only operate to increase the amount distributable to Grandchild 1 and Grandchild 2, and decrease the amount distributable to their issue. Therefore, the modification does not shift a beneficial interest in Trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification. Further, the modification does not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in Trust. Therefore, based on the facts and representations, we conclude that the proposed modification will not result in Trust losing exempt status for GST tax purposes.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other

provisions of the Code or regulations. Specifically, no opinion is expressed regarding whether Trust has a zero inclusion ratio.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statements executed by the appropriate parties. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

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

In accordance with the power of attorney on file with this office a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

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

Enclosure
Copy for section 6110 purposes

cc: