

Trust was created as one of the separate equal parts for the benefit of the children of Niece. Under Paragraph G of Item VIII, until the termination of Trust, the trustee is to make equal distributions of net income to the children of Niece who are living, and to the living issue of any deceased child or children of Niece, per stirpes. The trustee may also pay to or apply for the benefit of the income beneficiaries such amounts of principal as the trustee deems advisable for the proper maintenance, support, and education, taking into account such other income received from other sources. Trust shall terminate upon the expiration of 21 years from the date of the death of the last survivor of all the issue of Niece living at the time of Testator's death. Upon termination of Trust, the principal shall be distributed to the issue then living in equal shares, per stirpes.

The trustee of Trust is Corporate Trustee.

Corporate Trustee has petitioned Court to reform Trust. Pursuant to the proposed reformation, Item VIII, Paragraph G, subparagraph 1, will provide that the trustee will pay, distribute, or disburse, to or for the benefit of the children of Niece who are living, and to the then living issue of any deceased child or children of Niece, for life, in each calendar year, an amount equal to \underline{x} percent of the average fair market value of the Trust as of the close of the last business day of the three previous calendar years, or the net income from Trust for the calendar year, whichever is greater. All payments are to be made in equal shares, per stirpes.

Under the proposed reformation, the corporate trustee will have the authority to petition the Court to change the \underline{x} percent distribution rate, in appropriate circumstances. Any such change must be approved by Court. Further, no individual trustee shall have any authority to determine if the rate shall be changed.

Under Item VIII, Paragraph G, subparagraphs 2 and 3 of the proposed reformation, all computations of fair market value will include accounting income and principal, but no accruals are required. If Trust includes assets for which there is not a ready market, the trustee will adopt a method of evaluation as the trustee deems reasonable in its discretion under the circumstances. The distribution amount is to be paid first from net accounting income, next from net realized short-term capital gains, then from net realized long-term capital gains and, as necessary, from principal.

In all other respects, the terms of the reformed Trust will be identical to those of the original Trust.

You have asked us to rule that the proposed reformation of Trust will not result in Trust losing its grandfathered status for GST tax purposes.

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 (Act), the 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.

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 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 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, illustrates 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 or 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 result in a shift in beneficial interest 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. 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.

In this case, the modification of Trust to provide for the distribution of the greater of Trust income for the calendar year or an amount equal to \underline{x} percent of the average

fair market value of Trust as of the close of the last business day of the three previous calendar years does not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification. See section 26.2601-1(b)(4)(i)(E), Example 8. Further, the modification does not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original Trust.

Accordingly, based on the facts submitted and the representations made, the modification to Trust, as proposed, will not cause Trust to lose its exempt status for GST tax purposes.

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. We are specifically not ruling on the gift tax and income tax consequences of the transaction.

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.

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

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

Sincerely,

George L. Masnik
Chief, Branch 4
Office of Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosure

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