

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Refer Reply To:
CC:PSI:4 - PLR-101444-02
Date: JANUARY 08, 2003

In re:

Legend:

Settlor =
Daughter =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Greatgrandchild 1 =
Greatgrandchild 2 =
Greatgrandchild 3 =
Greatgrandchild 4 =
Trust =
Year =
Court =

Dear _____ :

This responds to your letter dated December 28, 2001, and subsequent correspondence, requesting a ruling regarding the generation-skipping transfer (GST) tax consequences of the proposed modification to Trust.

FACTS

The facts submitted and representations made are as follows. Settlor created Trust in Year to provide for his wife, Daughter and Daughter's descendants. Settlor and his wife are deceased. Article I, Paragraph B of Trust provides as follows:

So long as the Settlor's wife is living, and thereafter so long as the Settlor's daughter is living, the Trustees shall further pay or apply so much of the

net income from the trust property as may remain from time to time after the payment of premiums or charges on unexpired policies of life insurance on the life of the Settlor's wife to or for the benefit of such one or more of the Settlor's daughter and issue of the Settlor's daughter as may be living from time to time, and at such times and in such amounts as the Trustees shall in their sole discretion determine, accumulating and adding to the principal of the trust property any income not so paid or applied. In determining the time, amount and proportion of each such payment or payments, and the person or persons to whom such payment or payment shall be made, the decision of the Trustees shall be final and binding on all persons.

Article II of Trust provides:

Upon the death of the survivor of the Settlor's wife and the Settlor's daughter, the Trustees shall pay over the then remaining principal of the trust property together with any undistributed income free of all trusts, to the issue of the Settlor's daughter by right of representation.

Daughter has three children, Grandchild 1, Grandchild 2, and Grandchild 3. Daughter also has four grandchildren, Greatgrandchild 1, Greatgrandchild 2, Greatgrandchild 3, and Greatgrandchild 4. The Trustees have consistently distributed Trust's net income to Daughter.

The parties petitioned Court to reform Trust to allow the Trustees to invest for total return, including both income yields and growth in capital appreciation, and to distribute not only income as conventionally defined, but also as much of principal as they deem prudent and as they believe is within the scope of Settlor's intent. However, the Trustees may only make distributions in excess of income as defined under the original trust instrument to Settlor's Daughter and to those of the Settlor's issue who would receive a share if the Settlor's Daughter were to die on the date of the distribution and the remainder were to be distributed to her issue by right of representation.

Trust was irrevocable on September 25, 1985. You represent that no additions, actual or constructive, have been made to Trust since September 25, 1985.

We have been asked to rule as follows that the reformation of Trust will not cause Trust to lose its exempt status for generation-skipping transfer tax purposes of § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1) or cause Trust, or any distributions from Trust, to be subject to generation-skipping transfer taxes under § 2601 of the Internal Revenue Code.

LAW AND ANALYSIS

Section 2601 imposes a tax on every generation-skipping transfer. Under § 1433(a) 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 § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to any generation-skipping transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. 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 will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the provisions of chapter 13, if (1) the judicial action involves a bona fide issue, and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(i)(D) provides that a modification 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. 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.

Section 26.2601-1(b)(4)(i)(E), Example 8, considers a situation where a trust is modified to convert the income interest into a unitrust interest. The grantor established an irrevocable trust under the terms of which trust income is payable to A for life and, upon A's death, the remainder is to pass to A's issue, per stirpes. The 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 to be paid each year to A for life. 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. In this example, 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 the present case, Trust was irrevocable on September 25, 1985, and it is represented that no additions, actual or constructive, have been made to Trust after that date. The proposed reformation 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 reformation. As in Example 8, the modification can only operate to increase the amount distributable to Daughter and decrease the amount distributable to Daughter's issue. In addition, the proposed reformation 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 the reformation of Trust will not cause Trust to lose its exempt status for generation-skipping transfer tax purposes of § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) or cause Trust, or any distributions from Trust, to be subject to generation-skipping transfer taxes under § 2601. Accordingly, after the proposed reformation Trust will continue to be exempt from the GST tax imposed under § 2601 provided there are no additions to Trust after September 25, 1985.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. Specifically, no opinion is expressed on whether the reformation will be respected for purposes of § 643(b).

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

By _____

Lorraine E. Gardner
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Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

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