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Department of the Treasury

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Person to Contact:

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Date:

March 20, 2000

Legend

Trust =

Settlor =

Date 1 =

Date 2 =

Year =

t =

u =

v =

w =

x =

y =

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A =

B =

State 1 =

State 2 =

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Dear Sir:

We received your letter, dated September 17, 1999, requesting a ruling regarding the application of the generation-skipping transfer (GST) tax imposed under § 2601 of the Internal Revenue Code to the proposed modification of Trust. This responds to your request.

On Date 1, Settlor created an irrevocable Trust to benefit Settlor's Spouse, Settlor's daughters or issue of any deceased daughters, and Settlor's grandchildren and great-grandchildren. The Trust Agreement provided that initially t percent of the Trust income was to be paid to Settlor's spouse and u percent was to be paid in equal shares to Settlor's daughters living from time to time and to the living issue, per stirpes, of any deceased daughter. On the death of Settlor's spouse, v percent of her share of the income, or w percent of the total income, was to be added to the u percent of total income payable to Settlor's living daughters or the issue of the deceased daughters. After the death of Settlor's spouse, x percent of the total income was to be paid to the daughters or their issue. The remaining y percent of Settlor's spouse's share of the income, z percent of the total income, became payable equally per capita to all of Settlor's grandchildren and great grandchildren living from time to time.

The Trust Agreement also provided that Trust was to terminate on the death of the last survivor of all of Settlor's children and grandchildren that were living on Date 1. At termination, under the Trust Agreement, the Trust principal must be divided into as many equal shares as there are daughters of the Settlor then deceased leaving issue then living, and one equal share must be paid to the then living issue, per stirpes, of each such deceased daughter.

From the inception of Trust, the principal consisted entirely of stock in A and B, State 1 corporations. The Trust Agreement provided that the Trustees may sell all the stock of either A or B, but required that the shares of A or B were to be sold "as an entirety." The Trust Agreement further provided that Settlor's sons were to be given the first option to purchase the shares of A and/or B.

On Date 2, the then acting Trustees exchanged all of their shares in B for shares in A. After that date, Trust's principal consisted entirely of A. In Year, the Trustees sold all of the Trust's shares in A for cash.

The Trust Agreement authorizes the Trustees to invest the principal of the trust in securities other than such as are known as "legal securities for Trustees," provided that no investment shall be made in the capital stock of any corporation. The Trustees intend to petition a State 2 court (i) to release the Trustees from the restriction prohibiting them from investing in stocks, and (ii) to authorize the Trustees to invest and

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reinvest the Trust principal in the common, capital and other stock of corporations as the Trustees deem appropriate under applicable current and future State 2 law.

You have requested the following rulings regarding the GST tax consequences of reforming Trust to remove the investment restriction and to authorize Trustees to invest and reinvest Trust principal in conformity with State 2 law: (i) the Reformation will not cause Trust to lose its exemption from the GST tax by reason of the effective date set forth in § 26.2601-1(b)(1)(i), (ii) the Reformation will not cause additions, actual or constructive, to Trust, and (iii) the Reformation will not cause future distributions from Trust to be subject to the GST tax under § 2601.

Section 2601 of the imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term “generation-skipping transfer” to include a taxable distribution, taxable termination, and a direct skip.

Section 2612(a)(1) provides that the term “taxable termination” means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in 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).

Section 2612(c) provides that the term “direct skip” means a transfer subject to a tax imposed by Chapters 11 or 12 of an interest in property to a skip person.

Section 2613(a) defines the term “skip person” as (1) a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor, or (2) a trust if all interests in the trust are held by skip persons, or if there is no person holding an interest in such trust, and at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 2613(b) provides that, for purposes of the GST tax, the term “non-skip person” means any person who is not a skip person.

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that the generation-skipping transfer tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a

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pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii) provides that, except as provided in § 26.2601(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(1)(v)(A) provides that where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse of the power of appointment over that portion of the trust is treated to any extent as a taxable transfer under Chapter 11 or Chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed will be treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under Chapter 11 or Chapter 12. In the latter case, the transferor for purposes of Chapter 11 or Chapter 12 is the transferor for purposes of Chapter 13.

Section 26.2601-1(b)(1)(v)(B) provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) will not be treated as an addition to a trust if (1) the power of appointment was created in an irrevocable trust that is not subject to Chapter 13 under § 26.2601-1(b)(1), and (2) in the case of an exercise, the power of appointment is not exercised 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 of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years.

An amendment to a trust, which was irrevocable on September 25, 1985, and thus, is exempt from the GST tax, will cause the trust to lose its exemption if the amendment modifies or otherwise changes the quality, value or timing of any of the powers, beneficial interests, rights, or expectancies originally provided under the terms of the trust. A trust's exemption from the GST tax is not affected, however, by amendments relating to the administration of the trust.

Trust is a generation-skipping trust because it provides for distributions to more than one generation of beneficiaries below the grantor's generation. Taxpayer represents that Trust was last amended before September 25, 1985, and that no additions have been made to Trust since then. Taxpayer also represents that there will be no additional transfer of assets to Trust on removal of the investment restriction. Trust was created as an irrevocable Trust on Date 1. Based on these representations, Trust is exempt from the GST tax pursuant to § 26.2601-1(b)(1)(i).

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Based on the information submitted and the representations made, we conclude that the proposed removal of the investment restriction and authorization to invest and reinvest Trust principal in conformity with State 2 law relates to the administration of Trust and will not modify or otherwise change the quality, value, or timing of any of the powers, beneficial interests, rights or expectancies originally provided under the terms of Trust. Accordingly, Trust will continue to be deemed irrevocable as of September 25, 1985. In addition, we conclude that the Reformation will not cause Trust to lose its exempt status from the GST tax by reason of the effective date set forth in § 26.2601-1(b)(1)(i). Further, we conclude the Reformation of Trust will not cause additions, constructive or actual, to Trust under § 26.2601-1(b)(1)(v). Finally, we conclude that neither distributions to skip persons nor terminations of interests of non-skip persons will be subject to the GST tax.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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,

Christine E. Ellison

Christine E. Ellison
Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure

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