

Internal Revenue Service

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Department of the Treasury

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Person to Contact:

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Refer Reply To:
CC:PSI:4 - PLR-124429-01
Date: August 29, 2001

Re:

Legend:

Decedent =
Date 1 =
Son =
Will =

Trust =

Remainder Beneficiary =
Date 2 =
Bank =
Date 3 =
Petition =
Court =
Date 4 =
Date 5 =
Order =

Dear _____ :

This is in response to a letter dated February 7, 2001, and subsequent correspondence, requesting a ruling regarding the generation-skipping transfer tax (GSTT) consequences of a court ordered modification of Trust.

Facts

The facts submitted and representations made are as follows. Decedent died on Date 1, before September 25, 1985, survived by Son. Decedent's Will provided for Decedent's residuary estate to be held in Trust.

Under Article Seventh, section 1(a) of Will, Son is to receive one-fifth of the net income until he reaches age 35, one-half of the net income until he reaches age 40, and all of the net income thereafter. Any surplus income before Son reaches age 40 is to be added to principal.

Under Article Seventh, section 1(b), at Son's death, Trust will terminate; and the remainder will be paid to Remainder Beneficiary, if then-living, or, if not then-living in equal shares to Decedent's nieces and nephews then-living, otherwise to the issue of a deceased niece or nephew per stirpes.

Under Article Seventh, section 2(c), all stock dividends or dividends paid in stocks of other corporations, stock acquired under rights to subscribe, and net proceeds of stock sales must be allocated to principal. All other corporate distributions must be treated as income, except that distributions upon reduction of par value or upon partial or complete liquidations may be allocated between income and principal in the Trustees' discretion. In all other cases, the Trustees may determine what is income and what is principal.

Son was born on Date 2, and is currently receiving all of the net income of Trust. Bank is currently serving as Trustee of Trust.

On Date 3, Son filed Petition with Court requesting a modification of Trust. Notice was served on the Trustee, on Remainder Beneficiary, and on a guardian ad litem appointed to represent the interests of the unknown, unborn, or unascertained remainder beneficiaries.

On Date 4, Court issued Order modifying Trust, effective as of Date 5, subject to Trustee's receipt of a favorable ruling from the Service. Pursuant to Order, Son's income interest under Article Seventh, Section 1(a), of Trust is modified to provide for payment to Son of an annual amount equal to the greater of 4.5 percent of the average value of the trust estate (the "Unitrust Amount") or the net income of Trust for the year. The annual amount will be paid monthly. The Unitrust Amount will be determined annually on the first business day of January and will be based on the average month end value of the trust estate for each of the 36 consecutive months immediately preceding January 1. If the average total return for those months is less than 6 percent, the Unitrust Amount for that year will be the average total return for those months minus 1.5 percent. In any year that the annual amount distributed is less than 4.5 percent of the average value of the trust estate without regard to the 1.5 percent reduction, the shortfall will be made up in subsequent years in which the average total return on the trust estate for the 36 consecutive months immediately preceding January 1 of the subsequent years exceeds 6 percent.

Pursuant to Order, a new section 2(h) will be appended onto Article Seventh, section 2, which contains the Trustee's powers. The new section incorporates the provisions of the Prudent Investor Rule and directs the Trustee to design and manage a portfolio to maximize total return. The new section provides that the distribution to Son will be paid first from income and then from principal to the extent that income is insufficient. The Trustee has discretion to distribute capital gains and may allocate capital gains to income to the extent of the distributions to Son. Son and the Trustee are required to establish together an initial investment policy statement including strategy, specific investments, benchmarks for investment performance, and acceptable deviations from these benchmarks.

No additions, actual or constructive, were made to Trust after September 25, 1985.

We have been asked to rule as follows:

1. The modification of Trust pursuant to Order will not cause any portion of Trust to be treated as if it had been added to Trust after September 25, 1985.
2. The modification of Trust pursuant to Order will not subject Trust to the generation-skipping transfer (GST) tax.

Law

Section 2601 imposes a tax on each generation-skipping transfer made by a transfer to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a 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 generation-skipping transfer tax will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its 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 § 1001.

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.

In the present case, Trust was irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, were made to Trust after that date.

The modification of Trust pursuant to Order will not result in a shift of any beneficial interest in the trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the date Order becomes effective. Under Article Seventh, section 1(a), Son is currently receiving all of the net income of Trust. Pursuant to Order, Son will be paid annually the greater of the Unitrust Amount or the net income of Trust. In either case, under Order, Son will receive an annual distribution from Trust equal to at least as much as he currently receives from Trust. Further, the modification of Trust pursuant to Order will not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Accordingly, based on the facts submitted and the representations made, we rule as follows:

1. The modification of Trust pursuant to Order will not cause any portion of Trust to be treated as if it had been added to Trust after September 25, 1985.
2. The modification of Trust pursuant to Order will not subject Trust to the generation-skipping transfer (GST) tax.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the modification under the cited provisions or under any other provisions of the Code. Specifically, we express no opinion on the federal income and gift tax consequences of the modification.

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,
James F. Hogan
Assistant to the Chief
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy for section 6110 purposes