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Person To Contact:

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Date:
December 16, 2008

Re:

Legend

Settlor	=
Sibling A	=
Trustee	=
Revocable Trust	=
Trust	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
X	=
Y	=
State A	=
Local Court	=
Year	=
Child A	=
Child B	=
Grandchild A	=
Grandchild B	=
Grandchild C	=
Great-grandchild A	=
Great-grandchild B	=
Great-grandchild C	=
Great-grandchild D	=

Dear _____ :

This is in response to the April 3, 2008 letter requesting a ruling on the generation-skipping transfer (GST) tax consequences of an amendment to a trust.

The facts submitted and representations made are as follows. Settlor created a revocable trust (Revocable Trust) on Date 1. He amended it x times over a y-year period. He last amended it on Date 2. Trustee, a corporate fiduciary, has continuously served as the trustee. The Revocable Trust became irrevocable when Settlor died on Date 3, before September 26, 1985, and the following provisions took effect.

Article I, Paragraph (4), provides that, on Settlor's death, the trust property is to be divided into two equal shares, one of which is to be held for Sibling A and her living lawful issue (the Trust).¹ Paragraph (4) further provides that the words "issue" or "descendants," as used in the Trust, shall not include legally adopted issue.

Under Article I, Paragraphs (5), (6), (7) and (8), the Trust income is to be distributed to Sibling A and, on her death, to her living lawful issue, by representation. The Trust is to terminate fifteen years after the death of the last survivor of the trust beneficiaries in being at Settlor's death. On termination, the Trust property is to be distributed to the persons then entitled to the income, in the same proportions as they are entitled to the income.

Article V, Paragraph (9), provides that the validity, construction, and all rights under the Trust are to be governed by the laws of State A.

Child A, Child B, Grandchild A, and Grandchild B were in being at the creation of the Trust and are the current measuring lives for the trust term.

On Settlor's death, the Trust was established for the benefit of Sibling A and her issue. Sibling A received all of the Trust income until her death in Year. She was survived by two children, Child A and Child B, who then became entitled to the Trust income. One-half of the Trust income is currently distributable to Child A.² At Child A's death, that one-half of Trust income (and, ultimately, the corresponding one-half of Trust principal) will be distributable, by representation, to those of Child A's progeny who are considered to be Sibling A's "living lawful issue."

¹ The other share was to be held for Settlor's other sibling and the sibling's living lawful issue. However, the sibling died without issue shortly after Settlor's death. Under the terms of the Revocable Trust, the deceased sibling's share was added to the Trust for Sibling A and her living lawful issue.

² The other half of the Trust income is distributable to Child B and, on Child B's death, to her living lawful issue. At termination, one-half of the Trust principal will be distributable to Child B's living lawful issue. At present, Child B has no legally adopted issue.

Child A has two natural children (Grandchild A and Grandchild B). Child A also has a legally adopted child (Grandchild C). Grandchild A has two legally adopted children (Great-grandchild A and Great-grandchild B). Grandchild B has two natural children (Great-grandchild C and Great-grandchild D). Because the Trust specifies that the term “issue” is not to include legally adopted issue, Grandchild C, Great-grandchild A, and Great-grandchild B, who were all legally adopted, are barred from receiving distributions.

On Date 4, Trustee filed a petition in the Local Court asking the court to reform the provision in Article 1, Paragraph (4), of the Trust under which legally adopted children are barred from receiving distributions. On Date 5, the court ordered that the Trust is to be reformed and construed to allow infants or minor children who are legally adopted by descendants of Settlor’s siblings to qualify as “issue” or “descendants.”

You have requested a ruling that the modification of the Trust to include adopted children as “issue” and “descendants” will not affect the GST tax exempt status of the Trust.

Section 2501 of the Internal Revenue Code imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511 provides that the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 25.2511-1(a) of the Gift Tax regulations provides that the gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) provides that the gift tax also applies to gifts indirectly made. Any transaction, in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Section 25.2511-1(h), Example 6, provides that, if A is possessed of a vested remainder interest in property, subject to being divested only in the event he should fail to survive one or more individuals, an irrevocable assignment of all or any part of his interest would result in a transfer includible for federal gift tax purposes.

Section 2601 imposes a tax on each generation-skipping transfer. Section 2611(a) defines a generation-skipping transfer to mean (1) a taxable distribution, (2) a taxable termination, or (3) a direct skip.

Section 2651(b)(1) provides that an individual who is a lineal descendant of a grandparent of the transferor shall be assigned to that generation which results from

comparing the number of generations between the grandparent and such individual with the number of generations between the grandparent and the transferor.

Section 2651(b)(3)(A) provides that a relationship by legal adoption shall be treated as a relationship by blood.

Section 1433(a) of the Tax Reform Act of 1986 (TRA of 1986) provides that, except as provided in § 1433(b), the GST tax applies to generation-skipping transfers made after October 22, 1986.

Section 1433(b)(2)(A) of the TRA of 1986 provides that the GST tax does not apply to transfers under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that a trust qualifies for transitional rule relief from the provisions of Chapter 13 of the Code, 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)(A), any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in a grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(1)(iv) provides that, if an addition is made after September 25, 1985, to an irrevocable trust, a proportionate amount of distributions from, and terminations of interests in, property held in the trust is subject to the provisions of Chapter 13.

Section 26.2601-1(b)(4) 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 under § 26.2601-1(b)(1), (2), or (3) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST 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 of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph (b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, 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.

Section 26.2601-1(b)(4)(i)(E), Example 7, provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's grandchildren, A, B, and C. The trust provides that income is to be paid to A, B, and C, in equal shares for life. The trust further provides that, upon the death of the first grandchild to die, one-third of the principal is to be distributed to that grandchild's issue, per stirpes. Upon the death of the second grandchild to die, one-half of the remaining trust principal is to be distributed to that grandchild's issue, per stirpes, and upon the death of the last grandchild to die, the remaining principal is to be distributed to that grandchild's issue, per stirpes. In 2002, A became disabled. Subsequently, the trustee, with the consent of B and C, petitioned the appropriate local court and the court approved a modification of the trust that increased A's share of trust income. The modification does not shift a beneficial interest to a lower generation beneficiary because the modification does not increase the amount of a GST transfer under the original trust or create the possibility that new GST transfers not contemplated in the original trust may be made. In this case, the modification will increase the amount payable to A who is a member of the same generation as B and C. 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 trust as modified will not be subject to the provisions of chapter 13. However, the modification increasing A's share of trust income is a transfer by B and C to A for Federal gift tax purposes.

In this case, Child A and Child B are the current beneficiaries of the Trust. One-half of the Trust income is currently distributable to Child A. On Child A's death, her one-half share of Trust income (and, ultimately, the corresponding one-half of Trust principal) will be distributable, by representation, to those of Child A's progeny who are considered to be Sibling A's "living lawful issue." Child A has two natural born children and a legally adopted child. Grandchild A has two adopted children.

On Date 5, Local Court reformed the Trust to allow infants or minor children who are legally adopted by descendants of Settlor's siblings to qualify as "issue" or "descendants" under the trust instrument. Thus, at Child A's death, her interest in Trust will pass to Grandchild A, Grandchild B, and the adopted child, Grandchild C per stirpes. As a result of the modification, Grandchild A and Grandchild B have relinquished a portion of their future interest in the Trust that otherwise would be paid only to them.

Similarly, on Grandchild B's death, Great-grandchild C and Great-grandchild D are to receive the portion of the income otherwise payable Grandchild B. Ultimately, Great-grandchild C and Great-grandchild D would have received one-half of the Trust principal when the Trust terminates. As a result of the modification, Great-grandchild C and Great-grandchild D have also relinquished a portion of their future interest in the Trust and Great-grandchild A and Great-grandchild B have also become beneficiaries.

This case is similar to the situation in Example 7 in § 26.2601-1(b)(4)(i)(E). The modification in this case does not shift a beneficial interest to a lower generation beneficiary. The modification merely shifts an interest in the Trust to individuals who are members of the same generation or higher a generation in the case of Grandchild C. In addition, the modification does not extend the time for vesting of any beneficial interest in the trust beyond the time provided for in the original trust. Therefore, provided that the reformation is effective and binding on the beneficiaries, we conclude the modification will not cause Trust to be subject to the provisions of chapter 13.

However, by adding Grandchild C, Great-grandchild A and Great-grandchild B as beneficiaries, each of Grandchild A, Grandchild B, Great-grandchild C, and Great-grandchild D have made a gift of the interest in income and/or principal each has relinquished. Thus, provided the reformation is effective and binding under applicable law, as a result of the modification to the Trust each beneficiary noted above is making a taxable gift for purposes of § 2501.

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.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 letter is being sent to your authorized representative.

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.

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 4
(Passthroughs & Special Industries)

Enclosures
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