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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:04 – PLR-133852-08
Date:
December 16, 2008

In Re:

Legend:

Settlor =

Son =

Son's Spouse =

Bank =

Trust =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

State =

Court =

Dear _____ :

This is in response to the July 8, 2008 letter and additional correspondence requesting rulings on the gift tax and generation-skipping transfer tax consequences of the proposed modification of Trust.

Settlor executed Trust on Date 1 for the benefit of Son and Son's children. Trust became irrevocable at Settlor's death on Date 2, before September 25, 1985. It is represented that no person has contributed assets to Trust since Date 2; and there have been no additions (actual or constructive) to Trust since Date 2. The current individual trustee is Son's Spouse. The current corporate trustee is Bank.

Under Article Second, paragraph (A), of Trust, the income is to be distributed annually or at more frequent intervals to or for the benefit of Son during life. Article Third, paragraph (A), provides that Son is to have a discretionary power of appointment, exercisable by him at any time during life, to direct a distribution of any portion of Trust principal to or for the benefit of any or all of Son's children or grandchildren.

Article Third, paragraph (B), provides that, in any calendar year, Son is to have the right to direct the trustee to pay to Son or apply for his benefit such amounts of principal as Son may designate, but not exceeding the value of \$5,000 or 5 percent of the principal, whichever is larger. This lifetime right is not to be cumulative.

Article Third, paragraph (C), provides that if, in the trustee's opinion, the income from all sources of which the trustee has knowledge is not sufficient to suitably support, maintain, and provide for the comfort of Son or any of the other Trust beneficiaries in the manner to which they are accustomed, or in the event of an emergency, the trustee may use such part of principal as the trustee deems necessary or desirable to make up the deficiency or to meet the emergency and to provide for Son's or the beneficiaries' comfortable support and maintenance, including medical, surgical, hospital or other institutional care.

Article Third, paragraph (D), provides that, on Son's death, the principal and undistributed income are to be distributed to Son's children and/or grandchildren, in such amounts or proportions as Son may direct in his will.

Under Article Fourth, paragraph (A), if Son does not dispose of all of the trust estate, either as a result of his exercise or failure to exercise his special power of appointment, then, on Son's death, the principal and undistributed income are to be divided into equal shares and held in further trust, one of each such shares to be held for the benefit of a respective child of Son. If a child predeceases Son and has children surviving, then the share which would have been set aside for the benefit of that deceased child is to be held in trust for the benefit of that deceased child's surviving children per stirpes.

Under Article Fourth, paragraph (B), the income from the respective portion of the trust estate set aside for a respective beneficiary is to be paid out and distributed annually or at more frequent intervals to or for the benefit of the beneficiary.

Under Article Fourth, paragraph (C), if prior to the full distribution of the portion of the trust estate held for any given beneficiary, that beneficiary dies with children

surviving, then the net income from that portion of the trust estate is to be distributed annually or at more frequent intervals to or for the benefit of the children of the deceased beneficiary in proportion to which those children are entitled to receive eventual distribution of the principal; however, the interest in income of any such child to whom a share of the principal may be distributed will cease upon the distribution to him or her of his or her share of principal or upon his or her death, whichever occurs first.

Article Fourth, paragraph (E), provides that when a beneficiary for whose benefit a portion of the trust estate has been set aside attains age 35, the beneficiary is to receive outright one-third of either the then value of the portion or an undivided one-third interest in the portion. On attaining age 40, the beneficiary is to receive one-half of the then value of the portion (or an undivided one-half interest in the portion), and upon attaining age 45, the beneficiary is to receive the balance of that portion.

Article Fourth, paragraph (F), provides that if prior to the full distribution of the portion of the trust estate set aside for any beneficiary, the beneficiary dies and is survived by children, the principal and any undistributed income in that portion is to be distributed to or for the benefit of the then living children of the deceased beneficiary.

Under Article Fourth, paragraph (G), if, prior to the full distribution of the portion of the trust estate set aside for a beneficiary, the beneficiary and all of the beneficiary's children have died, the entire principal and undistributed income of the portion are to be distributed among Son's surviving children and grandchildren, per stirpes.

Article Eleventh provides that Trust is to be governed by the laws of State.

Under Article Fifteenth, all trusts are to terminate at the expiration of 21 years after the death of the last to die of Settlor, her children, and her grandchildren living at the time of her death. On termination, the principal and undistributed income are to be distributed outright to the beneficiaries entitled to take.

The co-trustees propose to modify Article Third, paragraph (B) to limit the time during which Son may exercise his annual power to withdraw, during his life, such amounts from the principal of Trust as he may designate, up to but not exceeding the sum or value of \$5,000 or 5 percent of the Trust principal, whichever is larger, in any one calendar year. The proposed modification will provide that Son may exercise the withdrawal power during the month of January of each calendar year (rather than at any time during each calendar year, as presently provided in the trust instrument). It is represented that Son has not previously exercised the withdrawal right.

On Date 3, the co-trustees submitted to the Court a Petition for Modification of Trust. On Date 4, the Court issued a Conditional Order Amending Trust. The order is subject to and conditioned on Trust receiving a favorable letter ruling in this matter. The final order will modify Trust to provide that Son shall have the right, at any time during the month of January of each calendar year prior to his death to direct the trustee in

writing to pay to or apply for Son's benefit such amounts from the principal of Trust as he may designate, up to but not exceeding the sum or value of \$5,000 or 5 percent of the trust principal, whichever is larger, in any one calendar year.

You have requested the following rulings:

1. The modification of Trust and the implementation of the Court's order modifying Trust will not result in a transfer by Son that is subject to the gift tax under § 2501 of the Internal Revenue Code.

2. The modification of Trust and the implementation of the Court's order modifying Trust will not cause Trust to lose its grandfathered status under § 26.2601-1 of the Generation-Skipping Transfer Tax regulations.

Law and analysis

Ruling 1

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during the calendar year.

Section 2511(a) provides that the gift tax shall apply 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 2514(b) provides that the exercise or release of a general power of appointment shall be deemed the transfer of property by the individual possessing the power.

Section 2514(c) provides that the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or creditors of his estate.

Section 2514(e) provides that the lapse of a power of appointment during the life of the individual possessing the power shall be considered a release of such power. The rule shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of \$ 5,000 or 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied.

In this case, after the modification, each beneficiary will have the same interest in the Trust assets as he or she had before the modification. Because the beneficial interests, rights, and expectancies of the beneficiaries are substantially similar both before and after the modification, no transfer of property for less than adequate and full

consideration in money or money's worth will occur as a result of the proposed modification. Accordingly, based on the facts submitted and representations made, we conclude that the modification of Trust and the implementation of the Court's order modifying Trust will not result in a transfer by any beneficiary of Trust.

Ruling 2

Section 2601 provides that a tax is imposed on every generation-skipping transfer made by a "transferor" to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer (GST) Tax Regulations, 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), 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.

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. The regulation provides that the rules contained in the paragraph are generally applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Unless the regulations specifically provide otherwise, 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 by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the tax 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 generation-skipping transfer or the creation of a new generation-skipping transfer. A modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust.

In this case, Trust is exempt from the GST tax because it was irrevocable on or before September 25, 1985, and no actual or constructive additions have been made to Trust since that date. After the modification, Son will continue to have a noncumulative power to withdraw the greater of \$5,000 or 5 percent of the value of the Trust property.

However, the withdrawal right will be exercisable only during the month of January of each year. The modification will 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. Further, the modification will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. Under these circumstances, we conclude that the modification of Trust and the implementation of the Court order modifying Trust will not cause Trust to lose its exempt status for GST purposes and that distributions from Trust, as modified, will not be subject to GST tax.

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. 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.

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

Sincerely yours,

James Hogan
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special
Industries)

Enclosure
Copy for section 6110 purposes

cc: