

Internal Revenue Service

Department of the Treasury

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Refer Reply To:
CC:PSI:4 - PLR-116540-99
Date: October 12, 2000

Re:

LEGEND:

A =

B =

D =

Grantor =

Trust D =

Date 1 =

Date 2 =

County =

State =

\$x =

Dear :

This is in response to your letter dated October 5, 1999, and subsequent correspondence requesting a ruling on the generation-skipping transfer (GST) tax consequences of a proposed trust reformation.

The facts and representations submitted are summarized as follows: On Date 1, prior to January 1, 1990, Grantor transferred \$x to A and B as trustees. The trustees were directed to immediately divide the trust corpus into two equal shares. One trust, Trust D, is to be held for the benefit of Grantor's grandchild, D.

Article I(B)(1) of the trust instrument provides, that until D attains the age of 21, the trustees have the discretion to distribute the net income for the best interests of D. Any net income that is not so paid must be added to the principal of the trust. After D attains age 21, the trustees are directed to pay all the net income of the trust to D, annually or at more frequent intervals as the trustees deem appropriate. Unproductive property is not to be retained as part of the corpus of the trust without the consent of D.

In addition, under Article I(B)(1), the trustees are to make the following periodic distributions of principal: (i) when D attains the age of 25 years, one-third of the then principal of Trust D is to be distributed to D; (ii) when D attains the age of 30 years, one-half of the then balance of Trust D is to be distributed to D; and (iii) when D attains the age of 35 years, the entire balance of the principal is to be distributed to D and Trust D is to terminate. If D dies before all of the principal of Trust D is distributed to D, the trust will terminate and the trustees will distribute the remaining principal as D may appoint in his will, alone and in all events, to his estate or in any other way. If, upon D's death, the whole or some part of the principal of Trust D is not effectively appointed by D's will, the trustees are to divide the remaining property, per stirpes, for the then living descendants of D or, if there are none, for the living descendants of the Grantor's daughter, A, or if there are none, to the Grantor's then living descendants.

Under Article I(C)(1) the trustees are authorized to pay D so much of the principal of Trust D as the trustees deem necessary or advisable (a) for the maintenance and education of D, (b) for accidents, illness or other emergencies affecting D, (c) to enable D to purchase, build or improve a home or to become established in a business or profession, or (d) for any other purpose which the trustees shall deem to be worthwhile and in D's best interests.

Article I(C)(2) provides that the trustees are authorized, if at any time the trustees are of the opinion that continuance of Trust D is neither necessary nor desirable in the interests of D, to terminate Trust D by distributing the entire principal thereof to D without further accountability therefor to anyone.

Article VIII provides that Trust D is irrevocable and shall not be amendable by the Grantor or any other person.

The trustees of Trust D brought a judicial action in the Circuit Court of County in State, to reform the trust to eliminate the provisions requiring mandatory distributions of trust principal to D at ages 25, 30, and 35. For purposes of this action the court appointed a Guardian Ad Litem to represent the interests of D who is a minor.

The Court's Order, issued on Date 2, which is contingent upon a favorable ruling from the Internal Revenue Service, provides that the trust is to be reformed by deleting the existing Article I(B) and inserting in its place a new Article I(B) which is identical to the existing Article I(B) except that the provisions requiring distributions of principal to D at age 25, 30, and 35, have been eliminated. Specifically, under Article I(B)(1) as revised, the trustees are to distribute trust income to D before and after D's attaining

age 21 under the same terms and conditions provided in the original Article I(B)(1). Further, under Article I(B)(1) as revised, on D's death the principal of the trust is to pass, under terms identical to existing Article I(B)(1), pursuant to the exercise of D's testamentary power exercisable in favor of D's estate or in any other way. As noted, the only change is that the mandatory distributions to be made upon D reaching age 25, 30 and 35 have been eliminated.

It is represented that there have been no transfers to Trust D since Date 1. A ruling is requested that after the reformation described above, the Trust D corpus will continue to qualify for the exclusion from GST tax under § 1433(b)(3) of the Tax Reform Act of 1986.

Section 2601 imposes a tax on every generation-skipping transfer made by the "transferor" to a "skip person." In general, under § 1431(a) of the Tax Reform Act of 1986 (the 1986 Act), the tax is generally applicable to generation-skipping transfers made after October 21, 1986.

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(c)(1) defines the term "direct skip," to mean a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613(a) defines the term "skip person" to mean – a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor, or a trust –

(A) if all interests in such trust are held by skip persons, or

(B) if—

- (i) there is no person holding an interest in the trust, and
- (ii) at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 1433(b)(3)(A) of the 1986 Act provides an exception to the effective date rule contained in § 1431(a) for certain transfers to grandchildren that were made prior to January 1, 1990. That section provides that for purposes of Chapter 13, the term direct skip shall not include any transfer before January 1, 1990, from a transferor to a grandchild of the transferor to the extent the aggregate transfers to such grandchild do not exceed \$2,000,000.

Section 1433(b)(3)(B) provides with respect to transfers in trust, that for purposes of § 1433(b)(3)(A):

[A] transfer in trust for the benefit of a grandchild shall be treated as a transfer to such grandchild if (and only if)-

(i) during the life of the grandchild, no portion of the corpus or income of the trust may be distributed to (or for the benefit of) any person other than such grandchild

(ii) the assets of the trust will be includible in the gross estate of the grandchild if the grandchild dies before the trust is terminated, and

(iii) all of the income of the trust for periods after the grandchild has attained the age of 21 will be distributed to (or for the benefit of) such grandchild not less frequently than annually.

Section 1014(h)(3)(B) of the Technical and Miscellaneous Revenue Act of 1988 provides that § 1443(b)(3)(B) of the 1986 Act applies to transfers made after June 10, 1987.

Section 2041(a)(2) provides for the inclusion in the gross estate of any property with respect to which the decedent possesses, at the time of his death, a general power of appointment created after October 21, 1942. Section 2041(b)(1) provides that the term "general power of appointment" means a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate.

In the present case, the original terms of Trust D (prior to reformation) satisfy the requirements of § 1433(b)(3)(B) of the 1986 Act: 1) during the life of D, no portion of the corpus or income of the trust may be distributed to (or for the benefit of) any person other than D; 2) the assets of the trust will be includible in the gross estate of D if D dies before the trust is terminated because D possesses a general testamentary power of appointment with respect to the trust; and 3) all of the income of the trust for periods after D attains age of 21 will be distributable to D at least annually.

The provisions for mandatory distribution of principal to D at ages, 25, 30, and 35 had no effect on the qualification of the trust under § 1433(b)(3)(B). Accordingly, if these provisions are deleted, as proposed, the terms of Trust D will continue to meet the requirements of § 1433(b)(3)(B).

The grandchild exclusion under § 1433(b)(3)(A) and (B) protects certain transfers in trust made after the enactment of the GST tax and before January 1, 1990, from the application of the GST tax if the trust meets the statutory requirements contained in § 1433(b)(3)(B). Trust D, as modified, will continue to meet these requirements (and the beneficiary of Trust D will remain the same). Thus, the continued exemption of Trust D under § 1433(b)(3)(A) and (B) after the proposed modification is consistent with those provisions. Accordingly, we conclude that the exempt status of the corpus of Trust D will not be affected by the court ordered modification and the corpus attributable to the initial transfer to Trust D will continue to qualify for the grandchild exclusion under § 1433(b)(3)(A) and (B) of the 1986 Act.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision 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 yours,
Associate Chief Counsel
(Passthroughs and Special Industries)
By George Masnik
Branch Chief, Branch 4

Enclosure

Copy of letter for section 6110 purposes