Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
ID No.
Telephone Number:

Refer Reply To:
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Date:
November 03, 2021

<u>Legend</u>

Grantor =
Spouse =
Trust A =
Trust B =
Date 1 =
Date 2 =
Date 3 =
Child =
Beneficiary 1 =
Beneficiary 2 =
Trustee =
Court =

Dear :

This letter responds to your authorized representative's letter dated April 12, 2021, and subsequent correspondence, requesting rulings on the estate and generation-skipping transfer (GST) tax consequences of a proposed modification of a trust pursuant to a court-approved settlement agreement.

The facts and representations submitted are summarized as follows:

Under Clause 3. of Grantor's will, dated Date 1, Grantor bequeathed all of the rest and remainder of Grantor's property to two trusts, Trust A and Trust B. Trust B is the subject of this ruling request. Grantor died on Date 2, a date prior to September 25, 1985.

Under Clause 5., Trust B is established for the benefit of Grantor's sole surviving child, Child. Under Clause 5., Paragraph (1), Trustee must distribute all of the net income from Trust B to Child during Child's life. Clause 5., Paragraph (5) provides that Trustee has the authority in the exercise of its sole and absolute discretion to withdraw from the corpus of the trust, such sum or sums as it may deem necessary for the maintenance, education, welfare and comfort of any beneficiary or beneficiaries, and such exercise of discretion by Trustee shall be final and not subject to question by any person or persons. Under Clause 5., Paragraph (2), upon Child's death, Trust B terminates and is to be distributed, *per stirpes*, to Child's surviving descendants, if any, and if none, to the heirs at law of Grantor's wife, Spouse.

You represent that no additions have been made to Trust B since it was created.

A controversy arose regarding the administration of Trust B and Trustee's desire to exercise its discretion to provide Child with a power of appointment over certain assets of Trust B. Trustee asserts that the exercise of this discretionary authority is to carry out the intent of Grantor to keep trust assets in the hands of Grantor's descendants upon Child's death and to minimize transfer taxation upon Trust B assets. However, according to Trustee, due to family dynamics, including separation and divorce, as well as changing tax laws, Grantor's intent may not be carried out.

Child and the other beneficiaries of Trust B have been in negotiations regarding Trustee's proposed exercise of its discretionary authority for approximately several months. During this time, Beneficiary 1 and Beneficiary 2 (individually and as representative of his minor children) opposed the proposed exercise of Trustee's discretionary authority. Litigation was commenced, but after further negotiations, the parties were able to reach a settlement agreement. Court has approved, after a hearing on the matter, the settlement agreement in an order, dated Date 3 (Settlement Agreement), subject to a favorable private letter ruling by the Internal Revenue Service.

Settlement Agreement provides that Trust B, Clause 5., Paragraph (2) is modified to grant Child a testamentary general power of appointment to appoint a "Defined Portion" of Trust B principal to Child's estate. The term "Defined Portion" means the largest portion of Trust B that could be included in Child's federal estate without increasing the total amount of the "Transfer Taxes" actually payable at Child's death over and above the amount that would have been actually payable in the absence of this provision. The term "Transfer Taxes" means all inheritance, estate, and other death taxes, plus all federal and state GST taxes, actually payable by reason of Child's death. In the event Child fails to exercise this power, and to the extent the trust property is not subject to this power, upon Child's death, Trustee shall distribute such property, *per stirpes*, to Child's then living descendants, if any, and if none, to the heirs at law of Spouse.

You request the following rulings:

(1) The exercise by Trustee of its discretionary authority over Trust B principal upon the terms of the Settlement Agreement will not result in a transfer of property that is subject to GST tax and Trust B will retain its GST exempt status.

(2) The exercise by Trustee of its discretionary authority over Trust B principal upon the terms of the Settlement Agreement will result in only the trust property subject to Child's testamentary general power of appointment to be included in Child's gross estate under § 2041(a)(2).

LAW AND ANALYSIS

Ruling 1

Section 2601 imposes a tax on every generation-skipping transfer. The term "generation-skipping transfer" is defined in § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer 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 GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

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 under § 26.2601-1(b) will not cause the trust to lose its exempt status.

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 § 26.2601-1(b)(4)(i)(A), (B), or (C)) 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. 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. 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, pursuant to the proposed modification to Trust B, the trust will be modified to grant Child a testamentary general power of appointment under § 2041(a)(2) to appoint a “Defined Portion” of Trust B principal to Child’s estate. In the event Child fails to exercise this power, and to the extent Trust property is not subject to this power, upon Child’s death, Trustee shall distribute such property, *per stirpes*, to Child’s then living descendants, if any, and if none, to the heirs at law of Spouse.

Under these circumstances, we conclude that the modification of Trust B pursuant to Court order will not shift any beneficial interest in Trust B 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 will not extend the time for vesting of any beneficial interest in Trust B beyond the period provided for in Trust B. Accordingly, based on the facts submitted and the representations made, we conclude that the modifications of Trust B pursuant to the Date 3 Court order will not cause Trust B to lose its exempt status from the GST tax or otherwise become subject to the GST tax.

<u>Ruling 2</u>

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of death.

Section 2041(a)(2) provides that to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent’s gross estate under §§ 2035 to 2038, inclusive. For purposes of this paragraph (2), the power of appointment shall be considered to exist on the date of the decedent’s death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent’s death notice has been given or the power has been exercised.

In this case, the modification of Trust B to grant Child a testamentary general power of appointment pursuant to the Court-approved Settlement Agreement will not cause Trust B property to be includible in Child’s gross estate. However, the exercise by Child of Child’s testamentary general power of appointment will result in the appointed property being includible in Child’s gross estate under § 2041(a)(2). Accordingly, based on the facts submitted and the representations made, we conclude that the exercise by Trustee of its discretionary authority over Trust B principal upon the terms of the Settlement Agreement will result in only the trust property subject to Child’s testamentary general power of appointment to be included in Child’s gross estate under § 2041(a)(2).

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

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.

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.

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,

___*Leslie H. Finlow*__________________
Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy for § 6110 purposes

cc: