

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

December 17, 1998

Re:

Legend:

Settlor =
Child =
Grandchild =
Trust =

\$X =
State =

This is in response to your letter of September 3, 1998, and prior correspondence submitted by your authorized representative, in which you request several rulings on the application of the generation-skipping transfer (GST) tax provisions of Chapter 13 of the Internal Revenue Code.

In 1947, Settlor created Trust for the benefit of Grandchild and her future issue. Subject to a monthly payment to Child, Grandchild is the current income beneficiary of Trust.

Article III, paragraph 6 of Trust provides that "the trustees shall have the fullest power to determine all matters to which any doubts, difficulty or question may arise, under or in relation to the execution of the trust especially including the question of what is corpus and what is income,"

From the inception of Trust, the corpus consisted primarily of certain oil and gas leases. In 1984, the trustee obtained a final judgement from the local probate court which,

among other things, ratified the trustee's decision not to establish a reserve for depletion, and thus pay out the entire net income of Trust to Grandchild (subject to the payment to Child). The court order contains the following statement regarding the depletion reserve with respect to the proceeds of the sale of oil and gas interests:

The trustee . . . has broad discretion to determine whether a depletion reserve should be established with respect to the proceeds of the sale of the Trust's oil, gas, and other minerals. As no depletion reserve has previously been established and it is consistent with the Settlor's intention that no reserve for depletion should be established, it would not be an abuse of discretion and would be a proper exercise of the discretion conferred upon the trustee for the trustee to establish no reserve for depletion with respect to the proceeds of the sale of the Trust's oil, gas and other minerals. Accordingly, the trustee should be ordered and directed by the court to establish no reserve for depletion with respect to the proceeds from the sale of the trust's oil, gas, and other minerals, and the trustee's prior decision not to establish such a depletion reserve should be ratified and approved.

The order also contained the following statement:

In keeping with the Settlor's primary intention to benefit the income beneficiary of [the Trust], for future interpretation of this final judgement and any of the provisions of the trust instruments creating [the Trust], the Trustee shall be governed by the findings of this court that the Settlor intended the income beneficiaries at any given time, now or in the future, to be objects of his bounty during such beneficiaries' lifetimes, and that during such beneficiaries' lifetimes, all ambiguities and uncertainties with respect to [the Trust] or the administration of [the Trust] should be resolved in a manner favorable to the income beneficiaries.

In 1995, the trustee sold the oil and gas leases. According to the terms of Trust, the proceeds are required to be invested in United States government bonds, municipal bonds, first mortgages on real estate, and corporate bonds. Trust also provides that the trustee's fees are to be determined as a percentage of the oil and gas income.

In 1998, the trustee obtained a court order with respect to Trust which authorized the one-time distribution to Grandchild of \$X from the proceeds of the sale of the oil and gas properties. The order concludes that a one-time distribution to Grandchild of \$X is authorized under the terms of Trust and under the 1984 Final Judgement authorizing the trustee not to maintain a reserve for depletion, and thus pay out to the income beneficiary a portion of trust receipts that would otherwise be allocated to corpus under State law. The court order also authorized the trustee to

make investments permissible under State law without regard to the restrictions on investments contained in the Trust instrument. In addition, the court order authorized the trustee to pay reasonable trustee fees.

The taxpayer has requested a ruling that the court order authorizing the \$X distribution to Grandchild, and the modifications to Trust regarding permissible investments and trustee fees will not affect the exempt status of Trust for GST tax purposes by reason of the effective date rule set forth in § 1433(b)(2) of the Tax Reform Act of 1986.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping transfer tax shall not apply to any generation-skipping 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)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from the application of Chapter 13 by § 1433(b)(2)(A) of the Act, a pro rata portion of subsequent 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)(1)(v) describes "constructive" additions to trusts in certain situations involving powers of appointment and relief from liability.

A modification of a generation-skipping trust that is otherwise exempt from GST tax under the 1986 Act will generally result in a loss of its exempt or "grandfathered" status, if the modification changes the quality, value, or timing of any powers, beneficial interests, rights, or expectancies originally provided for under the terms of the trust.

The court order authorizing the \$X payment to Grandchild is consistent with the terms of Trust as interpreted under the 1984 Final Judgement. Further, the court order authorizing broader investment powers and the payment of reasonable trustee fees relates to the administration of the trust.

Accordingly, we conclude that the court order does not change the quality, value, or timing of any powers, beneficial interests, rights, or expectancies originally provided for under the terms of Trust. We also conclude that the court order does not result in a constructive addition to Trust, as described in § 26.2601-1(b)(1)(v).

Except as we have ruled under the cited provisions of the Code, we express no opinion about the tax consequences of the proposed transaction under those provisions or under any other provisions of the Code.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Chief, Branch 4

Enclosure
Copy for 6110 purposes