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January 13, 1999

This responds to a letter dated September 11, 1998, submitted by your authorized representative on your behalf in which a ruling is requested concerning the federal gift and generation-skipping transfer tax consequences of a proposed court order affecting the provisions in certain trusts.

As represented, the facts are as follows:

In Year 1, A created Trust A and named Trustee as the trustee. Trust A was irrevocable from its creation and there have been no additions to Trust A since its creation. Trust A was created for the benefit of A's three daughters, B, C, and D. Trust A provides that, during their lifetimes, B, C, and D are to receive one-third of Trust A's net income. Upon the death of a daughter, that daughter's share of the income is to be distributed to the daughter's issue. Upon the death of the last to die of B, C, and D, each daughter's one-third share of trust assets is to be distributed to the issue of each deceased daughter by right of representation. In the event that there is no surviving issue of a deceased daughter, that share is to be divided among the other living beneficiaries by right of representation.

After the creation of Trust A, C adopted two children. Pursuant to State law that existed at the time of the creation of Trust A, adopted children were not considered issue and therefore C's adopted children would not be entitled to share in future distributions from Trust A. After C adopted the two children, A advised Trustee by letter that A intended to include adopted children in the definition of issue as that term was used in Trust A. No amendment, however, was ever sought to change the governing instrument for Trust A to reflect A's intent as set forth in the letter and Trust A remained unchanged at A's death.

In Year 2, A created Trust B and also named Trustee as the trustee. Trust B became irrevocable upon A's death in Year 3. All distributions to Trust B were made on A's death and there have been no additions to Trust B since the administration of A's estate. In an effort to correct the potential inequality of treatment between natural and adopted grandchildren, A included a provision in Trust B that specifically includes adopted grandchildren and provides for equalizing distributions to compensate A's adopted grandchildren for any inability to benefit from Trust A.

Subsequent to the creation of Trust A, State law changed to provide that, in the construction of a trust agreement or will, whether executed on, before, or after June 23, 1966, the term "child," "grandchild," "issue," "heir," "descendant," "beneficiary" or other equivalent term is to be construed to include any adopted person and his descendants whether natural or adopted unless a contrary intention appears by the terms of the instrument or unless the estate devised to the "child," "grandchild," "issue," "heir," "descendant," "beneficiary," or equivalent person vested before June 23, 1966, in an already ascertained person or persons who have an immediate indefeasible right of enjoyment or a present indefeasible fixed right of future enjoyment in the estate. In 1985, a State court of appeals held that a remainder interest does not vest until the death of the party holding the life interest. The court's rationale is that vesting may not be effective until such time because an interest could be defeated by the birth of other children.

B predeceased A. At the time of A's death, A was survived by C and D. C died in Year 4 survived by her two adopted children. D is still living.

Trustee proposes to petition Court to clarify that C's two adopted children are "issue" for purposes of taking under Trust A and that the equalization clause in Trust B be eliminated as unnecessary. The following rulings have been requested:

1. A Court order interpreting Trust A as including adopted children as "issue" and the resulting distribution of trust assets consistent with such interpretation, will not result in the loss of exempt trust status for purposes of the generation-skipping transfer tax, constitute a modification of Trust A within the meaning of § 26.2601-1(b)(1)(iv), and will not result in federal gift tax.

2. A Court order removing the equalization clause in Trust B and the resulting distribution of trust assets consistent with such interpretation, will not result in the loss of exempt trust status for purposes of the generation-skipping transfer tax, constitute a modification of Trust B within the meaning of § 26.2601-1(b)(1)(iv), and will not result in federal gift tax.

Section 2501 imposes a tax on the transfer of property by gift during any calendar year.

Section 2511 provides that the gift tax applies 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 2601 imposes a tax on every generation-skipping transfer made after October 22, 1986.

Section 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).

Trust A became irrevocable in Year 1, and Trust B became irrevocable on A's death in Year 3. Both events occurred before September 25, 1985. You represent that there have been no constructive or actual additions to Trust A since its creation. You also represent that there have been no constructive or actual additions to Trust B since the completion of the administration of A's estate which was before September 25, 1985.

A modification of a trust that is otherwise exempt for purposes of Chapter 13 and the applicable regulations, will generally result in a loss of exempt or "grandfathered" status, if the modification changes the quality, value, or timing of any powers, beneficial interest, rights or expectancies originally provided for under the terms of the trust.

In this case, under the applicable State law, the rights of the issue of B, C, and D did not vest before June 23, 1966, and the adopted children are entitled to benefit as issue under the terms of Trust A. As a result, the proposed modification to clarify the term "issue" in Trust A as including adopted children and the proposed modification to remove the equalizing provision in Trust B, will not change the quality, value, or timing of any powers, beneficial interests, rights or expectancies originally provided for under the terms of Trust A or Trust B. Therefore, provided the Court order is approved as proposed, we conclude that:

1. The proposed Court order interpreting Trust A as including adopted children as "issue" does not constitute a modification of Trust A for purposes of § 2601. The resulting distribution of trust assets consistent with such interpretation will not result in the loss of exempt trust status for purposes of the generation-skipping transfer tax and will not result in federal gift tax.

2. The proposed Court order removing the equalization clause in Trust B does not constitute a modification of Trust B for purposes of § 2601. The resulting

distribution of trust assets consistent with such order will not result in the loss of exempt trust status for purposes of the generation-skipping transfer tax and will not result in federal gift tax.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or 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(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
Katherine A. Mellody
Assistant to the Chief
Branch 4

Enclosure
Copy for § 6110 purposes