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**AMERICAN BAR ASSOCIATION  
REAL PROPERTY, PROBATE AND TRUST LAW SECTION  
INCOME AND TRANSFER TAX PLANNING GROUP  
2006 JOINT FALL CONTINUING LEGAL EDUCATION MEETING**

**SUMMARY OF SELECTED  
RECENT GST TAX PRIVATE LETTER RULINGS**

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1. ***Court-approved settlement will not affect a trust's generation-skipping transfer tax ("GSTT") exempt status. (IRS Letter Ruling 200631008)***
  - (a) The potential remainder beneficiaries of a trust disagreed on whether shares of the trust were divided at the level of grantor's children or grandchildren.
  - (b) The trustees petitioned a court for a construction of the trust agreement to resolve the dispute.
  - (c) The court appointed four guardians ad litem to represent the interests of the minor, unborn, and unascertained beneficiaries of the trust.
  - (d) All of the guardians ad litem and most of the current beneficiaries joined the trustees' petition for construction.
  - (e) Based on the face of the trust instrument, the court found that the grantor intended distribution of the principal to begin at the grandchildren's generational level.
  - (f) Certain beneficiaries appealed the court's decision to the state's supreme court arguing that the terms of the instrument were ambiguous and that extrinsic evidence reflected the grantor's clear intent to treat each of his children's families equally.
  - (g) The individual beneficiaries entered into a settlement agreement on the distribution of the trust and other issues.
  - (h) The state's supreme court approved the settlement conditioned upon the receipt of a favorable private letter ruling from the IRS.

- (i) Under the settlement agreement, the trust would be divided into portions that would fund three subtrusts.
- (j) The trustees of the trust requested rulings that the division of the trust into three subtrusts and the allocation of the trust assets under the terms of the settlement agreement would not cause the trust or any of the subtrusts to be subject to the GST tax.
- (k) It was determined that the interests of all the parties to the settlement agreement, including the interests of any unborn heirs, were represented in the litigation and in the negotiations that preceded the proposed settlement agreement.
- (l) Accordingly, the terms of the proposed settlement agreement were based on arms-length negotiations among all interested parties to a bona fide controversy and fairly reflected the relative merits of the claims made by the parties.
- (m) As a result, implementation of the settlement agreement would not result in a transfer of property that would subject the trust or the resulting trusts, or distributions thereunder, to the GST tax.

**2. *Proposed amendment to trust will not shift a beneficial interest in trust to any person in a generation lower than the person who held the beneficial interest prior to the modification and will not extend the period for vesting of any beneficial interest in trust beyond period provided for in the original trust. (IRS Letter Rulings 200604025 and 200604026)***

- (a) In this ruling, amendments were proposed to a GSTT exempt trust.

- (b) The original trust provided for a child (or the child's lineal descendants if the child did not survive) to receive the assets of the trust upon termination of the trust, the earlier of the deaths of both the husband and the wife or a specified date, subject to the husband's special power of appointment.
- (c) Under the proposed amendments, the child (or the child's lineal descendants if the child does not survive) will receive specified payments when the child reaches specified ages, and upon termination, the remaining property of the trust will be distributed to a foundation.
- (d) It was determined that that the amendments to the trust do not shift a beneficial interest in the trust to any person in a generation lower than the persons who held the beneficial interests prior to the modification and do not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

**3. *Proposed division of a trust into successor trusts will not cause trusts to lose their GSTT exempt status. (IRS Letter Rulings 200624003 and 200624004)***

- (a) The trustees represented that the current beneficiaries had different investment goals and distribution needs, and accordingly, it was difficult to invest the trust estate and administer the trust in the best interests of all the beneficiaries.
- (b) The trustees proposed to partition and divide the trust pro rata into separate trusts for each beneficiary.
- (c) The ruling cited Code Section 26.2601-1(b)(4)(i)(E), Example 5,<sup>1</sup> which illustrates a situation where a trust that is

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<sup>1</sup> References to "Code" refer to the Internal Revenue Code of 1986, 26 U.S.C. §1 et seq., and references to "Section" without further modification refer to Sections of the Code.

otherwise exempt from the GST tax is divided into two trusts.

- (d) The proposed division of the trust into successor trusts was determined to not result in a shift of any beneficial interest in the trust to any beneficiary who occupied a generation lower than the persons holding the beneficial interests, nor extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for in the original trust.

**4. *Proposed restatement and partition of trust into three separate trusts will not cause the trust to lose its GSTT exempt status. (IRS Letter Ruling 200603022)***

- (a) The trustees of a GSTT exempt trust petitioned a court for the partition and restatement of the trust.
- (b) In the proposed restatement of the trust, a provision of the trust agreement would be modified to eliminate the settlor's statement of intent with respect to equalizing the incomes of the settlor's three sons and to eliminate the definition of and formula for computing "equalizing source income."
- (c) The trustees also proposed to modify the trustee succession provisions of the trust agreement.
- (d) The ruling cited Section 26.2601-1(b)(4)(i)(E), Example 5, in which the division of a trust into two trusts did not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the division, and the division did not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Accordingly, the two partitioned trusts would not be subject to the GST tax.

- (e) The ruling also cited Section 26.2601-1(b)(4)(i)(E), Example 10, in which the grantor executed an irrevocable trust for the benefit of the grantor's issue, naming a bank and five other individuals as trustees and subsequently, the appropriate local court approved a modification of the trust that decreased the number of trustees, which resulted in lower administrative costs. The modification pertained to the administration of the trust and did not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification. In addition, the modification did not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust was not be subject to the generation-skipping transfer tax.
- (f) Accordingly, it was determined that the proposed restatement, partition, pro rata distribution, and proposed administrative changes would not result in a shift of any beneficial interest in the trust or the separate trusts to any beneficiary who occupied a generation lower than the persons holding the beneficial interests. Further, the proposed modifications would not extend the time for vesting of any beneficial interest in the new trusts beyond the period provided for in the original trust.

**5. *Proposed modification to trusts to create a limited liability company trust and a contingent beneficiary trust will not cause the trusts to lose their GSTT exemption. (IRS Letter Ruling 200601010)***

- (a) As a result of litigation among parties associated with a trust, judicial modifications were proposed, including the creation of a trust to hold the interests in any limited liability companies (the "LLC Trust") and the creation of a trust for contingent beneficiaries (the "Contingent Beneficiary Trust").

- (b) Because the LLC Trust and the Contingent Beneficiary Trust would be funded pro-rata out of each of the existing separate trusts, the proposed modifications dividing the existing separate trusts to create the LLC Trust and the Contingent Beneficiary Trust would not cause the interests of the beneficiaries of the separate trusts to differ materially from their interests in the original trust.
- (c) Accordingly, the creation of the LLC Trust and the Contingent Beneficiary Trust would not shift a beneficial interest in any trust operating under the original trust to a beneficiary who occupied a lower generation than the persons who held beneficial interests prior to the creation of the LLC Trust and the Contingent Beneficiary Trust.
- (d) In addition, the LLC Trust and the Contingent Beneficiary Trust would terminate at the same time or earlier than the trusts that operate under the original trust would terminate. Therefore, the creation of these trusts would not extend the time for vesting of any beneficial interest beyond the period provided in the original trust.

**6. *Gift tax returns contained sufficient information to conclude that the allocation of the taxpayers' GSTT exemptions to an irrevocable trust was timely made. (IRS Letter Ruling 200622015)***

- (a) The taxpayer transferred limited partnership interests to a trust, and the taxpayer and his spouse timely filed gift tax returns to report the transfer and consented to split the gifts pursuant to Section 2513.
- (b) The taxpayer and his spouse attached Notices of Allocation identifying the gift to which the allocation was applicable, the value of the gift and the amount of GST tax exemption the taxpayer and his spouse wished to allocate.

- (c) However, neither taxpayer nor his spouse included the amount of the allocation of GST tax exemption on line 5 of Schedule C of his or her Form 709.
- (d) The taxpayer and his spouse requested a ruling that they substantially complied with the requirements of making a timely allocation of GST tax exemption to the trust with respect to their Form 709s.
- (e) The ruling explained that Section 2642(g)(2) provides that an allocation of GST exemption under Section 2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer or a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio and that in determining whether there has been substantial compliance, all relevant circumstances shall be taken into account, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant.
- (f) The taxpayer and his spouse were found to have intended to allocate part of their exemption to the trust, in part based upon the following:
  - (1) A Notice of Allocation and the trust agreement were attached to each gift tax return; and
  - (2) the trust agreement included language indicating that a material purpose of the trust was to utilize the available exemption from the generation-skipping transfer tax.

7. *Taxpayers gift tax returns contained sufficient information to constitute substantial compliance under Section 2642(g)(2). (IRS Letter Rulings 200622029 and 200622030; also IRS Letter Ruling 200626007)*
- (a) The taxpayer made gifts to four irrevocable trusts with GST tax potential.
  - (b) The taxpayer's spouse consented on her gift tax return to have the gifts made by the taxpayer considered as made one-half by her.
  - (c) The taxpayer and spouse relied upon their return preparer to prepare their respective gift tax returns; however, the return preparer mistakenly believed that the transfers were direct skips and subject to both gift and GST tax.
    - (1) The return preparer reported the transfers to the four trusts on Schedule A, part 2 and included a computation of GST tax on Schedule C.
    - (2) On Schedule C, part 2, line 4, the return preparer indicated that taxpayer was claiming a portion of his GST exemption on the return and that, as a result of taxpayer's allocation of GST exemption, each trust would have an inclusion ratio of zero.
    - (3) The return preparer did not attach a notice of allocation to the gift tax return since he mistakenly believed that the transfers were direct skips.
  - (d) The taxpayer requested a ruling that he substantially complied with the requirements for making a timely allocation of GST exemption to the value of the property transferred to each trust.
  - (e) As evidenced by Schedule C of taxpayer's gift tax return, taxpayer was found to have intended to allocate a portion of

his GST exemption in order to obtain an inclusion ratio of zero for each trust.

- (f) The taxpayer's gift tax return was found to contain sufficient information to constitute substantial compliance under Section 2642(g)(2).

**8. *Conversion of income interests in trusts to unitrust interests will not result in the loss of GSTT exempt status. (IRS Letter Ruling 200609003)***

- (a) The trustees of two trusts sought to convert the trusts into unitrusts under a state unitrust statute.
- (b) The ruling explains that administration of a trust in conformance with an applicable local law that defines the term "income" as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of Section 1.643(b)-1.
- (c) The facts were analogized to Section 26.2601-1(b)(4)(E), Example 11, which provides that the conversion of an income interest to a unitrust interest pursuant to a state statute will not be considered to shift a beneficial interest in a trust for GST purposes.
- (d) Provided that the proposed conversion met the requirements of the state unitrust statute and an order from the state court approving the conversion was obtained, the conversion of the income interests to unitrust interests was

determined to not shift any beneficial interests in the trusts and not cause either trust to lose its exempt status.

9. *Proposed resignation of current advisors and appointment of successor advisers is a modification which is administrative in nature and will not cause a trust to lose its GSTT exempt status. (IRS Letter Rulings 200622004, 200622009, 200622010 and 200622042)*
- (a) The members of an advisory committee of a GSTT exempt trust entered into an agreement of sequential resignations and successor appointments in accordance with the terms of the decedent's will. The resignations and appointments were to become effective upon the receipt of favorable rulings from the IRS.
  - (b) The rulings cited Section 26.2601-1(b)(4)(i)(E), Example 10, which considered a situation where a trust is modified by decreasing the number of trustees, stating that the modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification, nor does the modification extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.
  - (c) Accordingly, the proposed resignation of the current advisors and the appointment of successor advisors with respect to the trust at issue was determined to be a modification that was administrative in nature, which would not shift any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests nor extend the time for vesting of any beneficial interest beyond the period provided under the provisions of the decedent's will or constitute an addition to the trust.