

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:9 -PLR-161035-01

Date:

April 12, 2002

Re:

### LEGEND:

Bank =

Child 1 =

Child 2 =

Child 3 =

Complaint =

Court =

Date 1 =

Decedent =

Ruling =

Spouse =

Statute =

Trustees =

Trusts =

Will =

PLR-161035-01

X =

Dear Trustees:

This is in response to your letter dated November 2, 2001, and subsequent correspondence, requesting a ruling under sections 2601 and 2041 of the Internal Revenue Code.

The facts presented and representations made are summarized as follows. Decedent died survived by Spouse and three children, Child 1, Child 2, Child 3.

Item IV of Decedent's Will provides that, if Decedent is survived by Spouse and children, the residue of Decedent's estate is to be divided into two shares, Share No. 1 and Share No. 2. Share No. 1 shall be funded with that fractional share of Decedent's residuary estate that is equal in value, as of the date of valuation for federal estate tax purposes, to 45 percent of the value of Decedent's adjusted gross estate, less the value of all interests in property that pass or have passed to Spouse other than under the provisions of Decedent's Will, but only to the extent that such interests in property are included in determining Decedent's gross estate subject to federal estate tax and are allowed as a marital deduction.

Item IV further provides that the balance of Decedent's residuary estate shall constitute Share No. 2. Share No. 2 is the subject to this ruling request.

Item VI provides that, if Decedent is survived by Spouse and children, Share No. 2 shall be divided into one share for each of Decedent's then living children and one share collectively for the then living descendants of each deceased child, and held in further trust.

Item VI, Paragraph A, Section 1 of Decedent's Will provides that:

During the lifetime of my said wife, the net income from each separate trust shall be accumulated, and the net income and accumulated income may be paid over or applied by my Trustees, in whole or in part, to or for the benefit of my said wife, or the child of mine for whom, the separate trust was established, or his or her surviving spouse or descendants if such child shall predecease my said wife, as my Trustees shall decide in their sole and absolute discretion.

Item VI, Paragraph A, Section 2, Sections (a) through (c) of Decedent's Will provide that, upon Spouse's death, the net income from a child's trust shall be distributed to the child for whom the trust was established, at least quarterly, for the child's lifetime. When the child attains age 30, the child has a noncumulative right each calendar year

PLR-161035-01

to withdraw 5 percent of the market value of the child's trust. Further, during the trust term, trustees may distribute to the child part or all of the trust principal or the previously accumulated and undistributed income as the trustees deem necessary or desirable for the child's comfort, support, maintenance, education, and well-being, considering funds otherwise then available to the child.

Item VI, Paragraph A, Section 3 provides that, after the death of Spouse and the child for whom a separate trust was created, the trust property shall be distributed: (1) pursuant to a testamentary power of appointment in the child's will among a group consisting of the child's surviving spouse and then living descendants; or (2) in default of the exercise of this power of appointment, the property shall pass, free of trust, to such child's then living descendants, per stirpes; (3) but if there are none, to Decedent's then living descendants, per stirpes; (4) but if there are none, to the then living descendants of X, per stirpes. Any payment that would be made to Child 3 shall be made to Child 3's trust established in Item VI, Paragraph B of Decedent's Will. Any payment that would be made to any descendant of Child 3 shall be made to Child 3's trust, if such trust is then in existence with respect to such descendant.

Item VI, Paragraph A, Section 4 provides that the trustee may defer payments of principal to a beneficiary under age 21. The trustees may pay income and principal to a parent, guardian, or other person caring for the beneficiary, or to the beneficiary as an allowance. If the beneficiary dies before attaining age 21, the then remaining principal and interest shall be paid to the beneficiary's estate.

Item X of Decedent's Will provides, in part, that Spouse and Bank shall be appointed as co-trustees of the trusts established pursuant to Decedent's Will.

In PLR 9323028 (PLR-57127-92) issued on Date 1, the Internal Revenue Service ruled that Spouse's power of appointment over the Trusts was limited by an ascertainable standard under state law. Accordingly, Spouse, in her capacity as co-trustee, did not hold a general power of appointment under section 2041 or section 2514 over the income or accumulated income of the Trusts.

Trustees filed Complaint with Court requesting that in order to effectuate the true intent of Decedent, the pertinent provisions of Item IV, Paragraph A, Section 1, should be amended to read as follows:

During the lifetime of my said wife, the greater of the income from each separate trust or an amount not to exceed [5] percent of the market value of the trust determined on the first day of the calendar year may be paid over or applied by my Trustees, in whole or in part, to or for the benefit of my said wife, or the child of mine for whom the separate trust was established, or his or her surviving spouse or descendants if such child

PLR-161035-01

shall predecease my said wife, as my Trustees shall decide in their sole and absolute discretion.

It has been represented that there have been no additions (actual or constructive) to the Trusts since their inception.

The following rulings have been requested:

1. The proposed modification will not cause the Trusts or any such resulting trusts to be subject to GST tax.
2. The proposed modification will not cause the Internal Revenue Service to alter its earlier ruling that Spouse, in her capacity as a co-trustee, does not hold a general power of appointment under section 2041 or section 2514 of the Internal Revenue Code over the income or accumulated income of the Trusts.

#### RULINGS 1 - LAW and ANALYSIS:

Section 2601 imposes a tax on each generation-skipping transfer made by a transferor to a skip person.

Under section 1433(a) of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under section 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under section 2038 or 2042, if the settlor had died on September 25, 1985.

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 will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of section 1001.

Sections 26.2601-1(b)(4)(i)(D)(1) and (2) provide that a modification 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

PLR-161035-01

(as defined in section 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 will not result in the shift of a beneficial interest to a lower generation beneficiary if the modification does not result in an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer.

In the present case, Item IV, Paragraph A, Section 1 of Trust will be modified to provide for the distribution from each Trust of the greater of the income or an amount not to exceed 5 percent of the market value of the Trust, as determined on the first day of the calendar year. This modification will not result in a shift in beneficial interest to a beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification, nor extend the time for vesting of any beneficial interest in the Trusts beyond the period originally provided for under the terms of the Trusts. See section 26.2601-1(b)(4)(i)(E), Example 8. Accordingly, based on the facts submitted and the representations made, the proposed modification will not cause the Trusts or any resulting trust to lose their exempt status for purposes of the GST tax under section 2601.

#### RULING 2 - LAW and ANALYSIS:

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has at the time of 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 that 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 sections 2035 to 2038, inclusive.

Section 2041(b)(1)(A) provides that a general power of appointment is a power that is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate. However, a power to consume, invade, or appropriate property for the benefit of the decedent that is limited to the health, education, support, or maintenance of the decedent is not deemed to be a general power of appointment. Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, is considered a release of the power.

Section 2514(b) provides that, for gift tax purposes, the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing the power.

Section 2514(c)(1) provides the term "general power of appointment" means a power that is exercisable in favor of the individual possessing the power (possessor), his estate, his creditors, or the creditors of his estate. However, a power to consume,

PLR-161035-01

invade, or appropriate property for the benefit of the possessor that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor is not a general power of appointment.

Section 2514(e) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of the power to the extent that the property that could have been appointed by exercise of the lapsed power during the calendar year exceeds the greater of \$5,000 or 5 percent of the aggregate value of the assets out of which the exercise of the lapsed powers could be satisfied.

Section 25.2514-3(c)(4) provides that, if a trustee has, in his capacity as trustee, a power that is considered a general power of appointment, the trustee's resignation or removal as trustee will be considered a lapse of his power for purposes of section 2514(e).

Statute, section (A) provides that unless the governing instrument conferring the powers specifically refers to Statute and states that Statute does not apply and except as provided in divisions (B), (C), and (D) of this section, any of the following powers conferred upon a fiduciary by the governing instrument cannot be exercised by the fiduciary: (1) the power to make any discretionary distribution of either principal or income to or for the benefit of the fiduciary in the fiduciary's individual capacity; (2) the power to make any discretionary distribution of either principal or income to satisfy any of the fiduciary's legal obligations in the fiduciary's individual capacity for support or other purposes; (3) the power to make any discretionary distribution of either principal or income to or for the benefit of one or more beneficiaries to the extent that the fiduciary would or could receive a similar distribution in the fiduciary's individual capacity under any governing instrument from the beneficiary or beneficiaries acting as a fiduciary; (4) the power to make any discretionary distribution of either principal or income to or for the benefit of one or more beneficiaries who possess both the right to remove the fiduciary and the right to appoint a successor fiduciary, if the successor fiduciary has been appointed by the exercise of both of those rights by the beneficiary or beneficiaries.

Statute, section (B)(1) provides that if division (A)(1), (3), or (4) of this section prohibits a fiduciary from exercising any power conferred by the governing instrument, the fiduciary, notwithstanding division (A)(1), (3), or (4) of this section, may exercise the power to the extent set forth in the governing instrument, provided that the exercise of that power, in all events, shall be limited to an ascertainable standard.

Statute, section (E) provides that Statute does not apply to any of the following: (1) any purely discretionary power to distribute either principal or income to or for the benefit of a beneficiary, other than a beneficiary who is also a fiduciary, that is exercisable in a fiduciary capacity in the sole and absolute discretion of the fiduciary and without any other direction or limitation as to its exercise or use set forth in the governing

PLR-161035-01

instrument; (2) any power of appointment or withdrawal that specifically is granted in the governing instrument to a beneficiary and that is exercisable in an individual capacity but not in a fiduciary capacity.

In this case, the proposed modification will not cause the Internal Revenue Service to alter the ruling issued on Date 1 that Spouse, in her capacity as a co-trustee of the Trusts, does not hold a general power of appointment under section 2041 or 2514 over the income or accumulated income of the Trusts.

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. Specifically, we are not ruling on the gift tax and income tax consequences of the proposed modification. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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.

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

Sincerely,  
James F. Hogan  
Senior Technician Reviewer, Branch 9  
(Passthroughs and Special Industries)

Enclosure  
Copy for section 6110 purposes