

## Internal Revenue Service

Number: **200604026**

Release Date: 1/27/2006

Index Number: 2601.03-01, 2041.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-154518-04

Date: SEPTEMBER 23, 2005

In Re:

### LEGEND:

Husband	=
Wife	=
Child 1	=
Child 2	=
Trust	=
Date 1	=
Date 2	=
Date 3	=
Foundation 1	=
Foundation 2	=
<u>a</u>	=
<u>b</u>	=
<u>c</u>	=
<u>d</u>	=
<u>e</u>	=
<u>f</u>	=

Dear :

This is in response to your letter of October 1, 2004, concerning the generation-skipping transfer tax (GST) consequences of certain amendments made to the Trust.

You have requested the following rulings:

1. The amendments to Trust do not shift a beneficial interest in 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 under section 26.2601-1(b)(4)(i)(D) of the Generation-Skipping Transfer Tax Regulations.

2. The amendments to Trust are not constructive additions to Trust because they constitute a release or lapse of a non-general power of appointment over a GST exempt trust and will not result in the loss of its exempt status.

The facts submitted are as follows:

On Date 1 (before September 25, 1985), Trust was created with Wife as grantor and Husband as trustee.

Article 2.1 provides that Trust is to terminate on the earlier of the deaths of both Husband and Wife or Date 3. Trust is to be liquidated as soon as possible after termination and trust assets, including any undistributed income, are to be distributed. Article 2.2 provides that Trust is irrevocable.

Article 3.1 provides that the trustee may pay or accumulate such amounts of income or principal to Child 2 as he may determine in his sole discretion. However, no successor trustee may distribute more than 25 percent of the corpus within any calendar year.

Article 3.2 provides that Husband may by will appoint the corpus of the trust estate not including accumulated income to the date of his death to such beneficiaries as he may select that will not include his estate or the creditors of his estate. In the event that he fails to exercise the special power of appointment, the trust estate is to be distributed according to the terms of Trust.

Article 3.3 provides that upon termination of the trust, the trust estate is to be distributed to Child 2. If Child 2 dies prior to the expiration of the term of Trust, the trust estate is to be distributed to Child 2's surviving issue per stirpes. If Child 2 leaves no issue surviving the residue of trust is to be distributed to Child 2's brothers and sisters and the issue of any then deceased brother or sister per stirpes. If a beneficiary is under the age of 25, the trustee is to distribute 50 percent of his share at the age of 25, and the remainder is to be distributed at age 30. If the issue has attained either of such ages at the time his share is established, the trustee is to make immediate distribution to the issue for whom it is held of that portion. Until final distribution of a share is made, the trustee is to pay to the issue for whom it is held such amounts of income and principal from his share necessary for his maintenance, welfare and education to maintain his standard of living.

Article 3.3 further provides that all interests are to become indefeasibly vested 21 years after the death of Wife's last surviving child and distribution is to be according to the above provisions. If a beneficiary in whom an interest has been indefeasibly vested dies before his share has been distributed, his share is to be distributed to his estate.

On Date 2, Trust was amended and restated. Article 2.1 of the amended Trust provides that the trustee is to distribute the following amounts to Child 2: \$a at age 30, \$b at age 35, \$c at age 40, \$d at age 45, \$e at age 50, and \$e at age 55.

Article 2.2 provides that if Child 2 does not survive the payment dates but leaves lineal descendants, the payments mandated in Article 2.1 are to continue to be made as if Child 2 has survived, will be divided into equal separate shares, and will be distributed to Child 2's lineal descendants by right of representation. The share of any lineal descendant then under age 40 will continue to be held in trust in accordance with the following:

(A) The trustee is to distribute to each lineal descendant for whom a separate share is established those amounts of income and principal that are necessary for the health, education, support, and maintenance of the lineal descendant to enable the lineal descendant to maintain the standard of living to which he or she has become accustomed. The trustee also may distribute to each lineal descendant for whom a separate share is established those amounts of income and principal that the trustee, in its sole discretion, considers advisable for any other purpose.

(B) The trustee is to distribute to each lineal descendant for whom a separate share is established one-fourth of the then remaining corpus of the separate share when the lineal descendant reaches age 25, one-third of the then remaining corpus of the separate share when the lineal descendant reaches age 30, one-half of the then remaining corpus of the separate share when the lineal descendant reaches age 35, and the balance of the corpus of the separate share when the lineal descendant reaches age 40.

(C) If a lineal descendant for whom a separate share has been established does not survive the payment dates, the payments will be paid to the deceased lineal descendant's lineal descendants by right of representation.

(D) If a lineal descendant for whom a separate share has been established does not survive the payment dates and does not leave lineal descendants, the payments will be paid to the deceased lineal descendant's siblings in equal shares by right of representation.

(E) If a lineal descendant for whom a separate share has been established does not survive the payment dates and leaves neither lineal descendants nor siblings, the payments will be paid to Child 1, or to Child 1's lineal descendants by right of

representation if Child 1 is not then living, until a total of \$f has been paid from Trust to any beneficiaries. At such time as the trust has distributed \$f, the separate share established for the deceased lineal descendant will terminate.

Article 2.3 provides that notwithstanding paragraph 2.2, Child 2 may, by her will, appoint from among his lineal descendants the beneficiaries to whom payments are to be made from the trust after Child 2's death, the portions that each are to receive, and the times for payments, in which case the trustee is to make payments to Child 2's lineal descendants as designated by Child 2 in Child 2's will, subject to the provisions of Article 2.2(E).

Article 2.4 provides that in the event that Child 2 does not survive the payment dates and does not leave lineal descendants, the trustee is to pay to Child 1, or to Child 1's surviving lineal descendants if Child 1 is not then living, the payments mandated by Article 2.1, until a total of \$f has been paid from Trust to any beneficiaries. At such time as Trust has paid \$f, the Trust is to terminate.

Article 2.5 provides that the Trust is to terminate upon the final payment under Article 2 to Child 2 or Child 2's lineal descendants or Child 1 or Child 1's lineal descendants.

Article 2.6 provides that upon termination of Trust or of any separate share of Trust, any property remaining in Trust or the terminated separate share will be distributed to Foundation 1; provided, however, that if that foundation is not then in existence, the property will be distributed to Foundation 2, provided that Foundation 2 qualifies under section 501(c)(3) of the Internal Revenue Code.

Article 2.7 provides that if there remains in the hands of the trustee any part of the trust estate for which there is no named or described beneficiary, such part will be distributed to Foundation 1; provided, however, that if that foundation is not then in existence, the property will be distributed to Foundation 2, provided that Foundation 2 qualifies under section 501(c)(3) of the Internal Revenue Code.

## LAW AND ANALYSIS

### Rulings 1 and 2

Section 2041(a)(2) of the Internal Revenue Code 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, the property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive. For purposes of section 2041(a)(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.

Section 2041(b)(1) provides that a general power of appointment is a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. Under section 2041(b)(1)(A), a power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not a general power of appointment.

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

Under section 1433(a) of the Tax Reform Act of 1986 (Act) and section 26.2601-1(a), 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), 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). 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 section 2042, if the settlor had died on September 25, 1985.

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 chapter 13 by reason of section 26.2601-1(b)(1), 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)(A) provides that, except as provided under section 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

Section 26.2601-1(b)(1)(v)(B) provides a special rule for certain powers of appointment. This section provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in section 2041(b))

will not be treated as an addition to the trust if -- (1) such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under section 26.2601-1(b)(1), and (2) in the case of an exercise, such power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of twenty-one years.

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 generation-skipping transfer 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 generation-skipping transfer 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.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (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 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 generation-skipping transfer or the creation of a new generation-skipping 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, the original trust provided for Child 2 (or Child 2's lineal descendants if Child 2 does not survive) to receive the assets of Trust upon termination of the Trust, the earlier of the deaths of both Husband and Wife or Date 3, subject to Husband's special power of appointment. Under the modified Trust provisions, Child 2 (or Child 2's lineal descendants if Child 2 does not survive) will receive specified payments when Child 2 reaches the ages provided in Article 2.1. Upon termination, the remaining property of Trust will be distributed to Foundation 1 (or Foundation 2 if Foundation 1 is not then in existence). Accordingly, based on the facts submitted and representations made, we conclude that the amendments to Trust do not shift a beneficial interest in 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.

Further, under Trust's original provisions, Husband had a testamentary special power of appointment that could be exercised in favor of beneficiaries other than his estate or the creditors of his estate. The Date 2 amendments to Trust caused Husband's power of appointment to lapse. The special power of appointment was created in an irrevocable trust that is not subject to chapter 13. Accordingly, based on the facts submitted and representations made, we conclude that amendments to Trust are not constructive additions to Trust because they constitute a lapse of a non-general power of appointment over a GST exempt trust and will not result in the loss of its GST exempt status.

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

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(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

---

Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes