

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:04 – PLR-127676-04

Date: SEPTEMBER 22, 2004

Re:

Legend

Decedent =

Son =

Grandchild 1 =

Grandchild 2 =

Trust =-----

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Bank =

State =

State Court =

State Law 1 =

State Law 2 =

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Dear _____ :

This is in response to your letter dated May 18, 2004, concerning the estate tax and generation-skipping transfer (GST) tax consequences of a proposed modification of Trust and the appointment of a successor trustee.

The facts and representations submitted are summarized as follows: On Date 1, prior to September 26, 1985, Decedent established an irrevocable trust, Trust, for the benefit of Decedent's granddaughter, Grandchild 1. Trust is administered under the laws of State. Decedent's son, Son, was the initial trustee of Trust.

Pursuant to Paragraph 4 of Trust, the trustee is to pay so much of the net income and principal of the trust estate to Grandchild 1 as, in the sole discretion of trustee, is necessary for Grandchild 1's support, education and medical care. Any unexpended balance of income is to be accumulated and added to principal until the termination of Trust.

Upon the death of Grandchild 1, Trust shall terminate and the trustee is to distribute the trust estate pursuant to Son's exercise of a limited power to appoint the trust corpus among Decedent's issue (other than Son). In the absence of an appointment by Son disposing of the entire trust estate, the unappointed portion is to be distributed pursuant to Grandchild 1's exercise of a testamentary limited power to appoint the trust corpus among Decedent's issue. However, Grandchild 1 may not appoint the trust property to Grandchild 1, her estate, her creditor or her spouse. In the absence of such appointment completely disposing of the trust estate, the unappointed portion shall be distributed, free of trust, to the then living issue of Grandchild 1, by right of representation.

Paragraph 10 of Trust provides that Son may resign as trustee without leave of court at any time and for any reason by giving written notification to Grandchild 1. Son may appoint, by written notification, any person or corporation qualified to act as trustee in State to act as his successor if for any reason he fails to act as trustee. If Son fails to appoint a successor to act in his place, then Bank shall act as trustee. No successor trustee has the right to appoint a successor.

By an instrument dated Date 2, Son appointed Grandchild 2 as successor trustee of Trust in the event that Son failed or ceased to act as trustee. The instrument further provided that if Grandchild 2 fails or ceases to act as trustee, Son appoints as successor trustee, the individual or corporation, or series thereof, as may be designated in writing by Grandchild 2. Son died on Date 3 and Grandchild 2 accepted his appointment as trustee on Date 4.

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Grandchild 2 has resigned as trustee of Trust effective upon the court acceptance of his resignation and appointment of a successor trustee.

On or about Date 5, Grandchild 1 petitioned State Court requesting that the court instruct the trustee of Trust that whenever any current beneficiary of Trust is acting as trustee:

...such person shall exercise the trustee's discretionary distribution powers (set forth in paragraphs 4(a) and 4(b) of the Trust) only for such his or her support, education and medical care within the meaning of sections 2041 and 2514 of the Internal Revenue Code of 1986, as amended.

Grandchild 1 further requested State Court to accept the resignation of Grandchild 2 and to modify Paragraph 10 of Trust to appoint successor trustees in the following order of priority: Grandchild 1; then any person designated by written instrument signed by Grandchild 1; then Bank. Bank, as the current successor trustee named in Paragraph 10, has consented to the proposed State Court order changing the trustee succession. In a written instrument dated Date 6, Grandchild 1 consented to act as trustee of Trust.

State Law 1 provides that if the vacancy in the office of the trustee is not filled as provided in subdivision (b) or (c) of State Law 1, on petition of any interested person or any person named as trustee in the trust instrument, the court may, in its discretion, appoint a trustee to fill the vacancy. If the trust provides for more than one trustee, the court may, in its own discretion, appoint the original number or any lesser number of trustees. In selecting a trustee, the court shall give consideration to any nomination by the beneficiaries who are 14 years of age or older.

State Law 2 provides, in part, that if a trust instrument confers "absolute," "sole," or "uncontrolled" discretion on a trustee, the trustee shall act in accordance with fiduciary principles and shall not act in bad faith or in disregard of the purposes of the trust. Moreover, notwithstanding the use of terms like "absolute," "sole," or "uncontrolled" by a settlor or a testator, a person who is a beneficiary of a trust that permits the person, either individually or as trustee or cotrustee, to make discretionary distributions of income or principal to or for the benefit of himself or herself pursuant to a standard, shall exercise that power reasonably and in accordance with the standard. State Law 2 further provides that unless a settlor or a testator clearly indicates that a broader power is intended by express reference to this subdivision, a person who is a beneficiary of a trust that permits the person, as trustee or cotrustee, to make discretionary distributions of income or principal to or for the benefit of himself or herself may exercise that power in his or her favor only for his or her health, education,

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support, or maintenance within the meaning of sections 2041 and 2514 of the Internal Revenue Code.

Trust was irrevocable on September 25, 1985. It is represented that no actual or constructive additions have been made to Trust after that date.

You have requested the following ruling requests:

- (1) The issuance of instructions, as contained in the petition, regarding the trustee's power to make discretionary distributions when the beneficiary is acting as trustee, will not cause Trust to lose its GST exempt status.
- (2) The appointment of a successor trustee, in accordance with the petition, will not cause Trust to lose its GST exempt status.
- (3) The appointment of Grandchild 1 as successor trustee will not create a general power of appointment and cause the Trust's corpus and any undistributed income of Trust to be included in Grandchild 1's gross estate.

Issues 1 and 2

Section 2601 imposes a tax on every generation-skipping transfer made by a "transferor" to a "skip person". In general, under section 2652(a)(1) and section 26.2652-1(a)(1) of the Generation-Skipping Transfer (GST) Tax Regulations, the transferor for GST tax purposes is the last person with respect to whom the property was subject to the estate or gift tax.

Under section 1433(a) of the Tax Reform Act of 1986, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Tax Reform Act and section 26.2601-1(b)(1)(i) of the regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985. The rule does not apply to the extent additions (actual or constructive) were made to the trust after that date. Further, this rule does not apply to a transfer of property after September 25, 1985, pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer for estate or gift tax purposes. 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 chapter 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)(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 under section 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in section 26.2601-1(b)(4) are, except as otherwise noted, applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not generally 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)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy section 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, 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 (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.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of section 26.2601-1(b)(4)(i)(D)(1), 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 GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a 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. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 10, involves a situation where in 1980, Grantor executed an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. 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

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generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, 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. Therefore, the trust will not be subject to the provisions of chapter 13 of the Internal Revenue Code.

In this case, Trust was irrevocable on September 25, 1985. It is represented that no additions have been made to Trust after that date. Grandchild 1 petitioned State Court to instruct the trustee, in the event that the beneficiary of Trust is acting as trustee, that such person shall exercise the trustee's discretionary distribution powers only to provide for the beneficiary's support, education and medical care. State Law 2 establishes that a trust beneficiary, who is also a trustee, can only make distributions to himself or herself based on an ascertainable standard relating to health, education, support, and maintenance, as provided in sections 2041 and 2514 of the Code.

Based upon the information submitted and the representations made, the issuance of instructions regarding the trustee's power to make discretionary distributions when the beneficiary is acting as trustee is consistent with the terms of the instrument and applicable State law. Therefore, the instructions would not result in any shift of a beneficial interest in Trust to a person or persons who occupy a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification. Further, State Court's instructions will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for prior to the modification. Therefore, based upon the information submitted and representations made, we conclude that the proposed modification to Trust will not constitute an addition to Trust, or otherwise subject Trust, or distributions from Trust to the GST tax. Accordingly, assuming State Court orders the issuance of instructions regarding the trustee's power to make discretionary distributions when the beneficiary is acting as trustee, such instructions will not cause Trust to lose its GST exempt status.

Grandchild 1 also petitioned State Court to modify Paragraph 10 of Trust to provide for a new succession of trustees in the following order of priority: Grandchild 1; then any person designated by written instrument signed by Grandchild 1; then Bank. State Law 1 provides that an interested person may petition the court, in its discretion, to appoint successor trustees. Based upon the information submitted and the representations made, the proposed modification of Paragraph 10 is administrative in nature and does not shift a beneficial interest in Trust to a person or persons who occupy a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification. Further, the modification will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for prior to the modification. Therefore, the modification will not cause Trust to lose its exempt status for GST tax purposes. Further, as discussed below, the appointment of Grandchild 1 as trustee of Trust will not result in Grandchild 1 possessing a general

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power of appointment over Trust corpus and income for purposes of section 2041. Accordingly, the appointment of Grandchild 1 as trustee of Trust will not constitute an addition to Trust, or otherwise subject Trust, or distributions from Trust to the GST tax. Moreover, assuming State Court orders the appointment of successor trustees as petitioned, the modification to Paragraph 10 of Trust or the appointment of Grandchild 1 as trustee, will not cause Trust to lose its GST exempt status.

Issue 3

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property with respect to which the decedent has at the time of his 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 which 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.

A general power of appointment is defined in section 2041(b)(1) as a power which 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 relating to the health, education, support, or maintenance of the decedent shall not be considered a general power of appointment.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that if a trust instrument provides that the beneficiary may appropriate or consume the principal of the trust, the power to consume or appropriate is a power of appointment. However, the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no interest therein except as an incidental consequence of the discharge of such fiduciary duties is not a power of appointment.

Section 20.2041-1(c)(1) provides, in part, that the term "general power of appointment" as defined in section 2041(b)(1) means any power of appointment exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, except: (i) joint powers, to the extent provided in sections 20.2041-2 and 20.2041-3; and (ii) certain powers limited by an ascertainable standard, to the extent provided in section 20.2041-1(c)(2). A power of appointment exercisable for the purpose of discharging a legal obligation of the decedent or for his pecuniary benefit is considered a power of appointment exercisable in favor of the decedent or his creditors.

Section 20.2041-1(c)(2) provides that a power to consume, invade, appropriate income or corpus, or both, for the benefit of the decedent which is limited by an

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ascertainable standard relating to the health, education, support, or maintenance of the decedent is, by reason of section 2041(b)(1)(A), not a general power of appointment. A power is limited by such a standard if the extent of the holder's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, the words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living," "education, including college and professional education," "health," and "medical, dental, hospital and nursing expenses and expenses of invalidism." In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

Section 2514 provides for a similar definition of a general power of appointment for gift tax purposes, and section 25.2514-1(c)(2) of the Gift Tax Regulations contains provisions similar to section 20.2041-1(c)(2). Section 2514(b) provides that 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 such power.

In the present case, the appointment of Grandchild 1 as trustee of Trust will not cause Grandchild 1, as a beneficiary of Trust acting as trustee, to possess a general power of appointment over Trust. Grandchild 1's power, as trustee, to distribute net income and principal from Trust to herself, is limited by an ascertainable standard relating to health, maintenance, support and education, under the terms of the Trust instrument and State laws. Accordingly, pursuant to sections 20.2041-1(c)(2) and 25.2514-1(c)(2), Grandchild 1, as successor trustee, will not possess a general power of appointment that will cause the corpus and any undistributed income of Trust to be included in Grandchild 1's gross estate under section 2041. See, Rev. Rul 78-398, 1978-2 C.B. 237.

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. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code 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

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In accordance with the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

George L. Masnik
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter