

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4/ PLR-119091-99

Date:

October 25, 2000

Re:

Legend:

Decedent	=
Spouse	=
Son	=
Daughter	=
Child 1	=
Spouse 1	=
Child 2	=
Spouse 2	=
Child 3	=
Spouse 3	=
Cousin	=
State X	=
State X Court	=
State X law	=
Cite 1	=
Cite 2	=
Trust	=
Trust Company	=
Date 1	=
Date 2	=
Date 3	=
Year 1	=
Year 2	=
State X real property	=

Dear :

This is in response to your letter dated November 29, 1999, and subsequent correspondence, requesting rulings under §§ 2041, 2514, and 2601 of the Internal Revenue Code concerning a proposed division of Trust and the modification of the fiduciary succession provisions contained in Trust.

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Decedent died testate, a resident of State X. Pursuant to Article Fifth of Decedent's will, Decedent's residuary estate was distributed to a residuary trust (Trust) to be held for the benefit of Spouse and Decedent's children. Article Fifth designates Son as trustee of Trust.

Article Fifth, Section 1 of Decedent's will provides that the trustee is to pay all of the net income of Trust to Spouse during her lifetime. Pursuant to Article Fifth, Section 2, upon the death of Spouse, one-half of the Trust estate is to be distributed outright to Son, if living, or to Son's issue, if Son predeceases Spouse.

Article Fifth, Section 3 provides that the residue of the Trust estate, after the distribution of one-half of the Trust estate to Son or Son's issue pursuant to Article Fifth, Section 2, is to be retained in Trust. The trustee is to pay the net income of Trust to Daughter for her care, maintenance, and support during Daughter's lifetime. Upon Daughter's death, the trustee is directed to divide the Trust estate into equal shares (to be administered as separate trusts without being required to make a physical segregation of the trust estate), one share to be held for the benefit of each child of Daughter then living and one share for each deceased child of Daughter with issue then living. The trustee is to pay the net income from each trust share to the beneficiary or beneficiaries of such trust "for his or her proper care, maintenance and support, or education."

Each trust established pursuant to Article Fifth, Section 3(b) is to terminate as a whole or as to a beneficiary's interest in such trust upon the death of such beneficiary.

Article Fifth, Section 4 states, generally, that upon the termination of a trust as to the whole or any part of the trust share, the trustee is to pay and distribute such trust share, and any undistributed net income attributable to such trust share, to the person designated in Decedent's will to receive such share, "or to the issue of the beneficiary or beneficiaries thereof, if then living by right of representation; but if there should be no such issue then living then to my issue then living, by right of representation; . . ."

Article Fifth, Section 5 states that, in any event, all trusts created pursuant to Decedent's will shall terminate upon the death of the survivor of Spouse and the issue of Decedent and Spouse who are living at the time of Decedent's death.

Article Fifth, Section 7 states that:

If at any time, or from time to time, in the judgment of the trustee, further funds are needed to provide for the comfortable maintenance or support of [Spouse] or for the comfortable maintenance, support or education of [Daughter] or her issue, to preserve the health of or to provide necessary medical or similar service for them, or any of them, or to meet emergencies, due consideration being given to the income and other resources which

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may then be available to such person or persons and which shall be known to the trustee, the trustee is hereby authorized and empowered to pay to or for the benefit of my said wife or child, or [Daughter's issue], as the case may be, out of the principal of the Trust estate, whether or not such beneficiary is at the time receiving or entitled to receive income hereunder (but after my wife's death only out of the trust estate which has been set aside for such beneficiary or for his or her ancestor), such sum or sums as the trustee may deem necessary or desirable for the purpose of affording the assistance or relief of which such person or persons may be in need. The trustee shall be the sole and final judge of any such necessity and of the amounts required for the purpose. The decision of the trustee made in good faith to make or not to make any such payments shall be final and incontestable by anyone, and no amounts so paid out need thereafter be restored to the principal of the trust estate. Nothing contained in this paragraph shall create any legal or equitable rights in any person or persons whatsoever.

Article Fifth, Section 15 of Decedent's will provides that in the event Son is deceased, or unable, or fails, or refuses to act as, or ceases to be trustee, then Decedent appoints Trust Company, or its successor, as substitute trustee with the same duties and powers to act in Son's place.

It is represented that Spouse died survived by Son and Daughter. Subsequently, Daughter died in Year 1, survived by three children (Child 1, Child 2, and Child 3), and Son died in Year 2. Pursuant to the terms of the Article Fifth, Section 3 of Decedent's will, the Trust is currently administered as three shares, one share for each of Child 1, Child 2 and Child 3. The trustee is required to pay to Child 1, Child 2, and Child 3 the net income from the share set aside for such child for his or her proper care, maintenance and support, or education. Additionally, the trustee may make discretionary distributions of principal in certain circumstances, as described in Article Fifth, Section 7, to Child 1, Child 2, and Child 3, or their respective issue, from the share set aside for such child's benefit.

Son served as the sole trustee from the creation of Trust on Date 1 until his death in Year 2. Trust Company declined to serve as successor trustee. On Date 2, Cousin was appointed successor trustee by order of State X court.

It is represented that there have been no additions of property to Trust, either actual or constructive, since Date 1. The Trust corpus currently consists of State X real property and publicly traded securities.

On Date 3, State X Court issued an order modifying Trust, contingent on receipt of a favorable ruling from the Internal Revenue Service. Pursuant to the court order:

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(1) Each separate share of Trust will be divided into a separate trust, one trust for the benefit of each of Child 1, Child 2, and Child 3. Each new trust will continue to be administered pursuant to the terms of Trust, except for the modifications discussed below.

(2) Article Fifth, Section 15 of Trust providing for trustee succession is deleted in its entirety and replaced with a new provision. Under the new provision, Child 1 shall act as trustee of the trust for his benefit and may designate successor trustees. If Child 1 and all his designees fail or cease to act as trustee, his spouse, Spouse 1, shall act as successor trustee. Child 2 shall act as trustee of the trust for her benefit and may designate successor trustees. If Child 2 and all her designees fail or cease to act as trustee, her spouse, Spouse 2, shall act as successor trustee. Finally, Child 3 shall act as trustee of the trust for her benefit and may designate successor trustees. If Child 3 and all her designees fail or cease to act as trustee, her spouse, Spouse 3, shall act as successor trustee.

(3) Article Fifth, Section 7 of Trust will be modified by adding the following paragraph to such section: "Anything in this paragraph to the contrary notwithstanding, no trustee of any trust under this instrument may make any distribution of trust property that would relieve any legal obligation of support owed by such trustee."

In addition, the court order affirms that each separate trust will remain subject to the law of State X. However, because each beneficiary will be the trustee of the trust for his or her own benefit, the court order provides that each trust will be removed from continuing court supervision.

You have requested the following rulings:

(1) The modifications to Trust will not constitute the grant of a general power of appointment under §§ 2041 and 2514 to Child 1, Child 2 or Child 3 with respect to the resulting trusts established for the benefit of each beneficiary; and

(2) The modifications to Trust will not cause Trust or the three resulting trusts to lose status under Section 1433 of the Tax Reform Act of 1986 as exempt from the generation-skipping transfer tax under Chapter 13 of the Code.

Law and Analysis

Ruling Request #1

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

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decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b) provides that the term general power of appointment means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that:

(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 deemed a general power of appointment.

(B) A power of appointment created on or before October 21, 1942, which is exercisable by the decedent only in conjunction with another person shall not be deemed a general power of appointment.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides that if under the terms of a trust instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and the decedent has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, the decedent is considered as having a power of appointment.

Section 20.2041-1(c)(1) states that the term "general power of appointment" as defined in § 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 §§ 20.2041-2 and 20.2041-3, and (ii) certain powers limited by an ascertainable standard, to the extent provided in § 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 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,"

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“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(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. The definition of a general power of appointment under § 2514(c) is the same as provided in § 2041(b). Section 25.2514-1(c)(2) of the Gift Tax Regulations contains provisions similar to § 20.2041-1(c)(2), discussed above.

In determining whether property subject to a power is limited within the meaning of § 2041, the test is the measure of control over the property by virtue of the grant of power; i.e., whether the exercise of the power is restricted by definite bounds. To satisfy this test, the amount of property that could be consumed for the benefit of the donee need not be measurable or predictable. Rather, the test under § 2041 is the breadth of the power granted. See Strite v. McGinnes, 330 F.2d 234 (3rd Cir. 1964), cert. denied, 379 U.S. 836 (1964); Lanigan v. Commissioner, 45 T.C. 247 (1965).

Although the federal statute controls in determining how the powers and rights possessed by an individual are taxed, state law prevails in determining the nature and extent of the powers and rights possessed by such persons. See Morgan v. Commissioner, 309 U.S. 78 (1940), 1940-1 C.B. 229. Thus, whether a person's power is limited by an ascertainable standard relating to health, education, support or maintenance is a matter of state law.

State X law provides that notwithstanding the use of the terms like ‘absolute,’ ‘sole,’ or ‘uncontrolled’ by a settlor or 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. Cite 1.

In addition, State X law provides that, unless a testator specifically provides otherwise by referring directly to State X law, 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, support, or maintenance within the meaning of §§ 2041 and 2514. This provision applies to any trust created under a document executed before January 1, 1997, or any revocable trust executed before that date if the settlor was incapacitated as of that date, unless all parties in interest elect affirmatively not to be subject to such provision through a written instrument delivered to the trustee. That election shall be made on or before the latest of January

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1, 1998, three years after the date on which the trust became irrevocable, or in the case of a revocable trust where the settlor was incapacitated, three years after the date on which the settlor became incapacitated. Cite 2.

In this case, Child 1, Child 2 and Child 3, as trustee of his or her respective trust, will have the power to distribute principal, in the Child's sole discretion, to or for the benefit of himself or herself pursuant to the terms of Article Fifth, Section 7 of Decedent's will. However, under the instrument as modified, no trustee of any trust may make any distribution of trust property that would relieve any legal obligation of support owed by such trustee. In addition, under State X law, unless a testator specifically provides otherwise, a beneficiary of a trust who is permitted as trustee to make discretionary distributions 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, support, or maintenance within the meaning of §§ 2041 and 2514. It is represented that the parties in interest with respect to Trust did not elect to opt out of this statutory provision with respect to Trust. Accordingly, since under the court order, the trusts resulting from the division of Trust continue to be subject to the law of State X, the modification of Trust appointing each Child as trustee of the separate trust created for his or her benefit, and granting the Child the power to designate the successor trustees of such trust, will not constitute the grant of a general power of appointment under §§ 2041 and 2514 to Child 1, Child 2, or Child 3.

Ruling Request #2

Section 2601 provides that a tax is imposed on every generation-skipping transfer. Section 2611 defines the term "generation-skipping transfer" to mean a taxable termination, a taxable distribution, or a direct skip.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act), 1986-3 (Vol. 1) C.B. 1, and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the GST tax provisions of Chapter 13 will not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of principal added to the trust after September 25, 1985 (or out of income attributable to principal so added).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(ii)(B) or (C) (relating to property includible in a grantor's gross estate under §§ 2038 and 2042). The existing trust in this case is irrevocable because neither § 2038 nor § 2042 apply under the facts of this case.

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust that is otherwise exempt from the application of Chapter 13 by § 1433(b)(2)(A) of the Act, 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) describes "constructive"

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additions to trusts in certain situations involving powers of appointment and relief from liability.

In general, modifications that change the quality, value, or timing of any of the powers, beneficial interests, rights, or expectancies originally provided for under the terms of a trust will cause an exempt trust to lose its exempt status.

In this case, we conclude that based on the facts presented and the terms of Trust, and because the trusts resulting from the division of Trust continue to be subject to the law of State X, the modifications to Trust as described above will not change the quality, value, or timing of any of the beneficial interests, rights, or expectancies provided for under the terms of Trust. Accordingly, we rule that the modifications pursuant to the court order will not cause Trust or the three separate trusts to lose status as exempt from the application of the generation-skipping transfer tax imposed under § 2601.

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.

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 taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,
GEORGE MASNIK
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure (1)
Copy for section 6110 purposes