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Department of the Treasury  
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Person To Contact: \_\_\_\_\_, ID No. \_\_\_\_\_

Telephone Number:

Refer Reply To:  
CC:PSI:04  
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### Legend

Settlor =  
Trust =  
Taxpayer =

Date 1	=
Date 2	=
Child 1	=
Child 2	=
Child 3	=
Brother	=
<u>x</u>	=
<u>y</u>	=
State 1	=
State 2	=
Citation1	=
Citation 2	=
Citation 3	=
Citation 4	=
Citation 5	=
Citation 6	=
Citation 7	=
Citation 8	=
Citation 9	=

Dear \_\_\_\_\_ :

This is in response to your letter dated March 24, 2005, and other correspondence, concerning the modification of Trust.

The facts and representations submitted are summarized as follows: Settlor established Trust, an irrevocable trust, on Date 1, with amendment dated Date 2. Both dates are prior to September 25,                      Property transferred to Trust included personal and real property.

Paragraph FOURTH of Trust provides that upon the death of Settlor, the trust estate shall be divided into x shares.

Paragraph NINTH provides that y portion of Settlor's estate shall be retained in trust for Taxpayer during her lifetime. The trustee shall pay to Taxpayer the net income of the trust estate in installments convenient to the trustee, but in no event less often than quarter annually. In addition, the trustee shall pay to or for the benefit of Taxpayer such sums from principal as the trustee, in his sole discretion, shall deem reasonable, necessary, or advisable for her care, maintenance and support, after taking into consideration funds available for such purposes from other sources.

Paragraph TENTH, as amended, provides that upon the death of Taxpayer, the trust estate shall be divided to provide an equal fund for Child 1, Child 2, and Child 3, the issue of Taxpayer living at the time of the creation of Trust.

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

Brother, the current sole trustee, intends to resign as trustee of Trust and appoint Taxpayer as successor trustee. Trust is silent as to the appointment of a successor trustee. Trustee represents that he will obtain consents from each Trust beneficiary who has a present and cognizable future interest in the Trust consenting to the resignation of Brother as Trustee and the appointment of Taxpayer as successor trustee. Trust was executed in State 1. The initial trustees were Settlor and Brother. Brother resides in State 2. Taxpayer is the sole lifetime beneficiary of Trust. Taxpayer resides in State 2. Trust instrument is silent regarding the trust situs.

State 1 law provides that a trustee may resign after at least 30 days' notice to the qualified beneficiaries. (Citation 1). State 1 law also provides that a vacancy in a trusteeship must be filled if the trust has no remaining trustee by a person appointed by unanimous agreement of the qualified beneficiaries. (Citation 2). State 2 law provides that a trustee may resign with the consent of all adult beneficiaries who are receiving or are entitled to receive income under the trust or to receive a distribution of principal if the trust were terminated at the time consent is sought. (Citation 3). State 2 law also

provides that a vacancy in the trusteeship may be filled on petition of a beneficiary, by a court in its discretion. (Citation 4).

State 1 law provides that, unless the terms of the trust expressly provide otherwise, a person other than a settlor who is a beneficiary and trustee of a trust that confers on the trustee a power to make discretionary distributions to or for the trustee's personal benefit may exercise the power only in accordance with an ascertainable standard. (Citation 5). Ascertainable standard is defined as an ascertainable standard relating to an individual's health, education, support or maintenance within the meaning of section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code, as in effect on January 1, 2006. (Citation 6). These sections of State 1 law apply to all trusts created before, on or after January 1, 2006. (Citation 7).

State 2 law provides that unless a settlor or a testator clearly indicates that a broader power is intended by express reference to this subsection, 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 sections 2041 and 2514 of the Internal Revenue Code. (Citation 8). This section applies to any irrevocable trust created under a document executed before January 1, 1997, unless the parties in interest elect affirmatively not to be subject to the application of this section through a written instrument delivered to the trustee. (Citation 9). Date 1 is prior to January 1, 1997.

You have requested the following rulings:

(1) Taxpayer, acting as trustee of Trust, held for her benefit, will not hold a general power of appointment as defined under section 2041 or 2514.

(2) The resignation of Brother as trustee and the appointment of Taxpayer as successor trustee will not cause Trust to lose its exempt status under section 1433(b)(2)(A) of the Tax Reform Act of 1986 from the application of the generation-skipping transfer tax under chapter 13.

### Ruling 1

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 shall not be deemed 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.

Under section 20.2041-1(c)(2) of the Estate Tax Regulations, a power to consume, invade, or 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).

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by section 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

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 such power.

Section 2514(c) provides that 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, 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 power could be satisfied.

Section 25.2514-1(c)(2) of the Gift Tax Regulations provides that a power to consume, invade, or appropriate income or corpus, or both, for the benefit of the possessor of the power that is limited by an ascertainable standard relating to health,

education, support, or maintenance of the possessor is, by reason of section 2514(c)(1) not a general power of appointment.

While federal law controls what rights or interests shall be taxed after they are created, creation of legal rights and interests in property (such as the breadth and scope of a power of appointment over the corpus of a testamentary trust) is a matter of state law. United States v. Pelzer, 312 U.S. 399 (1941), 1941-1 C.B. 441; Morgan v. Commissioner, 309 U.S. 78 (1940), 1940-1 C.B. 229.

Whether State 1 or State 2 law controls in this situation has not been determined by a court of law. However, in this case, the result would be the same. Both states provide that where a trustee may make discretionary distributions of income or principal to himself or herself as beneficiary of the trust, the trustee may exercise that power in his or her favor only for his or her health, education, support, or maintenance within the meaning of sections 2041 and 2514.

Rev. Proc. 94-44, 1994-2 C.B. 683, sets forth the Service's position regarding the transfer tax consequences of the enactment of Florida Statutes Annotated section 737.402(4)(a)(1). Under this statute, any fiduciary power conferred upon a trustee to make discretionary distributions of either principal or income to or for the trustee's own benefit cannot be exercised by the trustee, except to provide for that trustee's health, education, maintenance, or support, as described in sections 2041 and 2514. The statute was effective with respect to trusts that were irrevocable on or after July 1, 1991. Pursuant to the revenue procedure, the Service will not treat the statute as causing the lapse of a general power of appointment for purposes of section 2041 and 2514, where the scope of a fiduciary power held by a beneficiary was restricted as a result of the statute.

Accordingly, we conclude that under either State 1 or State 2 law, whichever controls, if Taxpayer becomes the trustee of Trust, or any trust created under the terms of Trust, Taxpayer will not possess a general power of appointment with respect to such trust for purposes of sections 2041 and 2514, as a result of the trustee invasion power. Further, the appointment of Taxpayer as successor trustee of Trust will not cause Taxpayer to be treated as releasing a general power of appointment within the meaning of sections 2041 and 2514.

## Ruling 2

Section 2601 imposes a tax on every generation-skipping transfer, which is defined under section 2611 as a taxable distribution, a taxable termination, and a direct skip.

Section 1433(a) of the Tax Reform Act of 1986 (Act) and section 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping

transfer (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 tax does not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. This rule does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12. The transfer is made by the person holding the power at the time the exercise, release, or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985.

In Ruling 1, we concluded that Taxpayer, as successor trustee, to Trust, will not possess a general power of appointment and that her appointment as successor trustee will not cause the release or lapse of a general power of appointment within the meaning of section 2041 and 2514. Accordingly, the rules under section 26.2601-1(b)(1)(v) do not apply.

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 sections 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 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.

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)(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.

In the present case, the Trust was created and became irrevocable prior to September 25, and it has been represented that no additions, actual or constructive, have been made to Trust after that date. Accordingly, Trust is exempt from the GST tax under section 26.2601-1(b)(1).

We conclude that, assuming the beneficiaries of Trust consent to the resignation of Brother, as current trustee, and the appointment of Taxpayer, as successor trustee, and such consent renders the resignation and appointment valid under State law, then for purposes of chapter 13, the modification of Trust is an action that is administrative in nature and, accordingly, such action 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. Accordingly, based upon the information submitted and representations made, the resignation of Brother, as trustee, and the appointment of Taxpayer, as successor trustee, of Trust will not cause Trust to lose its status under section 1433(b)(2)(A) of the Tax Reform Act of 1986 as exempt from the application of Chapter 13.

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.

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,

Lorraine E. Gardner  
Senior Attorney, Branch 4  
(Passthroughs & Special Industries)