Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
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PLR-127286-04
Date:
May 16, 2005

In Re:

Legend

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

Trust 11 =

Trust 12 =

Trust 13 =

Trust 14 =

Decedent =
Date 1 =
Beneficiary 1 =
Beneficiary 2 =
Beneficiary 3 =
Beneficiary 4 =
Beneficiary 5 =
Beneficiary 6 =
Beneficiary 7 =
Beneficiary 8 =
Beneficiary 9 =
Beneficiary 10 =
Beneficiary 11 =
Beneficiary 12 =
Beneficiary 13 =
Beneficiary 14 =
Trustee 1 =
Foundation =
x =
Date 2 =
Consultant 1 =
Consultant 2 =
Consultant 3 =
Date 3 =
Court =
State =
Date 4 =
County =

Dear :

This letter responds to your letter, dated July 28, 2004, and prior correspondence requesting rulings relating to the estate, gift, and generation-skipping transfer tax consequences of modifying Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 7, Trust 8, Trust 9, Trust 10, Trust 11, Trust 12, Trust 13, and Trust 14 (collectively, the Testamentary Trusts).

Decedent died on Date 1 and the Testamentary Trusts were created under Article IV of Decedent's Will. Trust 1 is for the benefit of Beneficiary 1. Trust 2 is for the benefit of Beneficiary 2. Trust 3 is for the benefit of Beneficiary 3. Trust 4 is for the benefit of Beneficiary 4. Trust 5 is for the benefit of Beneficiary 5. Trust 6 is for the benefit of Beneficiary 6. Trust 7 is for the benefit of Beneficiary 7. Trust 8 is for the benefit of Beneficiary 8. Trust 9 is for the benefit of Beneficiary 9. Trust 10 is for the

benefit of Beneficiary 10. Trust 11 is for the benefit of Beneficiary 11. Trust 12 is for the benefit of Beneficiary 12. Trust 13 is for the benefit of Beneficiary 13. Trust 14 is for the benefit of Beneficiary 14. Trustee 1 currently serves as the trustee of the Testamentary Trusts. Date 1 is prior to September 25, 1985. The Testamentary Trusts each have the same operating provisions.

Article IV, paragraph 4.2 of Decedent's Will provides in relevant part that the trustee shall divide the initial trust property into equal shares: one share for each living grandchild of Decedent and one share for the living descendants (collectively) of each deceased grandchild of Decedent. Each share set aside for the descendants of a deceased grandchild shall be further divided into portions for such descendants per stirpes. Each such share set aside for a living grandchild and each such portion set aside for a descendant of a deceased grandchild shall constitute a separate trust. Each trust created under Article IV shall be known by the name of the grandchild or descendant of a deceased grandchild for whom it was set aside (the Beneficiary).

Article IV, paragraph 4.3(a) of Decedent's Will provides that the trustee shall, for thirty years after Decedent's death, distribute each year to Foundation collectively from the Testamentary Trusts a guaranteed annuity of $x, payable in installments at the end of each quarter. The annuity shall be taken pro rata from each of the Testamentary Trusts. Any trust income in excess of the $x annuity shall be accumulated annually in the trusts and after payment of any necessary taxes and trust expenses be used as a further guarantee of the payment of the annuity.

Article IV, paragraph 4.5 of Decedent's Will provides that beginning thirty years from the date of Decedent's death (Date 2), the trustees shall distribute all of the trust net income of each Testamentary Trust to the Beneficiary of the trust. In addition, beginning on Date 2, the trustee shall provide each Beneficiary and each descendant of such Beneficiary with distributions from the principal of the Beneficiary's trust as needed to maintain the Beneficiary or descendant of the Beneficiary in accordance with the standard of living enjoyed by Decedent's grandchildren at the time of Decedent's death.

Article IV, paragraph 4.6 of Decedent's Will provides that no Testamentary Trust shall terminate prior to Date 2. A trust created for a Beneficiary who is a grandchild of Decedent shall continue for such Beneficiary's lifetime, unless earlier terminated by a distribution of the entire principal of the trust. A trust created for a Beneficiary who is a descendant of Decedent other than a grandchild shall terminate on Date 2 or the Beneficiary's thirtieth birthday, whichever event occurs later. Paragraph 4.8 provides that unless otherwise terminated, each Testamentary Trust shall terminate one day less than twenty-one years after the death of the last to survive of Decedent's descendants living on Date 1. Upon such termination, all of the then remaining income and principal of each trust shall absolutely and indefeasibly vest in, and be distributed to, the trust Beneficiary.

Article VI, paragraph 6.3 of Decedent's Will provides that Consultant 1, Consultant 2, Consultant 3, and Beneficiary 8 (collectively, the consultants) shall act as consultants to the executor and trustees monitoring the administration of Decedent's Will. The consultants provide investment advice only and have no authority with respect to discretionary distribution decisions. Paragraph 6.3 further provides that the trustee of a Testamentary Trust must notify the consultants in writing prior to selling or disposing trust property with a value in excess of $10,000 and before investing trust funds in excess of $10,000 in any one asset. Paragraph 6.7 provides that the consultants may remove a corporate trustee at any time, with or without cause. If a corporate trustee resigns, is removed, or fails to serve or continue to serve for any other reason, the consultants shall appoint a successor corporate trustee to serve. Any successor trustee shall be a bank or trust company with trust powers, either state or national, with a combined capital and surplus of at least $20,000,000. There shall always be a corporate trustee.

On Date 3, Trustee 1 petitioned Court to modify the Testamentary Trusts to (1) allow a trust's beneficiaries to remove and replace trustees, (2) modify the capital requirements for successor corporate fiduciaries, and (3) modify the notification provision in paragraph 6.3 of Decedent's Will. The modification will insert a new Article Z. Court approved the modifications, as follows, under State law on Date 4. The Date 4 Court order provides that the judgment shall become effective as of the date that the Internal Revenue Service issues a favorable ruling holding that the modifications made under the judgment will not result in the loss of the Testamentary Trusts' exemption from the generation-skipping transfer tax, will not otherwise subject the trusts to the generation-skipping transfer tax, and will not cause any trust beneficiary to have a general power of appointment pursuant to §§ 2041 or 2514 of the Internal Revenue Code.

Article VI, paragraph 6.3 will be modified by replacing $10,000 with $100,000.

Article Z, paragraph Z.1 will provide that notwithstanding any provision to the contrary, in the event all the consultants have either died, resigned or shall have ceased to serve for any reason, those persons who are then living and competent, who have attained the age of thirty-five years of age and who are entitled to receive income or principal distributions (the powerholders) shall have the power to remove any corporate trustee, with or without cause.

Paragraph Z.2 will provide that any successor corporate trustee appointed must be created or organized in the United States or under the law of the United States or any state. Any successor trustee must be a bank with trust powers, either state or national, or a trust company with a combined capital and surplus of at least $5,000,000 at the time of its appointment. The powerholders of a trust may petition a court having jurisdiction in County, to seek the appointment by such court of a bank with trust powers, either state or national, or a trust company having at least the minimum capital and surplus required by applicable State or federal law for that type of entity. If such a

petition is filed prior to the time the entity to be named as successor trustee has obtained the necessary approvals of the appropriate regulatory agency under State or federal law, any order appointing such entity as a successor trustee shall be contingent upon obtaining such regulatory approvals. Any such petition must seek the appointment of a guardian ad litem to represent those beneficiaries of a trust who are unknown or who are under a legal disability.

Paragraph Z.3 will provide that any trustee must not be related or subordinate to any powerholder within the meaning of § 672(c) of the Internal Revenue Code.

Paragraph Z.4 will provide that the powers granted to the powerholders under Article Z to appoint a successor trustee shall be exercised by a majority of all such persons (whether or not one or more of such persons declines to exercise such powers); when there are only two such persons, such powers must be exercised jointly, and if only one such person qualifies, such person shall exercise such powers alone.

Paragraph Z.5 will provide that if the power to remove and replace a trustee is exercised by the powerholder with respect to any trust created under Article IV, then in no event may such power be exercised again for such trust for a five year period beginning from the date of the exercise of such power as evidenced by the effective date of the required writing.

Paragraph Z.6 will provide in relevant part that any removal notice must be by acknowledged instrument signed by all of the powerholders exercising the removal and replacement powers provided for in Article Z, must be actually delivered to the trustee being removed, must contain the acceptance of the successor trustee endorsed on it, and must include the effective date of such removal and acceptance.

Paragraph Z.7 will provide that the power to remove and replace a trustee may only be exercised by a person who then qualifies as a powerholder and may not be exercised by an assignee, guardian, attorney-in-fact or any other agent of the powerholder.

Paragraph Z.8 will provide that the powers vested in the powerholder shall not be deemed to be so vested in a fiduciary capacity.

You have requested a ruling that the proposed modifications to the terms of the trusts will not cause the trusts to lose their generation-skipping transfer tax exempt status or otherwise become subject to the generation-skipping transfer tax. In addition, you have requested a ruling that the proposed modifications to the terms of the trusts will not result in the trusts' beneficiaries possessing a general power of appointment for the trusts.

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term "generation-skipping transfer" to include a taxable distribution, taxable termination, and a direct skip.

Each of the Testamentary Trusts is a generation-skipping transfer trust because the trust provisions allow for distributions to one or more generation of beneficiaries below the Decedent's generation. Each of the Testamentary Trusts was irrevocable on September 25, 1985. The trustees represent that there have been no additions, actual or constructive, to these trusts after September 25, 1985.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, is considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C), that relate to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, the Testamentary Trusts are considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(4) 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 under § 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. In general, unless specifically provided for otherwise, the rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Unless specifically noted, 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 § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) 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 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 § 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 in the original trust. Furthermore, 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 a shift in a beneficial interest in a trust.

The proposed modifications to the Testamentary Trusts are administrative changes and will not be considered a shift in a beneficial interest in a trust under § 26.2601-1(b)(4)(i)(D)(1). Therefore, the Testamentary Trusts will not lose their status as exempt from the generation-skipping transfer tax under § 26.2601-1(b)(1). Accordingly, based on the facts submitted and the representations made, future distributions from or terminations of a Testamentary Trust will not be subject to the generation-skipping transfer tax.

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 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 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 §§ 2035 to 2038, inclusive. For purposes of § 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 decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate. However, 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 shall not be deemed a general power of appointment.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that a donee may have a power of appointment if he has the power remove or discharge a trustee and appoint himself. For example, if under the terms of the 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. 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 power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of the fiduciary duties is not a power of appointment.

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 possession such power.

Section 2514(c) provides that a general power of appointment is a power that is exercisable in favor of the individual possessing the power (the 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 posessor that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 25.2514-1(b)(1) of the Gift Tax Regulations provides, in part, that a donee may have a power of appointment if he has the power remove or discharge a trustee and appoint himself. For example, if under the terms of the 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. 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 power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of the fiduciary duties is not a power of appointment.

Rev. Rul. 95-58, 1995-2 C.B. 191, holds that a decedent/grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or corporate successor trustee that is not related or subordinate to the decedent within the meaning of § 672(c), is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus is not included in the decedent's gross estate under §§ 2036 or 2038. The ruling notes that the Eighth Circuit in Estate of Vak v. Commissioner, 973 F.2d 1409 (8th Cir. 1992), concluded that the decedent had not retained dominion and control over assets transferred to a trust by reason of his power to remove and replace the trustee with a party that was not related or subordinate to the decedent. Accordingly, the court held that under § 25.2511-2(c), the decedent made a completed gift when he created the trust and transferred assets to it.

Section 672(c) defines the term "related or subordinate party" to mean any nonadverse party who is (1) the grantor's spouse if living with the grantor; or (2) any one of the following: the grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

After the proposed modifications, the individual beneficiaries of the Testamentary Trusts as powerholders will have an unqualified power, either alone or in conjuction with the other beneficiaries, to remove a trustee and to appoint a successor corporate trustee. The Article Z modifications restrict any appointment to a successor corporate

trustee that is not related or subordinate to any powerholder within the meaning of § 672(c). The Article Z power granted to the Testamentary Trust beneficiaries is not the equivalent of the power referenced in the examples in §§ 20.2041-1(b)(1) and 25.2514-1(b)(1) where an individual may remove a trustee and appoint himself. Instead, the Article Z power granted to the Testamentary Trust beneficiaries is the equivalent of the power referenced in Rev. Rul. 95-58 where a replacement trustee may not be related or subordinate to the powerholder within the meaning of § 672(c). Accordingly, based on the facts submitted and the representations made, the proposed modifications will not cause any trust beneficiary to have a general power of appointment under §§ 2041 or 2514.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal 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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to your attorney.

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,

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

Enclosure
Copy of this letter for § 6110 purposes