

Internal Revenue Service

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Department of the Treasury

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Third Party Communication: None

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Person To Contact:

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Refer Reply To:

CC:PSI:B09

PLR-127403-04

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 =

Grantor =

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 =
Trustee 2 =
Trustee 3 =
Foundation =
Bank =
Date 2 =
Court =
State =
Date 3 =
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 Series VII Trusts).

Grantor created the Series VII Trusts, irrevocable trusts, on Date 1 for the benefit of her grandchildren. Date 1 is prior to September 25, 1985. 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, Trustee 2, and Trustee 3 are individuals and currently serve as the trustees of the Series VII Trusts. The Series VII Trusts each have the same operating provisions.

Article I, paragraph 1.1 of the Series VII Trust Agreement provides that the trustees shall divide the trust property into equal shares: one share for each grandchild of Grantor.

Article I, paragraph 1.2 of the Series VII Trust Agreement provides that beginning ten years after Date 1, the trustee shall distribute the net income from each trust at least quarterly; provided, however, during such time as the named beneficiary is a minor, the trustee may accumulate the income of the named beneficiary's trust and add such accumulated income to the principal of the trust. Each named beneficiary shall have the special power to appoint (outright, in trust or otherwise) all or any part of the accumulated income of his or her trust. The named beneficiary shall not have the power to appoint the trust property to himself or herself, his or her creditors, his or her estate, or the creditors of his or her estate. In addition, the trustee may distribute the principal of a trust to the named beneficiary and/or his or her descendants to provide for the health, support, maintenance, and education of the beneficiary or his or her descendants at any time after Date 1.

Article I, paragraph 1.3 of the Series VII Trust Agreement provides that each trust created for a named beneficiary who is a grandchild of the Grantor shall continue for that beneficiary's lifetime. Each trust created for a beneficiary who is a descendant of the Grantor other than a grandchild shall terminate when the beneficiary of the trust attains the age of thirty years, and the remaining unappointed income and principal of the beneficiary's trust shall thereupon be distributed to the beneficiary.

Article I, paragraph 1.4 of the Series VII Trust Agreement provides that on the death of a named beneficiary, the remaining unappointed income and principal of his or her trust shall be distributed to new trusts or to existing trusts for the benefit of the descendants of the Grantor. Upon the death of a beneficiary who is a grandchild of the Grantor and upon the death of any other beneficiary prior to the termination of the trust, the remaining unappointed income and principal of his or her trust shall pass and be divided into shares and portions of shares among the then living descendants of the deceased beneficiary per stirpes. If no descendant of the beneficiary is living at the death of the beneficiary, upon the death of the beneficiary all remaining unappointed income and principal of his or her trust shall instead pass and be divided into shares and portions of shares among the then living descendants of the grandchild of the Grantor who was the ancestor of the beneficiary per stirpes. If no such descendant is then living, all remaining unappointed income and principal of his or her trust shall instead pass and be divided into equal shares as follows: one share for each then living grandchild of the Grantor and one share for the then descendants (collectively) of each then deceased grandchild of the Grantor. If none of the Grantor's grandchildren or their descendants be then living, all remaining unappointed income and principal of the beneficiary's trust shall pass and be distributed to Foundation.

Article I, paragraph 1.5 of the Series VII Trust Agreement provides that notwithstanding any other provision of the trust agreement to the contrary, each trust that has not been earlier terminated shall terminate one day less than twenty-one years after the death of the last to survive of the Grantor's descendants who were living on Date 1. Upon termination, all of the then remaining income and principal of the trust shall absolutely and indefeasibly vest in, and be distributed to, the beneficiary thereof.

Article II, paragraph 2.1 of the Series VII Trust Agreement provides that if a trustee fails to qualify or, having qualified, dies, resigns, becomes incapacitated, or otherwise ceases to act, the remaining trustees shall appoint a successor trustee to serve in the trustee's place. There should always be three co-trustees under the Series VII Trust Agreement. If, however, the trusteeship should become vacant for any reason, Bank shall become sole trustee. When there are three trustees serving, the powers given to the trustees shall be exercised by the majority of them.

On Date 2, Trustee 1 petitioned Court to modify the Series VII Trusts to (1) allow a trust's beneficiaries to remove and replace trustees and (2) modify the capital requirements for successor corporate fiduciaries. The modification will insert a new Article Z. Court approved the modifications, as follows, under State law on Date 3. The Date 3 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 Series VII 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 Z, paragraph Z.1 will provide that notwithstanding any provision to the contrary, in the event the trustees have all 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 V, 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 Series VII Trusts is a generation-skipping transfer trust because the trust provisions allow for distributions to one or more generation of beneficiaries below the Grantor's generation. Each of the Series VII 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 Series VII 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 Series VII 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 Series VII 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 Series VII 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 possessing 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 possessor 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 and the death or resignations of the current trustees of the Series VII Trusts, the individual beneficiaries of the Series VII Trusts as powerholders will have an unqualified power, either alone or in conjunction 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 Series VII 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 Series VII 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