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Date:  
August 8, 2016

RE:

Legend

Date 1 =  
Grantor 1 =  
Grantor 2 =  
Trust =

X =  
Y =  
Child 1 =  
Child 2 =  
Child 3 =  
State =  
Date 2 =  
State Court =  
Statute =

Dear :

This letter responds to your authorized representative's letter of February 4, 2016, regarding the income, gift, estate, and generation-skipping transfer (GST) tax consequences of a proposed modification of Trust.

The facts and representations submitted are as follows. On Date 1, a date after September 25, 1985, Grantor 1 and Grantor 2 (collectively, Grantors) created an irrevocable trust, Trust. The current trustees of Trust are X, an Independent Trustee, and Child 1, Child 2, and Child 3 (collectively, Family Trustees).

Article 4 of Trust contains provisions for the distribution of Trust property. Section 4.3 provides that until the death of the surviving Grantor, the Independent Trustee shall have the power to pay to or apply for the benefit of any one or more of Grantors' issue the entire or such lesser portion of the net income and principal, in such amounts as in its sole discretion may be necessary or advisable from time to time for the medical care, education, support and maintenance in reasonable comfort of Grantors' issue. Any undistributed income shall be periodically, and at least annually, added to principal.

Section 4.4(a)(1) provides that upon the death of the surviving Grantor, if Grantors leave surviving issue, the Independent Trustee shall divide the property of trust into separate equal shares, one share for each then living child of Grantors and one share for each deceased child of Grantors who leave issue then living. Each share for a deceased child of Grantors who leave issue then living shall be further divided *per stirpes* into as many equal shares as there shall be issue then living. Each share for a child or issue of Grantors shall be retained in trust as a separate exemption trust (Exemption Trust) for that child or issue (Primary GST Beneficiary).

Section 4.4(a)(1)(B) provides that the Independent Trustee has the power to pay to or apply for the benefit of the Primary GST Beneficiary and his or her issue, or any one or more of them, the entire or such lesser portion of the net income, together with such sums from the principal of the Exemption Trust, in such shares and proportions, whether in equal or unequal amounts, as in its sole discretion may be necessary or advisable from time to time for the medical care, education, support and maintenance in reasonable comfort of the Primary GST Beneficiary and his or her issue in that order and as a group. Any undistributed income shall be periodically, at least annually, added to principal of the Exemption Trust.

Section 4.4(a)(1)(C) provides that upon attaining the age of 30 years, the Primary GST Beneficiary has a testamentary limited power to appoint his or her Exemption Trust property to and among, or for the benefit of, one or more of Grantors' issue or the spouses of Grantors' issue; provided, however that the testamentary power of appointment shall not be exercisable in favor of the Primary GST Beneficiary, the Primary GST Beneficiary's estate or creditors of the Primary GST Beneficiary or his or her estate.

Section 4.4(a)(1)(D) provides that upon attaining the age of 30 years, the Primary GST Beneficiary has the right and power to withdraw or appoint to or for the benefit of any issue of Grantors, including himself or herself, such amounts of the net income and/or principal of the Primary GST Beneficiary's Exemption Trust, as may be necessary for

the medical care, education, support and maintenance of such issue. This right or power is intended to be a limited power of appointment within the meaning of the Code and shall not be exercisable to the extent the amount may be withdrawn or appointed is not ascertainable upon review by a court of competent jurisdiction or to the extent that it could be exercised to discharge the Primary GST Beneficiary's legal duty to support any issue.

Section 4.4(a)(1)(E) provides that upon the death of the Primary GST Beneficiary, any income and/or principal (to the extent not appointed) shall be divided and allocated *per stirpes* among the surviving issue of the Primary GST Beneficiary, if any, otherwise *per stirpes* among the issue of the nearest lineal ancestor of the Primary GST Beneficiary who also was a descendant of the Grantor and of whom one or more descendants then are living, or, if none, *per stirpes* among the Grantor's surviving issue. Property so allocated to a person for whom an Exemption Trust has been established shall be added to that Exemption Trust, and property so allocated to any other person shall be retained in trust as a separate Exemption Trust named for him or her and disposed of in accordance with the terms and conditions provided in Section 4.4(a)(1).

Section 4.4(a)(1)(F) provides that upon the Vesting Date (defined below in Section 5.1), any income and/or principal of the Exemption Trust shall be distributed outright to the Primary GST Beneficiary. If the Primary GST Beneficiary dies subsequent to the Vesting Date, but prior to the receipt of the property, then the property shall be distributed *per stirpes* to the surviving issue of the Primary GST Beneficiary, if any, otherwise *per stirpes* to the issue of the nearest lineal ancestor of the Primary GST Beneficiary who also was a descendant of Grantors and of whom one or more descendants are living, or, if none, *per stirpes*, to Grantors' surviving issue.

Section 5.1 provides that if not otherwise terminated sooner, the term of any trust created in Article 4 for the benefit of any beneficiary shall terminate on the Vesting Date, which shall be the date which is the last to occur of (i) 90 years from the creation of the interest, to the extent the laws of State govern, or (ii) 21 years after the death of an individual alive on the date the interest is created.

Article 6 contains provisions governing the trustee powers and include the power to invest, retain, sell, improve, pledge, lease, lend, borrow, guarantee property in the trust and the power to maintain bank and brokerage accounts and hold title, litigate, manage, enter into business agreements, continue business, incur debt and pay expenses, purchase assets, allocate trust property, make tax elections, pay taxes, merge trusts, and engage in security and oil and gas interest transactions. Section 6.16 contains provisions governing the powers of an "Interested Trustee," who is defined as any trustee who has an interest as a beneficiary in Trust or any separate trust created thereunder. Section 6.16 provides that where an Interested Trustee distributes or participates in the distribution of income or principal to or for the benefit of such trustee, the distribution shall be limited by the ascertainable standards of medical care, education, support and maintenance. Further, no individual trustee shall exercise or

participate in the exercise of such discretionary power with respect to distributions to any person or persons such trustee is obligated to support, as to that support obligation.

Article 7(D) provides that either Grantor, acting in a non-fiduciary capacity, shall have the power to reacquire Trust assets by substituting assets of equivalent value (Substitution Power).

Article 8, Section 8.1, provides that Trust and the separate trusts created hereunder, shall have at least two offices of trusteeship, i.e., a Family Trustee and an Independent Trustee. Except as expressly provided otherwise, the Family Trustee and Independent Trustee shall act jointly and unanimously in exercising the powers and discretions set forth in Trust, and in such instances, shall be referred to as the "Trustees" or "Trustee."

Section 8.3 provides that upon the failure to serve, death, resignation, or incapacity of Child 1, Child 2, or Child 3 to serve as a Family Trustee, the remaining named person(s) shall continue to serve as Family Trustee. Following the death of the surviving Grantor, the Primary GST Beneficiary of an Exemption Trust, who has attained the age of 30 years and is not incapacitated, shall have the right to become the sole Family Trustee of his or her Exemption Trust in the place of any other person(s) who is then serving as Family Trustee of such trust.

Section 8.4 provides that X shall serve as the Independent Trustee.

Section 8.6 provides that upon attaining the age of 30, the Primary GST Beneficiary of his or her Exemption Trust shall have the right to remove and replace the Family Trustee of such trust with (i) another named Family Trustee or (ii) an individual who is a beneficiary of such trust or a lineal descendant of Grantors.

Section 8.7 provides that at any time either Grantor shall have the right to remove any Independent Trustee and replace said trustee with (i) a corporation regularly involved in the business of trust administration and counseling or (ii) an individual other than either Grantor; provided, however, in no event shall any appointed Independent Trustee be related or subordinate to either Grantor within the meaning of § 672(c). Further, upon the death or incapacity of the surviving Grantor, a majority of adult income beneficiaries of any separate Exemption Trust shall have the right to remove any Independent Trustee and replace said trustee with (i) a corporation regularly involved in the business of trust administration and counseling or (ii) an individual other than any such adult income beneficiary; provided, however, in no event shall any appointed Independent Trustee be related or subordinate to any beneficiary of Trust within the meaning of § 672(c).

Section 8.8 provides that in the event none of the Family Trustees named in Section 8.3 are able to serve, a majority of the adult income beneficiaries of any separate Exemption Trust shall name an individual who is a beneficiary of any such trust or a lineal descendant of Grantors to act as the Family Trustee.

Section 8.9 provides that in the event that the Independent Trustee named in Section 3.4 is not able to serve, a majority of the adult income beneficiaries of any separate Exemption Trust shall name either (i) a corporation regularly involved in the business of trust administration and counseling or (ii) an individual other than any such adult income beneficiary to act as the Independent Trustee.

Pursuant to Section 2.1, Trust is irrevocable and each Grantor relinquished any right to alter, amend, revoke or terminate Trust or to designate the persons who shall possess or enjoy the Trust property. During the term of Trust, no Grantor shall have any right, title or interest in any of the property held in Trust, and under no circumstances may either Grantor, by amendment or otherwise, vest or re-vest in either Grantor any part of the Trust property.

Article 15 provides that Trust is governed by the laws of State.

It is represented that Trust is a grantor trust within the meaning of § 671 and, thereafter, all items of income, deductions, loss, and credit of Trust are reflected on the Grantors' Form 1040 (U.S. Individual Income Tax Return).

Grantors each timely filed a Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, reporting their respective transfers to Trust on Date 1 and allocating their respective GST exemption to the transfers to Trust. It is represented that no additional contributions have been made by Grantors to Trust since Date 1. Accordingly, it is represented that Trust has an inclusion ratio of zero for GST tax purposes.

Due to unforeseen and unanticipated circumstances, payment by the Grantors of the income taxes on Trust's income has become unduly burdensome. The Independent Trustee sought court approval to modify Trust. Only the Independent Trustee has the power to make distributions to beneficiaries of Trust. The dispositive provisions under Article 4 are not modified. The modifications are as follows.

Section 5.1, containing the Rule Against Perpetuities provisions, is modified only to the extent to provide that the modification to Trust made pursuant to court order may not extend the term of any trust created under Trust.

Article 6 is modified to clarify trustee powers regarding business powers, loans and borrowing powers, limitations on the trustee's powers, limited amendment powers of the trustees, and reservation of investment powers to the Investment Trustee.

Article 8 is restated in its entirety to provide for successor trustee provisions. Section 8.1 provides that X, Child 1, Child 2, and Child 3 serve as the initial

Trustees. Neither Grantor may serve as a Trustee of any trust created under Trust. Section 8.2 provides that a Trustee may resign by giving written notice.

Section 8.3(a) provides that subject to a Plan of Trustees, if any of the initial Trustees cease to serve, the remaining initial Trustees shall serve without the necessity of a successor Trustee. Notwithstanding the preceding sentence, if X ceases to serve, then Y shall serve as Co-Trustee, with the remaining initial Trustees. If all of the initial Trustees cease to serve, Y shall serve as the sole successor Trustee.

Section 8.3(b) provides that the following persons may establish a Plan of Trustees for any trust; provided, that the plan established by a person other than Grantors shall not become effective for a given trust until all of the Trustees designated in Section 8.1 cease to act as Trustees: Grantors, acting unanimously; one Grantor, if the other Grantor is deceased or incapacitated; Grantors' children with respect to Trust; a child of Grantor with respect to an Exemption Trust where such child is the Primary GST Beneficiary; Grantor's children with respect to an Exemption Trust where the Primary GST Beneficiary is other than a child of Grantors; the Primary GST Beneficiary of any Exemption Trust who has attained age 35, but only with respect to that trust; and a majority of the then-acting Independent Trustees of Trust or any trust created hereunder.

Section 8.3(d) provides that any person listed above may remove any Trustee, with or without cause. Section 8.3(e) provides that a person may not participate in the selection of a successor to a removed Trustee of a trust if (i) the person participated in the removal of such removed Trustee, (ii) the person is a current or future beneficiary of such trust or a grantor of such trust, (iii) the successor Trustee would be the person or related or subordinate to such person, within the meaning of § 672(c) and (iv) any of the following apply: (1) the successor Trustee may pay trust property to the trust beneficiaries in a manner not limited by an ascertainable standard within the meaning of §§ 2041 and 2514, (2) the successor Trustee is required to make mandatory payments to be divided in Trustee's discretion among more than one beneficiary, (3) the successor Trustee may make payments that would discharge or satisfy a legal obligation of the person, (4) the successor Trustee may make payments to another beneficiary or grant a power to another beneficiary with respect to any portion or interest as to which the Trustee, in his individual capacity, made a "qualified disclaimer" as defined in § 2518, and (5) all or any portion of the trust property would be included in the gross estate of the person if the person were deemed to have the powers of Trustee being designated or removed.

Section 8.3(g) provides that upon the creation of an Exemption Trust, the Primary GST Beneficiary of that trust, may, upon attaining age 35, appoint himself or herself as a Co-Trustee of his or her separate trust to serve with the then-serving Trustee. At any time a beneficiary is serving as Co-Trustee of his or

her trust, there must be at least one other Trustee serving with the beneficiary. Notwithstanding the foregoing, any child of the Grantors who is a Primary GST Beneficiary of a trust may act as the sole Trustee of such trust.

Section 8.3(h) provides that if the office of Trustee of a trust is vacant, the Grantors may appoint an individual or corporate successor Trustee that is not related or subordinate to either Grantor within the meaning of § 672(c). If one Grantor is incapacitated or deceased, the other Grantor may appoint an individual or corporate successor Trustee that is not related or subordinate to the Grantor within the meaning of § 672(c). If both Grantors are incapacitated or deceased, the beneficiaries of Trust may appoint an individual or corporate fiduciary that is not related or subordinate to the person or person making the appointment within the meaning of § 672(c) to serve as successor Trustee. If both Grantors are deceased, the Primary GST Beneficiary of an Exemption Trust may appoint an individual or corporate fiduciary that is not related or subordinate to the person or persons making the appointment within the meaning of § 672(c) to serve as successor trustee.

Section 8.5 provides that any individual Trustee may appoint an individual or a corporate fiduciary as a Co-Trustee.

Section 8.8 provides that if for any reason the Trustee of any trust hereunder is unwilling or unable to serve, Grantors shall appoint a corporate fiduciary or an individual to serve as an Independent Special Trustee, which is defined as not related or subordinate to either Grantor or any trust beneficiary within the meaning of § 672(c). This section contains the same provisions in the event a Grantor is incapacitated or deceased or both Grantors are incapacitated or deceased as in Section 8.3(h).

Section 8.10 provides that Child 1, Child 2, and Child 3 will serve as the initial Investment Trustees and contains provisions for successor Investment Trustees and provides that these trustees will manage the investments of such trust, including the power to purchase, sell and retain trust property and the power to exercise all voting rights with respect to such property. The investment powers do not include distribution powers.

Article 9 is modified to add provisions regarding the indemnification of trustees, exoneration of the trustees in certain circumstances, limitations on trustee liability, and employment of professionals.

Article 12 is modified to define the terms "Independent Trustee" and "Interested Trustee." Specifically, Section 12.11 provides that the term "Independent Trustee" means any Trustee who is not an Interested Trustee as defined in Section 12.12 and includes an Independent Special Trustee appointed under Section 8.8. Whenever a power or discretion is granted exclusively to the

Independent Trustee, then any Interested Trustee who is then serving as the Trustee is prohibited from participating in the exercise of the power or discretion. If there is no Independent Trustee then serving, then an Independent Special Trustee may be appointed under Section 8.8 to exercise the power or discretion that is exercisable only by the Independent Trustee.

Section 12.12 provides that the term "Interested Trustee" means a Trustee who is a transferor or beneficiary; is related or subordinate to a transferor or beneficiary; can be removed and replaced by a transferor with either the transferor or a party who is related or subordinate to the transferor; or can be removed and replaced by a beneficiary with either the beneficiary or a party who is related or subordinate to the beneficiary. "Related or subordinate" is used as defined in § 672(c).

Section 13.3(a) is modified to provide that Article 7(D) (Substitution Power) and Section 13.3 in all respects shall comply with Rev. Rul. 2008-22, 2008-1 C.B. 796, as amplified by Rev. Rul. 2011-28, 2011-49 I.R.B. 830. Section 13.3(b) is modified to include a tax reimbursement clause requiring compliance with Situation 3 of Rev. Rul. 2004-64, 2004-2 C.B. 7. Specifically, Section 13.3(b), as modified, provides that Grantors shall not be entitled to any right of reimbursement under any applicable law for their tax liability (whether federal, state or otherwise), if any, attributable to a trust being treated as a "grantor trust" as to either Grantor under §§ 671 through 679. If in any calendar year, a trust created hereunder is treated as a "grantor trust" as to either Grantor under §§ 671 through 679, an Independent Trustee may from time to time, distribute to a Grantor so much of the income or principal of the trust as may be sufficient to satisfy all or part of such Grantor's personal income tax liability attributable to the inclusion of all or part of the trust's income in such Grantor's taxable income in excess of the amount of such taxes that would have been imposed if the trust's income, gains, losses and deductions had not been included in the determination of such Grantor's income tax liability.

The modifications to Trust are contingent on obtaining a favorable ruling from the Internal Revenue Service. On Date 2, State Court issued an order modifying Trust, as described, under Statute.

Under Statute, the court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration, or if, because of circumstances not anticipated by the settlor, modification will further the settlor's stated purpose or, if there is no stated purpose, the settlor's probable intention.

You request the following rulings:

1. The proposed modifications of Trust will not cause the property of Trust to be included in the gross estate of either Grantor for federal estate tax purposes.
2. The proposed modifications of Trust will not cause the property of Trust to be included in the gross estate of Child 1, Child 2, or Child 3 for federal estate tax purposes.
3. The proposed modifications of Trust will not be treated as a deemed transfer of any property of Trust by Grantors for federal gift tax purposes.
4. The proposed modifications of Trust will not be treated as a deemed transfer of any property of Trust by Child 1, Child 2, or Child 3 for federal gift tax purposes.
5. The proposed modifications of Trust will not cause Trust, as modified, to lose its zero inclusion ratio for generation-skipping transfer tax purposes under chapter 13.
6. The proposed modifications of Trust will not be treated as a transfer of any property of Trust by Grantors or any beneficiary for purposes of § 1001.

#### Ruling # 1

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of his or her death.

Section 2035(a) provides that if the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and the value of such property (or an interest therein) would have been included in the decedent's gross estate under § 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for life or for any period not ascertainable without reference to the decedent's death or for any period that does not in fact end before death the possession or enjoyment of, or the right to the income from, the property, or the right,

either alone or in conjunction with any persons, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 20.2036-1(b)(2) of the Estate Tax Regulations provides that the use, possession, right to income, or other enjoyment of transferred property is treated as having been retained by the decedent to the extent that the transferred property is to be applied towards the discharge of a legal obligation of the decedent.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power) to alter, amend, revoke, or terminate, or when any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Rev. Rul. 95-58, 1995-2 C.B. 191, holds that the decedent/grantor's reservation of an unqualified power to remove a trustee and 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 by the grantor of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus was not included in the decedent's gross estate under § 2036 or 2038.

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.

Under the terms of Trust, Trust is irrevocable and Grantors have no right, title or interest in or power over, privilege or incident of ownership in regard to any trust property. Grantors have retained no beneficial interest in the trust and have not retained any right to alter, amend, revoke, or terminate Trust within the meaning of § 2038, or the right to designate who will possess or enjoy the property or the income therefrom within the meaning of § 2036.

Trust prohibits Grantors from serving as trustees of Trust and any trusts created thereunder. However, pursuant to the modifications to Article 8 of Trust, Grantors will retain the power to remove and replace the Trustees, including the Independent Trustee. However, any successor Independent Trustee appointed by Grantors cannot be related or subordinate within the meaning of § 672(c) to the Grantors. Accordingly,

under Rev. Rul. 95-58, Grantor's retained removal and replacement powers are not considered the reservation of the Independent Trustee's powers for purposes of § 2038. Further, the Family Trustees do not possess any powers to distribute income or corpus to the Trust beneficiaries. Therefore, Grantors' powers to remove and replace the Family Trustees will not cause the Trust corpus to be included in the gross estate of either Grantor under § 2038. Accordingly, we conclude that the modifications to Article 8 which grants Grantors the power to remove and replace the Trustees will not cause the Trust corpus to be included in the gross estate of either Grantor under § 2038.

Article 5.1, containing the Rule Against Perpetuities provisions, is modified only to the extent to provide that the modification to Trust made pursuant to court order may not extend the term of any trust created under Trust. Article 6 is modified to clarify trustee powers regarding business powers, loan and borrowing powers, limitations on the trustees powers, amendment powers of the trustees, and reservation of investment powers to the Investment Trustee. Article 9 is modified to add provisions regarding the indemnification of trustees, exoneration of the trustees in certain circumstances, limitations on trustee liability, and employment of professionals. Article 12 is modified to define the terms "Independent Trustee" and "Interested Trustee." The proposed modifications to Articles 5, 6, 9, and 12 are administrative in nature and will not result in a change in the beneficial interests in Trust. Accordingly, we conclude that the modifications to Articles 5, 6, 9, and 12 will not cause the Trust corpus to be included in the gross estate of either Grantor for estate tax purposes.

Section 13.3(a) is modified to provide that Article 7(D) (Substitution Power) and Section 13.3 shall comply in all respects with Rev. Rul. 2008-22, as amplified by Rev. Rul. 2011-28.

Rev. Rul. 2008-22 considers whether corpus of a trust was includible in the grantor's gross estate under § 2036 or 2038 if the grantor retained the power, exercisable in a nonfiduciary capacity, to acquire property held in the trust by substituting other property of equivalent value. The ruling provides that, for estate tax purposes, the substitution power will not, by itself, cause the value of the trust corpus to be includible in the grantor's gross estate, provided the trustee has a fiduciary obligation (under local law) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value and further provided that the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries.

In this case, under Article 13, Grantors have retained the power to acquire Trust property by substituting other property of equivalent value to the property acquired, measured at the time of substitution. Under the terms of Trust, the Grantors' powers to acquire Trust property under this Section may only be exercised in a nonfiduciary capacity. Further, Trust provides that the trustee has a fiduciary obligation under local law to ensure Grantors' compliance with the terms of this power by satisfying itself that

the properties acquired and substituted by either Grantor are in fact of equivalent value and that the substitution power is not exercised in a manner that can share benefits among the trust beneficiaries. Accordingly, we conclude that the retention by Grantors of the power of substitution will not cause Trust property to be included in the gross estate of either Grantor for estate tax purposes.

Section 13.3(b) modifies the tax reimbursement clause to require compliance with Situation 3 of Rev. Rul. 2004-64. Specifically, Section 13.3(b), as modified, provides that Grantors shall not be entitled to any right of reimbursement under any applicable law for their tax liability (whether federal, state or otherwise), if any, attributable to a trust being treated as a “grantor trust” as to either Grantor under §§ 671 through 679. If in any calendar year, a trust created hereunder is treated as a “grantor trust” as to either Grantor under §§ 671 through 679, an Independent Trustee may from time to time, distribute to a Grantor so much of the income or principal of the trust as may be sufficient to satisfy all or part of such Grantor’s personal income tax liability attributable to the inclusion of all or part of the trust’s income in such Grantor’s taxable income in excess of the amount of such taxes that would have been imposed if the trust’s income, gains, losses and deductions had not been included in the determination of such Grantor’s income tax liability.

Rev. Rul. 2004-64 considers situations in which the trustee reimburses the grantor for taxes paid by the grantor attributable to the inclusion of all or part of the trust’s income in the grantor’s income. In Rev. Rul. 2004-64, a grantor created an irrevocable inter vivos trust for the benefit of the grantor’s descendants. The grantor retained sufficient powers with respect to the trust so that the grantor is treated as the owner of the trust under subpart E, part I, subchapter J, of chapter 1 of the Code. When the grantor of a trust, who is treated as the owner of the trust under subpart E, pays the income tax attributable to the inclusion of the trust’s income in the grantor’s taxable income, the grantor is not treated as making a gift of the amount of the tax to the trust beneficiaries. If, pursuant to the trust’s governing instrument or applicable local law, the grantor had to be reimbursed by the trust for the income tax payable by the grantor that was attributable to the trust’s income, the full value of the trust’s assets would be includible in the grantor’s gross estate under § 2036. If, however, the trust’s governing instrument or applicable local law gave the trustee the discretion to reimburse the grantor for that portion of the grantor’s income tax liability, the existence of that discretion, by itself, whether or not exercised, would not cause the value of the trust’s assets to be includible in the grantor’s gross estate. However, such discretion combined with other facts (including but not limited to: an understanding or pre-existing arrangement between grantor and the trustee regarding the trustee’s exercise of this discretion; a power retained by Grantor to remove the trustee and name grantor as successor trustee; or applicable local law subjecting the trust assets to the claims of grantor’s creditors) may cause inclusion of Trust’s assets in grantor’s gross estate for federal estate tax purposes.

In this case, under the terms of Section 13.3(b), as proposed, the Independent Trustee will have the discretion to reimburse either Grantor with respect to the income tax liability actually incurred by the Grantor attributable to Trust items, for periods after the Trust instrument is modified. Only a Trustee who is not related or subordinate to either Grantor, within the meaning of § 672(c) may exercise the powers to reimburse either Grantor. Accordingly, assuming there is no understanding, express or implied, between either Grantor and the Independent Trustee regarding the Independent Trustee's exercise of discretion, the Independent Trustee's discretion to satisfy either of the Grantor's obligation would not alone cause the inclusion of the trust in either of the Grantor's gross estate for federal estate tax purposes. However, as noted in Rev. Rul. 2004-64, such discretion combined with other facts (including but not limited to: an understanding or pre-existing arrangement between either of the Grantor and the Independent Trustee regarding the Independent Trustee's exercise of this discretion; a power retained by either Grantor to remove the trustee and name the grantor as successor trustee; or applicable local law subjecting the trust assets to the claims of either of the Grantor's creditors) may cause inclusion of Trust's assets in either of the Grantor's gross estate for federal estate tax purposes.

Based upon the facts submitted and representations made, we conclude that the proposed modifications of Trust will not cause the property of Trust to be included in the gross estate of either Grantor for federal estate tax purposes.

#### Ruling # 2

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 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.

Section 2041(b)(1) defines the term "general power of appointment" as 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 is not a general power of appointment.

Section 20.2041-1(b)(1) provides, in part, if under the terms of the instrument, the trustee or his successor has the power to appoint the principal of 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. A power to amend only the administrative provisions of a trust instrument, which cannot substantially affect the

beneficial enjoyment of the trust property or income, is not 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.

In this case, the current trustees include X, the Independent Trustee, and Child 1, Child 2, and Child 3, the Family Trustees. When X ceases to serve as Independent Trustee, Y will serve. It is represented that Y is not related or subordinate to Grantors, Child 1, Child 2, or Child 3. The modifications to Article 8 provide that Child 1, Child 2, and Child 3 have the right to remove any trustee and appoint a successor trustee provided that the successor may not be related or subordinate to that child within the meaning of § 672(c). As in Rev. Rul. 95-58, the power of Child 1, Child 2, and Child 3 to remove and replace the Independent Trustee does not cause Child 1, Child 2, or Child 3 to hold a general power of appointment within the meaning of § 2041 with respect to the property in Trust. Therefore, we conclude that Child 1, Child 2, and Child 3 will not have a general power of appointment over the assets in Trust for purposes of § 2041.

Child 1, Child 2, and Child 3 are beneficiaries of Trust and did not make any transfers to Trust. Further, the proposed modifications to Trust do not result in transfers by any of the children to Trust. Accordingly, §§ 2036 through 2038 do not apply. The proposed modifications to Articles 5, 6, 9, 12, and 13 are administrative in nature and will not result in a change in the beneficial interests in Trust.

Accordingly, based upon the facts submitted and representations made, we conclude that the proposed modifications of Trust will not cause property of Trust to be included in the gross estate of Child 1, Child 2, or Child 3 for federal estate tax purposes.

### Ruling # 3

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides that the gift tax shall apply 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 25.2511-2(b) of the Gift Tax Regulations provides that as to any property of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.

Section 25.2511-2(c) provides that a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

Rev. Rul. 95-58 holds that the grantor's reservation of an unqualified power to remove a trustee and appoint a new trustee (other than the grantor) will not be considered the reservation by the grantor of the trustee's discretionary powers of distribution for gift tax purposes under § 2511, if the donor can only appoint an individual or corporate successor trustee that is not related or subordinate, within the meaning of § 672(c), to the grantor.

In this case, Grantors made a completed gift of property to Trust on Date 1. Pursuant to Trust, Grantors relinquished complete dominion and control over the property in Trust on that date. Grantors did not retain any right to change beneficial interests. The proposed modifications to Articles 5, 6, 9, 12, and 13 are merely administrative changes to Trust and, therefore, will not be treated as a deemed transfer by Grantors to Trust for purposes of § 2501. The proposed modifications to Article 8 give Grantors the power to remove and replace the Trustees of Trust. However, as stated above, these powers are limited to replacing the Independent Trustee with a successor trustee who is not related or subordinate within the meaning of § 672(c) to the Grantors. Accordingly, under Rev. Rul. 95-58, Grantors' retained powers to remove and replace the Independent Trustee will not cause the Independent Trustee's powers to be attributed to Grantors for purposes of § 2511.

Therefore, based upon the facts submitted and representations made, we conclude that the proposed modifications of Trust will not be treated as a deemed transfer of any property of Trust by Grantors for federal gift tax purposes.

#### Ruling # 4

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides that the gift tax shall apply 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 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)(1) 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 possessor 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 to 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 A has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, A 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.

In this case, the powers exercisable by the trustees, other than the Independent Trustee, do not include discretionary powers over either income or principal. Only the Independent Trustee has the sole discretionary authority to make distributions of income and principal from Trust and any trusts created thereunder.

After the proposed modifications, Child 1, Child 2, and Child 3 will have the power, either alone or in conjunction with other beneficiaries, to remove a trustee and to appoint a successor trustee. However, the modifications restrict any appointment of a successor Independent Trustee to a trustee who is not related or subordinate within the meaning of § 672(c) to any beneficiary of Trust or trusts created thereunder. Accordingly, after the proposed modifications, Child 1, Child 2, and Child 3 will have the power to remove and replace the Independent Trustee or the successor Independent Trustee, only with a trustee who is not related or subordinate within the meaning of § 672(c) to himself or herself. These powers are equivalent to 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). The removal and appointment powers given to the beneficiaries are not the equivalent of the power referred to in the example in § 25.2514-1(b)(1) where an individual may remove a trustee and appoint himself. Instead, the proposed power given to the beneficiaries is the equivalent of the power referred to in Rev. Rul. 95-58. Accordingly, we conclude that the proposed modification to Article 8 does not create a general power of appointment in Child 1, Child 2, or Child 3 for purposes of § 2514.

The proposed modifications to Articles 5, 6, 9, 12, and 13 are administrative in nature and do not result in a change in beneficial interests in Trust. We conclude that these modifications do not result in a deemed transfer by any of the children for purposes of § 2501.

Accordingly, based upon the facts submitted and representations made, we conclude that the proposed modifications of Trust will not be treated as deemed transfers of any property of Trust by Child 1, Child 2, or Child 3 for federal gift tax purposes.

#### Ruling # 5

Section 2601 imposes a tax on every generation-skipping transfer (GST) made after October 26, 1986. A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term “taxable termination” means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that the term “taxable distribution” means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax of an interest in property to a skip person.

Section 2602 provides that the amount of tax imposed under § 2601 is determined by multiplying the taxable amount by the applicable rate. Under § 2641, the term “applicable rate” means the product of the maximum federal estate tax rate in the year that the GST occurs and the inclusion ratio. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a GST is 1 minus the applicable fraction. Under § 2642(a)(2), in general, the numerator of the applicable fraction is the amount of GST exemption allocated to the property transferred and the denominator is the value of the property transferred.

Under § 2631, every individual is allowed a GST exemption amount which may be allocated by the individual or the individual’s executor to any property with respect to which the individual is the transferor.

Under § 1433(a) of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to any GST from a trust if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

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 § 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 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 GST tax purposes. Thus (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 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 (including a trustee distribution, settlement, or construction that does not satisfy paragraph (b)(4)(i)(A), (B), or (C) of this section) 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 for in the original trust.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of this section, 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 § 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 § 26.2601-1(b)(4)(i)(E), *Example 10* considers the following situation. In 1980, Grantor established 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 generation (as defined in § 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.

In the instant case, Trust became irrevocable after September 25, 1985. It is represented that sufficient GST exemption was allocated to Trust so that Trust has an inclusion ratio of zero under § 2642. No guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a change that would not affect the GST status of a trust that was irrevocable on September 25, 1985, should similarly not affect the exempt status of such a trust.

Article 5.1 is modified only to the extent to provide that the modification to Trust may not extend the term of any trust created under Trust. Under Rulings 2 and 4, we concluded that the proposed modifications do not constitute the release, exercise, or lapse of powers of appointment for purposes of §§ 2041 and 2514. Accordingly, the proposed modifications do not constitute constructive additions to Trust. The modifications were effected in accordance with state law and pertain to the administration of Trust.

Accordingly, the proposed modifications to Articles 5, 6, 8, 9, 12, and 13 of Trust are administrative in nature and under § 26.2601-1(b)(4)(i)(D)(2), will not be considered to shift a beneficial interest to a lower generation in the trust or extend the time for vesting of any beneficial interest in the trust beyond the period provided for in Trust. See *Example 10* of § 26.2601-1(b)(4)(i)(E).

Therefore, based upon the facts submitted and representations made, we conclude that the proposed modifications of Trust will not cause Trust, as modified, to lose its zero inclusion ratio for GST tax purposes under chapter 13.

#### Ruling # 6

Section 61(a)(3) provides that gross income includes gains derived from dealings in property. Under § 1.61-1(a) of the Income Tax Regulations, gross income means all income from whatever source derived, unless excluded by law. Gross income includes income realized in any form, whether in money, property, or services.

Under § 1001(a), gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized. Under § 1.1001-1(a), the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially in kind or in extent, is treated as income or loss sustained.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

Section 1.1002-1(d) provides that ordinarily, to constitute an exchange, a transaction must be a reciprocal transfer of property.

In this case, there is no exchange (reciprocal transfer) of trust property for purposes of § 1001 merely on account of the grant of additional powers to the trustee since the Grantors are treated for federal income tax purposes as owners of the entire trust before and after the proposed modification. Moreover, the beneficiaries will have the same beneficial interests in the Trust after the modifications as they had prior to the modifications to the Trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed modifications to the Trust will not be treated as a transfer of any property of the Trust by either Grantor or any beneficiary for purposes of § 1001.

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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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.

Sincerely,

Lorraine E. Gardner

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Senior Counsel, Branch 4  
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Enclosures (2)

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