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Date:
June 14, 2016

Legend

Husband	=
Wife	=
Trust	=
Daughter 1	=
Daughter 2	=
Date 1	=
Date 2	=
Court	=
X	=
Y	=
State	=
County	=
Statute	=

Dear

This responds to the letter dated November 23, 2015, submitted on behalf of the taxpayers, in which rulings are requested concerning the federal gift, estate, and generation-skipping transfer tax consequences of the resignation of the co-trustees to a trust, the appointment of successor trustees, and the proposed amendments to the successor trustee provisions of the trust.

On Date 1, a date prior to September 25, 1985, Settlors, Husband and Wife, executed an irrevocable trust (Trust) for the primary benefit of their daughters, Daughter 1 and Daughter 2 (collectively, Daughters), and their issue. Trust was divided into two separate trusts, a GST non-exempt trust (Trust 1) and a GST exempt trust (Trust 2). This ruling request concerns Trust 2.

On Date 2, pursuant to a Settlement Agreement and an order of Court, Article I, Section 1.1 of Trust 2 was amended and restated. Article 1, Section 1.1, paragraph 3, provides that the Trustee may, in his absolute discretion, pay out such sums of money, whether the same be income or principal of Trust 2 to Daughters. The Trustee has the right to accumulate income, as in the absolute discretion of the Trustee may be beneficial to the beneficiaries hereunder. Article 1, Section 1.1, paragraph 4, provides that Trust 2 shall continue in existence for the life of the Daughters and upon the death of the last to die, the Trustee shall distribute all the remaining Trust 2 assets to the then surviving children of the Daughters by distributing one-half of the remaining Trust 2 assets equally between the children of Daughter 1 and one-half of the remaining Trust 2 assets equally between the children of Daughter 2. Daughters are the current beneficiaries of Trust 2 and their children are the remainder beneficiaries of the trust. Currently, Daughter 1 has one child, who is an adult, and Daughter 2 has two children, who are minors.

Under Article 1, paragraph 2 of Trust 2, Husband was named trustee of the trust. Further, Trust 2 provides that upon Husband ceasing to serve as trustee for any reason, Daughters 1 and 2 will serve as successor Co-Trustees of Trust 2. Currently, Daughters are serving as Co-Trustees of Trust 2. Article 2, Section 2.7 of Trust 2 provides that in the event the successor trustees fail or refuse to act as trustees of Trust 2, then "any person interested in the welfare of the beneficiaries of the trust may apply to any district court in County, State for appointment of a successor trustee."

At the death of one of the Daughters, the surviving daughter will become the sole trustee and sole current beneficiary of Trust 2. Daughters are concerned that the surviving daughter may be deemed to have a general power of appointment for purposes of §§ 2514 and 2041. Accordingly, Daughters propose to jointly resign as trustees and petition Court to name X and Y as successor co-trustees and approve the proposed amendment to the successor trustee provisions of Trust 2. Article 2, Section 2.7 does not name specific successor trustees and, instead, provides that application may be made by any interested person to the Court for appointment of successor trustees. Daughter 1's child will consent to the proposed amendment to the trustee provisions and Daughter 2 will appear before Court in her capacity as guardian ad litem for her minor children, as provided under Statute. It is represented that X and Y are not related or subordinate within the meaning of § 672(c), to Daughter 1 or Daughter 2.

The proposed amendments to the Trust 2 successor trustee provisions provide that in the event X dies, resigns, refuses, fails or ceases to act as a trustee, Daughter 1 shall appoint a successor trustee who is not related or subordinate within the meaning of § 672(c) to Daughter 1. Also, if Y dies, resigns, refuses, fails or ceases to act as a trustee, Daughter 2 shall appoint a successor trustee who is not related or subordinate within the meaning of § 672(c) to Daughter 2. Accordingly, pursuant to this amendment, any successor trustee would not be related or subordinate to either Daughter.

You represent that no additions, actual or constructive, have been made to Trust 2 since September 25, 1985.

You have requested rulings that the joint resignation of Daughter 1 and Daughter 2 as co-trustees, the appointment of X and Y as successor trustees, and the Court approval of the proposed amendment to the successor trustee provisions of Trust 2, (1) will not cause either Daughter to be treated as having possessed, exercised or released a general power of appointment for purposes of § 2041 or 2514; (2) will not cause the interests of Daughters in Trust 2 to be includible in their respective gross estates under § 2033, 2036, 2037, or 2038; and (3) will not cause Trust 2 to lose it GST tax exempt status under chapter 13.

Law and Analysis—Issue 1

Section 2501(a)(1) imposes a tax, for each calendar year, on the transfer of property by gift by any individual, resident or nonresident. Section 2511 provides that the tax imposed by § 2501 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, is deemed the transfer of property by the individual possessing such power. Under § 2514(c), the term “general power of appointment” is defined as a power which is exercisable in favor of the individual possessing the power (“the possessor”), his estate, his creditors, or creditors of his estate.

Under § 2514(c)(3)(B), a power of appointment created after October 21, 1942 is not a general power of appointment if the power is not exercisable by the possessor except in conjunction with a person having a substantial interest in the property subject to the power, which is adverse to exercise of the power in favor of the possessor – such power shall not be deemed a general power of appointment. For the purposes of this subparagraph, a person who, after the death of the possessor, may be possessed of a power of appointment (with respect to the property subject to the possessor’s power) which he may exercise in his own favor shall be deemed as having an interest in the property and such interest shall be deemed adverse to such exercise of the possessor’s power. Further, for purposes of subparagraph (B), a power shall be deemed to be exercisable in favor of the person if it is exercisable in favor of such person, his estate, his creditors, or the creditors of his estate.

Section 25.2514-3(b)(2) of the Gift Tax Regulations provides that an interest adverse to the exercise of the power is considered as substantial if its value in relation to the total value of the property subject to the power is not insignificant. A taker in default of appointment under a power has an interest which is adverse to an exercise of the

power. A coholder of the power has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a coholder of a power is considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of this estate. Thus, for example, if X, Y, and Z held a power jointly to appoint among a group of persons which includes themselves and if on the death of X the power will pass to Y and Z jointly, then Y and Z are considered to have interests adverse to the exercise of the power in favor of X. Similarly, if on Y's death the power will pass to Z, Z is considered to have an interest adverse to the exercise of the power in favor of Y.

In the present case, Article 1, Section 1.1, paragraph 3, gives the co-trustees discretionary power to distribute income and/or principal to either Daughter. This power is not limited by an ascertainable standard. Daughters 1 and 2 are serving as co-trustees and, therefore, have joint power to authorize distributions of income and/or principal to either Daughter from Trust 2. In this case, each coholder of this power has an adverse interest because either Daughter may possess the power after the other Daughter's death and may exercise such power at that time in favor of herself, her estate, her creditors, or the creditors of her estate. The facts are similar to the example in § 25.2514-3(b)(2). Thus, the distribution power held by each Daughter is not considered a general power of appointment. Further, Trust 2 does not grant Daughters any other inter vivos powers of appointment.

Accordingly, based upon the facts and representations made, Daughter 1 and Daughter 2 do not possess general powers of appointment for purposes of § 2514 and, therefore, the joint resignation by Daughters as co-trustees will not be treated as the exercise or release of a general power of appointment for purposes of § 2514(b).

Under § 2041(a)(2), the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has, at the time of death, a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) defines "general power of appointment" as a power which is exercisable in favor of the decedent, his estate, his creditors, or creditors of his estate.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that a power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment. For example, if under the terms of a trust instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself and the decedent has the unrestricted power to remove or discharge

the trustee at any time and appoint any other person including himself, the decedent is considered to have 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, 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.

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 the which the grantor is an executive.

In the present case, Daughters will resign as co-trustees. X and Y, two individuals who are not related or subordinate to either Daughter, will be appointed successor trustees pursuant to Court order. X and Y, as co-trustees, will be the only individuals who have the power to make distributions of income and/or principal to either Daughter. Under the amendments to the trustee provisions of Trust 2, if X and/or Y dies, resigns, refuses, fails or ceases to serve as a successor trustee, Daughters may only replace X and/or Y with a successor trustee who is not related or subordinate within the meaning of § 672(c) to either Daughter. All successor trustees must not be related or subordinate to Daughters within the meaning of § 672(c). The replacement powers given to Daughters are not the equivalent of the power referred to 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 proposed powers given to Daughters are the equivalent of the power referenced in Rev. Rul. 95-58 where a replacement trustee may not be a related or subordinate party within the meaning of § 672(c). Further, Trust 2 does not grant Daughters any other testamentary powers of appointment. Accordingly, based upon the facts and representations made, Daughters will not be treated as having general powers of appointment for purposes of §§ 2514 and 2041 solely as a result of retaining the replacement power.

Law and Analysis—Issue 2

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 shall include the value of all property to the extent of the interest therein of the decedent at the time of the decedent's 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 case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—(1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides generally that the value of the gross estate shall include the value of all property to the extent of any interest therein which the decedent has made a transfer, by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property.

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.

In the present case, Daughters were not the transferors of property to Trust 2 for purposes of §§ 2036 through 2038. Husband and Wife were the transferors. The joint resignation of Daughters as co-trustees, the appointment of X and Y as successor trustees, and the amendment to the Trust 2 trustee provisions do not cause Daughters

to be treated as transferors for purposes of §§ 2036 through 2038. Further, each Daughter's interest in Trust 2 terminates at each Daughter's death. Accordingly, based upon the facts and representations made, we rule that the joint resignation and Court approval of the successor trustees and amendments to Trust 2 will not cause the interests of Daughters in Trust 2 to be includible in their respective gross estates under §§ 2033 through 2038.

Law and Analysis—Issue 3

Section 2601 imposes a tax on every generation-skipping transfer. Section 2611(a) defines the term "generation-skipping transfer" as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (the Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, the GST tax shall not apply to any GST under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of any additions, actual or constructive, to the trust after September 25, 1985.

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 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 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 § 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 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.

Under § 26.2601-1(b)(4)(D)(2), a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

In the present case, the joint trustee resignation, appointment of the successor trustees, and the amendment to the trustee provisions of Trust 2 are administrative in nature and will not be considered to shift beneficial interests in Trust 2 to a beneficiary who occupies a lower generation than each Daughter. Accordingly, based upon the facts and representations made and assuming the Court order is consistent with the facts and representations, we conclude that Trust 2 will not lose its GST tax-exempt status under chapter 13.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction, including the Settlement Agreement or any 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.

Sincerely,

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

Enclosure (1)