Internal Revenue Service

Department of the Treasury
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Person To Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-115974-16

In Re:

Date:
September 19, 2016

Legend

Settlor
Spouse
Son
Trust A
Trust 1

Date 1
Date 2
Date 3
Date 4
Date 5
Date 6
Individual 1
Individual 2
Attorney 1
Attorney 2
Law Firm
State Statute 1
State Statute 2
State Court
x

Dear :

This letter responds to your authorized representative's letter dated May 12, 2016, requesting gift, estate, and generation-skipping transfer (GST) tax rulings with respect to the proposed modifications of a trust.

The facts and representations submitted are summarized as follows:

On Date 1, Settlor created Trust A. On Date 2, Trust A was amended and restated, at which point it became irrevocable. Date 1 and Date 2 are prior to September 25, 1985.

Pursuant to Article III of Trust A, three separate trusts have been established with identical terms, one for each of Settlor's three sons. One of those separate trusts, Trust 1, was established for the benefit of Son. Article III provides that the trustees (other than Settlor's spouse (Spouse)) may distribute net income among the son and his issue at the trustees' discretion. Any net income not distributed is to be accumulated and added to principal. The trustees (other than Spouse) also have the discretion to distribute principal for the son or his issue for their "health, maintenance, support and education or to assist any of them in the purchase of a home or in a business or profession."

If the son is living at the death of the survivor of Settlor and Spouse, the trustees are directed to distribute to the son one-tenth of the principal of the trust when he reaches thirty years of age and four-ninths when he reaches thirty-five years of age. If at the death of the survivor of Settlor or Spouse the son has already attained these ages, the trustees are at that time to make the required distributions to the son. The balance of the trust will continue on the same terms for income and principal distributions.

Upon the death of the son, the balance of principal and any undistributed income is to be distributed to the persons specified by the son in the exercise of a limited power of appointment. If the power of appointment is not exercised, the balance of the trust is to be distributed to the son's issue *per stirpes*.

If the son is deceased at the death of the survivor of Settlor and Spouse, the balance of the principal and undistributed income will be distributed to the son's issue *per stirpes*. If the son and all his issue die, the entire balance of his trust shall be added to the trusts for the other sons of Settlor.

Article VI, Paragraph B, provides, in relevant part, that all real estate decisions are to be made, during Settlor's lifetime, by Spouse, while she is trustee. All other decisions (including real estate decisions made after Settlor's death or while Settlor is alive and Spouse is not serving as trustee) are to be made by a majority of trustees entitled to act in any specific instance.

Under Article X, Paragraph A, Settlor appoints Spouse and Attorney 1 as the original trustees. Upon the death, resignation, or inability of Spouse to serve as trustee, Settlor appoints Individual 1 as successor trustee and upon Individual 1's death, resignation, or inability to serve, the vacancy is to be filled by such individual or series of individuals, other than Settlor, as the last to serve of Spouse and Individual may designate in writing.

Under Article X, Paragraph B, upon Settlor's death, Spouse, Individual 1, and Attorney 1 are to serve as co-trustees. Upon the death, resignation, or inability of either Individual 1 or Spouse to serve as trustee, Individual 2 is appointed as trustee. As each son attains the age of twenty-five, he will become a trustee of his trust.

Article X, Paragraph C, provides that upon the death, resignation, or inability of Attorney 1 to serve as co-trustee, the vacancy will be filled by a member of Law Firm that Attorney 1 may designate in his will, but in the event that he fails to designate, or if his designee dies, resigns or is unable to serve, said vacancy shall be filled, and shall continue to be filled, by a member of Law Firm as shall be designated by that firm, from time to time.

Article X, Paragraph D, provides that as each trustee attains the age of x, he or she shall resign and be succeeded in accordance with Paragraphs A, B, and C.

Article X, Paragraph E, provides, in relevant part, that a son or other issue of Settlor, who is serving as a trustee, is prohibited from participating in any decision relating to discretionary distributions of income or principal.

On Date 3, the three sons of Settlor signed a statement that acknowledges that each individual trustee (other than a son of Settlor) shall have one vote with respect to all business decisions to be made by the trustees. The sons of Settlor shall collectively have one vote with respect to all business decisions to be made by the trustees. The term "business decisions" is defined to mean any decision that pertains to or affects an interest in a closely held investment, including any decision to acquire additional interests in an existing closely held investment. On Date 4, State Court issued a decree that appointed each son as a co-trustee of his separate trust. On Date 5, Attorney 2 was appointed as a co-trustee of each separate trust.

Law Firm delivered a letter, dated Date 6, to Spouse stating that (i) Attorney 2 was serving as co-trustee with Attorney 1; (ii) Attorney 2 would serve as successor trustee to Attorney 1 upon Attorney 1's resignation; (iii) after the termination of service as trustee by both Attorney 1 and Attorney 2, Law Firm would designate as successor trustee a partner of Law Firm who is acceptable to Spouse, if she is living, or the sons of Spouse, if Spouse is not living; (iv) such procedure would be repeated each time a partner of Law Firm terminated his service as trustee; (v) if such procedure to appoint a

successor trustee by Law Firm did not result in the appointment of a trustee who is acceptable to Spouse, if she is living, or the sons of Spouse, if Spouse is not living, then Law Firm would assist and cooperate with any court proceeding to appoint a trustee who is not related or subordinate to any of the beneficiaries, within the meaning of § 672(c) of the Internal Revenue Code, to fill such vacancy.

Attorney 1 and Spouse resigned as trustees when they reached the age of x. Individual 1 was already more than x years old when Spouse resigned, so Individual 1 never served as trustee. Currently, Son and Attorney 2 are the only co-trustees of Trust 1.

State Statute 1 provides, in relevant part, that a noncharitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries even if the modification or termination is inconsistent with a material purpose of the trust. A settlor's power to consent to a trust's modification or termination may be exercised by a guardian, an agent under the settlor's general power of attorney or an agent under the settlor's limited power of attorney that specifically authorizes that action.

State Statute 2 provides, in relevant part, that all beneficiaries and trustees of a trust may enter into a binding nonjudicial settlement agreement with respect to any matter involving the trust. A nonjudicial settlement agreement is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court under this chapter or other applicable law.

Under the authority of State Statute 2, the beneficiaries, which include Son and Son’s children, and trustees of Trust 1 propose to enter into a nonjudicial settlement agreement to amend certain administrative provisions of Trust A. The settlement agreement will provide for successor trustee provisions in light of the fact that Law Firm dissolved. Under the settlement agreement, the Date 3 statement, Paragraph B of Article VI, and Article X in its entirety are revoked. Each son of Settlor is to serve as co-trustee of his separate trust with Attorney 2.

The settlement agreement also provides that a new Article X is to be added to Trust A. The new Article X provides, in relevant part, that at least one Independent Trustee is to serve each separate trust. Each son is to have the right, at any time, to remove any trustee, including an Independent Trustee, then serving his separate trust and to appoint a substitute trustee who is an Independent Trustee. Each son may appoint an individual or individuals to exercise such powers, known as an Appointment Person, to appoint a new Independent Trustee, in the case of son’s death or disability.

The settlement further provides that the individual trustees, by majority vote, may appoint individuals to serve as additional trustees, provided that only Independent Trustees are eligible to elect additional trustees who are not Independent Trustees. Each individual trustee may appoint one or more individuals to serve concurrently or

consecutively, as his or her successor. If at any time there is no Independent Trustee serving, the vacancy in the position is to be filled by the son of Settlor, or if none, by a majority of the income beneficiaries of such trust who are of age and able to give or withhold consent. No son or other issue of Settlor, who may at any time be serving as trustee, may participate in any decision relating to the discretionary distributions of income or principal. An Independent Trustee is defined as a trustee who is not a related or subordinate party, as defined in § 672(c) to Settlor, Spouse, or any of Settlor's issue.

You have requested the following rulings:

1. The proposed modifications to Trust 1 will not constitute the grant of a general power of appointment under §§ 2041 and 2514 and, thus, the assets of Trust 1 will not be includible in Son's gross estate at death and will not be deemed to be transferred by Son for gift tax purposes.

2. The proposed modifications to Trust 1 will not constitute a constructive addition to Trust 1 under § 2601 and will not affect the exempt status of Trust 1 for GST tax purposes.

3. The proposed modifications to Trust 1 will not cause distributions from or the termination of any interest in Trust 1 to be subject to GST tax.

LAW AND ANALYSIS

Ruling 1

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has, at the time of 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.

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 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 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 posessor that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 25.2514-1(b)(1) of the Gift Tax Regulations provides, in part, that a donee may have a power of appointment if he has the power 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 Rev. Rul. 95-58, 1995-2 C.B. 191, the Service ruled 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.

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.

In this case, none of the proposed modifications affect the dispositive provisions of Trust 1. At all times, both before and after the proposed modifications, no son or other issue of Settlor, who may at any time be serving as trustee, may participate in any decision relating to the discretionary distributions of income or principal. Under the proposed modification, at all times there is to be an Independent Trustee of each separate trust. A son of Settlor may remove a trustee and must replace that trustee with an Independent Trustee. The son of Settlor may not participate in any way with the selection of a non-Independent Trustee. Furthermore, in the case of the son's death or disability, only the Appointment Person may appoint an Independent Trustee. Son's power to remove and replace a trustee is 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). Accordingly, based on the facts submitted and the representations made, we conclude that the proposed modifications to Trust 1 will not constitute the grant of a general power of appointment under §§ 2041 and 2514 and, thus, the assets of Trust 1 will not be includible in Son's gross estate at death and will not be deemed to be transferred by Son for gift tax purposes.

Rulings 2 and 3

Section 2601 imposes a tax on every 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 § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the GST Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable

to corpus so added). Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(1)(iv) provides, in relevant part, that for purposes of chapter 13, a constructive addition under § 26.2601-1(b)(1)(v) is treated as an addition to a trust.

Section 26.2601-1(b)(1)(v)(A) provides, in relevant part, that, except as provided under § 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

Section 26.2601-1(b)(1)(v)(B) provides, in relevant part, that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) will not be treated as an addition to a trust if the power of appointment was created in an irrevocable trust that is not subject to chapter 13 under § 26.2601-1(b)(1).

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 paragraph (b)(1), (2), or (3) of this section (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 this paragraph 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, Settlor established an irrevocable trust for the benefit of Settlor'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 this case, Trust 1 was created, funded, and became irrevocable prior to September 25, 1985. It is represented that there have been no additions, actual or constructive, since that date. Son’s rights under the proposed modification to remove any Trustee and to appoint a successor to such Trustee, provided that any Trustee so appointed shall be an Independent Trustee, should not be considered a constructive addition to any trust because such rights do not constitute a general power of appointment within the meaning of §§ 2041(b) and 2514(c). The changes are administrative in nature under § 26.2601-1(b)(4)(i)(D)(2), and will not be considered to shift a beneficial interest to a lower generation in the trust. See Example 10 of § 26.2601-1(b)(4)(i)(E). The changes will not result in a shift in any beneficial interest to a lower generation nor do the changes extend the time for vesting of any beneficial interest in Trust. Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed modifications to Trust 1 will not constitute a constructive addition to Trust 1 under § 2601 and will not affect the exempt status of Trust 1 for GST tax purposes. We also conclude that the proposed modifications to

Trust 1 will not cause distributions from or the termination of any interest in Trust 1 to be subject to GST tax.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the 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.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures
Copy for § 6110 purposes
Copy of this letter