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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
April 18, 2000

Beneficiary =

Trustee =

Trust =

Agreement =

Third Amendment =

Court =

City =

State =

County =

Statute =

Dear :

We received a letter dated April 9, 1999, and subsequent correspondence, from your authorized representative requesting rulings concerning the possible estate tax consequences resulting from the proposed modifications to twelve trusts.

According to the facts submitted, Beneficiary is the current sole income beneficiary of twelve trusts created prior to September 25, 1985. This ruling request addresses one of these trusts, Trust. Trust was fully funded at the time it was established and no additions have been made to Trust. Under Article I.(1) of Trust, all trust income is to be paid to Beneficiary after Beneficiary attains age 30. On the death of Beneficiary, the Trust corpus is to be held in further trust for the benefit of Beneficiary's issue. Trustee is currently acting as the trustee of all twelve trusts. Under Article II, the powers of the trustee are at all times subject to the continued direction and

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control of an Investment Committee. Under Article III, a trustee may resign by giving written notice to all adult beneficiaries. In such event, a majority in interest of those to whom notice is given may designate a successor trustee. Any successor trustee must be a corporation doing business in County and authorized under the laws of State to execute trusts. Such successor trustee must also have been in existence not less than ten years and have a net worth in excess of two million dollars. The resigning trustee is to transfer to its successor the entire estate then remaining, and the successor trustee shall assume all the obligations of the resigning trustee.

Taxpayer represents that the Investment Committee no longer functions. Certain disputes have arisen between Beneficiary and Trustee regarding the management of Trust. In order to resolve these disputes, Trustee and Beneficiary entered into the Agreement with respect to the twelve trusts.

Paragraph 3.a. of the Agreement provides that at any time during the term of any trust, upon the written request of the current income beneficiary and the adult remainder beneficiary, a new trustee designated by the current income beneficiary and the adult remainder beneficiary is to be substituted as the trustee of the trust provided that any such new trustee: (1) is a corporation that has been, or its parent company has been, in existence at least ten years; (2) is a bank or trust company then doing business in City, State and that is authorized under the laws of State to execute trusts; (3) has a net worth (including the net worth of any parent company) in excess of two hundred million dollars; and (4) is not related or subordinate to any beneficiary within the meaning of § 672(c) of the Internal Revenue Code. Upon any resignation by any existing trustee of a trust, or any removal thereof other than pursuant to the immediately preceding sentence, a new trustee designated by the current income beneficiary and the adult remainder beneficiary shall be substituted as the new trustee of such trust provided that such new trustee meets the requirements set forth in items (1), (2), (3) and (4), above.

Paragraph 4.a. of the Agreement provides that the current income beneficiary shall have the right from time to time to have one or more investment managers or submanagers manage the investment of a portion of the assets. The current income beneficiary shall also have the right from time to time to transfer investment and management of certain assets from any submanager or investment manager then investing or managing such assets directly to another submanager or investment manager, or to return such assets to the trustee for investment or management.

Paragraph 4.b. provides that all assets managed, invested or administered by the trustee shall be managed, invested and administered in accordance with certain investment policies. All assets managed, invested or administered by an investment manager or submanager shall be managed, invested and administered in accordance with certain investment guidelines. The current income beneficiary may from time to time propose modifications to the investment guidelines by written notice to the trustee,

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and any investment manager or submanager. Each trustee, investment manager or submanager shall have the right to approve such modification, such approval not to be unreasonably withheld.

Paragraph 4.c. provides that a “submanager” is an agent of the trustee that has been designated and selected by the current income beneficiary and to which investment functions have been delegated pursuant to State Statute. The current income beneficiary shall have the right to propose potential submanagers from time to time for approval by the Trustee, such approval not to be unreasonably withheld.

Paragraph 4.d. provides that an “investment manager” is a third party fiduciary, not an agent of the trustee, that has been designated and selected by the current income beneficiary and to which investment, administration and fiduciary responsibilities for certain trust assets are transferred, with the trustee merely remaining as custodian of such assets with no fiduciary duties except to the extent provided by the provisions of State Statute. Any investment manager must meet the requirements to become a trustee, that is, an investment manager must be: (1) a corporation that has been, or its parent company has been, in existence at least ten years; (2) a bank or trust company then doing business in City, State and that is authorized under the laws of State to execute trusts; (3) have a net worth (including the net worth of any parent company) in excess of two hundred million dollars; and (4) not be related or subordinate to any beneficiary within the meaning of § 672(c) of the Internal Revenue Code.

Paragraph 1.a. of Third Amendment to Agreement provides that, notwithstanding any other provision of the Agreement, the trust instrument or applicable law to the contrary: (1) in exercising its rights and powers under Paragraphs 4.c. and 4.d. of the Agreement with respect to the selection, removal and replacement of investment managers and submanagers, the current income beneficiary shall be deemed to be acting in the role of a fiduciary as to all beneficiaries of Trust with respect to which any such rights or powers are exercised, and shall be subject to the Uniform Prudent Investor Act of State; and (2) each investment manager and submanager shall at all times be deemed to be a fiduciary of a trust for which it administers assets, shall be subject to the Uniform Prudent Investor Act of State, and shall not be a related or subordinate party to the current income beneficiary, as defined in § 672(c), determined as if the current income beneficiary was a grantor of the trust.

You represent that no additions of assets, actual or constructive, have been made to Trust subsequent to September 25, 1985. In addition, no modifications or amendments, other than the proposed modifications have been made to any of the trusts. In addition, all trusts were irrevocable as of the date of creation, prior to September 25, 1985. The Agreement has been approved by Court and you propose to have the Third Amendment approved by Court.

You have requested the following rulings:

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1. Modification of Trust in accordance with the Agreement and the Court order will not affect the exempt status of Trust for generation-skipping transfer tax purposes.

2. The power to remove and replace the Trustee and to institute investment guidelines and policies in accordance with the Agreement and the Court order will not cause inclusion of Trust in the gross estate of Beneficiary.

Issue 1

Section 2601 provides that a tax is imposed on every generation-skipping transfer. Under § 1431(a) of the Tax Reform Act of 1986 (the Act) the tax generally applies to any generation-skipping transfer made after October 22, 1986, the date of enactment of the Act. However, § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-skipping Transfer Tax Regulations provide that 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 addition, actual or constructive, to the trust after September 25, 1985 (or out of income attributable to corpus so added).

A modification of a generation-skipping trust that is otherwise exempt under the Act and the regulations will generally result in a loss of its exempt or “grandfathered” status if the modification changes the quality, value, or timing of any powers, beneficial interest, rights, or expectancies originally provided for under the terms of the trust.

Based on the facts presented and representations made, we conclude that the proposed modifications to Trust are administrative in nature and will not result in any change in the quality, value, or timing of any beneficial interest in Trust. Consequently, Trust will continue to be exempt from the GST tax. Therefore, provided there are no additions, constructive or otherwise, to Trust, neither distributions from nor the termination of Trust will be subject to the GST tax under § 2601.

Issue 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 such a power of appointment by a disposition that 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)(A) provides that a general power of appointment is a power that is exercisable in favor of the decedent, 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

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the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 20.2041-1(b) of the Estate Tax Regulations provides that a power in a decedent 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 as having a power of appointment.

Rev. Rul. 95-58, 1995-2 C.B. 191, revoking, Rev. Rul. 79-353, 1979-2 C.B. 325, holds that a decedent-settlor'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 of the trustee's discretionary powers of distribution over the property transferred by the decedent-settlor to the trust, for purposes of §§ 2036 and 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 the present case, the Agreement gives Beneficiary of Trust the power to remove and replace the trustee, to propose investment guidelines and policies, and to recommend investment managers and submanagers. The powers of the Beneficiary, the investment managers, and the submanagers are exercisable in a fiduciary capacity. Any trustee, investment manager, or submanager may not be related or subordinate to any beneficiary of Trust within the meaning of § 672(c). Further, the trustee has no discretionary power with respect to distributions of trust income and corpus. We conclude that Beneficiary will not be treated as holding a general power of appointment solely as a result of retaining the removal and replacement power. See Rev. Rul. 95-58. Therefore, the possession of the power will not cause Trust to be included in Beneficiary's gross estate.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code. This ruling is based on the facts and applicable law in effect on the date of this letter. If there is a change in material fact or law (local or Federal) before the transactions considered in the ruling take effect, the ruling will have no force or effect. If the taxpayer is in doubt whether there has been a change in material fact or law, a request for reconsideration of this ruling should be submitted to

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this office.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,
Assistant Chief Counsel
(Passthroughs and Special Industries)

By George Masnik
Chief, Branch 4

Enclosure

Copy for § 6110 purposes