**Internal Revenue Service**

Department of the Treasury
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Person To Contact:
, ID No.
Telephone Number:

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LEGEND

| | |
|---|---|
| Trustee | = |
| Trust | = |
| Year 1 | = |
| Settlor | = |
| Son 1 | = |
| Son 2 | = |
| Daughter | = |
| Wife | = |
| Year 2 | = |
| Trust Company | = |
| Corporation | = |
| Bank 1 | = |
| Bank 2 | = |
| Bank 3 | = |

Dear :

This responds to a letter dated June 16, 2006, submitted on your behalf, in which rulings are requested on the estate, gift, and generation-skipping transfer tax consequences of the proposed modification to Trust and the anticipated exercise of a limited testamentary power of appointment provided under Trust.

FACTS

The facts and representations submitted are summarized as follows. In Year 1, Settlor established Trust, an irrevocable trust, for the benefit of his wife and descendants. Son 1, Son 2, and Daughter are the children of Settlor and Wife. Settlor and Wife are

currently deceased, and Son 1, Son 2, and Daughter are over the age of 35. Trust was created before October 21, 1942.

According to the provisions of paragraphs (b), (c), and (d) of Article 1 of Trust, upon the death of Wife in Year 2, the trust corpus was divided into three shares, one for each child of Settlor and Wife. According to paragraph (d) of Article 1, the trustee of Trust may distribute to each child from his or her respective separate share so much of the net income as the trustee deems wise and prudent, in the trustee's absolute discretion. For each child over the age of 35, the trustee may distribute from his or her respective share so much of the principal and accumulated income of Trust as such child shall from time to time request in writing. Paragraph (d) of Article 1 further provides that upon the death of a child of Settlor and Wife, the trustee shall distribute the entire remaining principal and accumulated income of the child's separate share of Trust to or for the benefit of such of the descendants of the child as such child shall direct in his or her will.

Son 1, Son 2, and Daughter anticipate exercising their respective limited testamentary power to appoint the principal and income of their respective trust as provided in Trust.

The rules governing the appointment of successor trustees are provided in Article 2 of Trust. Paragraph (b) provides that if, after the death of Settlor, any trustee shall for any reason fail or cease to act as trustee, the power to appoint a successor trustee may be exercised by the following persons in the following order: (1) by a majority of trustees of Trust Company; (2) if Trust Company shall cease to exist and no business enterprise shall acquire the property comprising the trust estate of Trust Company, by the Board of Directors of Corporation (the "Board") or any successor organization which shall acquire substantially all of the assets and business of Corporation; and, (3) in the event of the nonexistence of all of the foregoing, by a majority in interest in the income beneficiaries who shall be under no disability.

Trust Company has ceased to exist and the Board currently has the power to appoint successor trustees. In a meeting of the Board after the death of Wife, the Board resolved to appoint successor trustees of the trusts established under Trust, as follows:

> If the current trustee or any successor trustee appointed hereunder ceases to act as trustee of any trust, the Board appoints as trustee of such trust such qualified bank or trust company as the beneficiary of such trust may appoint by signed written instrument delivered to the Board no later than thirty days after such cessation to act. If such beneficiary does not make an appointment, the Board appoints as trustee of such trust the first of the following that is then in existence, is then a qualified bank or trust company and is then willing to act as trustee of such trust: (a) Bank 1; (b) Bank 2; and (c) Bank 3.

The Board's resolution defines "qualified bank or trust company" as a bank or trust company that is qualified to accept trusts, that is not related or subordinate to any beneficiary of a trust (within the meaning of § 672(c) of the Code), that has engaged in the trust business for at least ten years immediately prior to its appointment as trustee by the Board, and that has assets under management of at least one billion dollars.

The Board further resolved that a bank or trust company ceases to act as trustee of a trust upon the first to occur of (1) its resignation, (2) its removal as trustee by thirty days written notice signed by the beneficiary of the trust and delivered to it and to the Board, and (3) its cessation to exist or to be qualified to accept trusts.

The Board's resolution is only effective upon the receipt of a favorable ruling issued by the Service confirming that the implementation of the resolution will not cause any trust to be subject to the generation-skipping transfer (GST) tax and will not cause any trust to be taxed in the estate of the beneficiary of that trust.

You request the following rulings:

(1) A beneficiary's power to appoint and remove a qualified bank or trust company as successor trustee of his or her respective trust will not be considered the creation of a general power of appointment under §§ 2041 or 2514 and the exercise of this power will not cause the assets of a beneficiary's trust to be includible in his or her estate, nor will the exercise of the power be considered a transfer for federal gift tax purposes.

(2) The exercise of a beneficiary's testamentary special power of appointment will not be considered an exercise of the beneficiary's lifetime general power of appointment.

(3) The implementation and operation of the Board's resolution will not cause Trust or the beneficiaries' trusts created thereunder to lose their exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(4)(i)(D) of the Generation-Skipping Transfer Tax Regulations, and will not subject distributions from any of the trusts to the GST tax.

Law and Analysis

Rulings 1 and 2

Section 2041(a)(1) of the Internal Revenue Code of 1954 provides that the value of the gross estate shall include the value of all property with respect to which a general power of appointment created on or before October 21, 1942, is exercised by the decedent by will or by certain lifetime disposition. The failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof. A general power of appointment is defined by § 2041(b)(1) as a power exercisable in favor of the decedent, his estate, his creditors or the creditors of his estate.

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 20.2041-1(c)(1) provides that a decedent may have two powers under the same instrument, one of which is a general power of appointment and the other of which is not. For example, a beneficiary may have a power to withdraw trust corpus during his life, and a testamentary power to appoint the corpus among his descendants. The testamentary power is not a general power of appointment.

Section 20.2041-2(f) provides that if a general power of appointment created on or before October 21, 1942, is exercised only as to a portion of the property subject to the power, § 2041 is applicable only to the value of that portion.

Section 2514(a) provides that an exercise of a general power of appointment created on or before October 21, 1942, shall be deemed a transfer of property by the individual possessing such power; but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof.

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.

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, another person, 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.

Section 25.2514-1(c)(1) provides that a beneficiary may have two powers under the same instrument, one of which is a general power of appointment and the other of which is not. For example, a beneficiary may have a general power to withdraw a limited portion of trust corpus during his life and a further power exercisable during his lifetime to appoint the corpus among his children. The latter power is not a general power of appointment.

Section 25.2514-2(e) provides that if a general power of appointment created on or before October 21, 1942, is exercised only as to a portion of the property subject to the power, the exercise is considered to be a transfer only as to the value of that portion.

Rev. Rul. 95-58, 1995-2 C.B. 191, holds that a decedent/grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or corporate successor trustee that is not related or subordinate to the decedent within the meaning of § 672(c), is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus is not included in the decedent's gross estate under §§ 2036 or 2038. The ruling notes that the Eighth Circuit in Estate of Vak v. Commissioner, 973 F.2d 1409 (8th Cir. 1992), concluded that the decedent had not retained dominion and control over assets transferred to a trust by reason of his power to remove and replace the trustee with a party that was not related or subordinate to the decedent. Accordingly, the court held that under § 25.2511- 2(c), the decedent made a completed gift when he created the trust and transferred assets to it.

Section 672(c) defines the term “related or subordinate party” to mean any nonadverse party who is (1) the grantor’s spouse if living with the grantor; or (2) any one of the following: the grantor’s father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

In regard to the first ruling requested, upon the resignation of the current trustee, a bank or trust company that is appointed as successor trustee will have the sole discretionary authority to make distributions of income from each trust. After the resignation of the current trustee, Son 1, Son 2, and Daughter will have an unqualified power to remove a trustee and to appoint a successor trustee. The Board’s resolution, however, restricts any appointment of a successor trustee to a “qualified bank or trust company,” which is defined therein as a bank or trust company that is qualified to accept trusts, that is not related or subordinate to any beneficiary of a trust (within the meaning of § 672(c) of the Code), that has engaged in the trust business for at least ten years immediately prior to its appointment as trustee by the Board, and that has assets under management of at

least one billion dollars. The removal and appointment powers given to Son 1, Son 2, and Daughter 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 power given to Son 1, Son 2, and Daughter is 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).

Accordingly, based on the facts submitted and the representations made, we conclude that the Board's resolution will not cause Son 1, Son 2, or Daughter to have a general power of appointment under §§ 2041 or 2514. Thus, the exercise of this power will not cause the assets of a beneficiary's trust to be includible in his or her estate, nor will the exercise of the power be considered a transfer for federal gift tax purposes.

In regard to the second ruling requested, we note that Son 1, Son 2, and Daughter anticipate exercising their respective limited testamentary powers of appointment to appoint property of his or her respective trust to his or her descendants. Son 1, Son 2, and Daughter also have an inter vivos general power to appoint as much principal and accumulated income from his or her respective trust as he or she requests in writing to the trustee.

As provided in §§ 20.2041-1(c)(1) and 25.2514-1(c)(1), the same trust instrument, as in this case, may give a beneficiary two separate powers, one of which is a general power of appointment and one of which is not. The exercise of a limited testamentary power of appointment is not considered as an exercise of a lifetime general power of appointment even though both powers are over the same trust assets. If Son 1, Son 2, or Daughter exercise only his or her respective limited testamentary power of appointment, and not his or her general power of appointment, the assets from each trust will not be included in his or her gross estate under § 2041. If Son 1, Son 2, or Daughter exercises his or her lifetime general power of appointment, the exercise will be considered to be a transfer under § 2514 to the extent of the value of property with respect to which the general power of appointment is exercised.

Ruling 3

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), 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) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

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) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument by judicial reformation, or nonjudicial reformation that is valid under applicable state law will not cause an exempt trust to be subject to the GST tax, 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. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST or the creation of a new GST.

Section 26.2601-1(b)(4)(i)(E), Example 10, provides as follows. In 1980, Grantor executed 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 present case, Trust was irrevocable on September 25, 1985. It is represented that no additions, actual or constructive, have been made to Trust after that date. The change in the process for appointing and removing successor trustees as set forth in the Board's resolution is similar to the change described in § 26.2601-1(b)(4)(i)(E), Example 10. The Board's resolution will not result in a shift of any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests in the trusts prior to the Board's resolution and the Board's resolution will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in Trust.

Accordingly, based on the facts submitted and the representations made, we conclude that the implementation and operation of the Board's resolution will not cause Trust to

lose its status under § 1433 of the Tax Reform Act of 1986 as a trust exempt from the application of the GST tax under chapter 13 of the Code.

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,

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)