

(f) * * * (1) * * * In addition, the surviving spouse's interest shall meet the condition set forth in paragraph (a)(1) of this section if the spouse is entitled to income as determined by applicable local law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of § 1.643(b)–1 of this chapter.

* * * * *

■ **Par. 11.** Section 20.2056(b)–7 is amended by adding a new sentence to the end of paragraph (d)(1) to read as follows:

§ 20.2056(b)–7 Election with respect to life estate for surviving spouse.

* * * * *

(d) * * * (1) * * * A power under applicable local law that permits the trustee to adjust between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries that meets the requirements of § 1.643(b)–1 of this chapter will not be considered a power to appoint trust property to a person other than the surviving spouse.

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■ **Par. 12.** Section 20.2056(b)–10 is amended by adding a new sentence at the end of the section to read as follows:

§ 20.2056(b)–10 Effective dates.

* * * In addition, the rule in the last sentence of § 20.2056(b)–5(f)(1) and the rule in the last sentence of § 20.2056(b)–7(d)(1) regarding the effect on the spouse's right to income if applicable local law provides for the reasonable apportionment between the income and remainder beneficiaries of the total return of the trust are applicable with respect to trusts for taxable years ending after January 2, 2004.

■ **Par. 13.** Section 20.2056A–5 is amended by adding a new sentence in paragraph (c)(2) after the third sentence to read as follows:

§ 20.2056A–5 Imposition of section 2056A estate tax.

* * * * *

(c) * * *

(2) * * * However, distributions made to the surviving spouse as the income beneficiary in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount), or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries, will be considered distributions of trust income

if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of § 1.643(b)–1 of this chapter. * * *

* * * * *

■ **Par. 14.** Section 20.2056A–13 is revised to read as follows:

§ 20.2056A–13 Effective dates.

Except as provided in this section, the provisions of §§ 20.2056A–1 through 20.2056A–12 are applicable with respect to estates of decedents dying after August 22, 1995. The rule in the fourth sentence of § 20.2056A–5(c)(2) regarding unitrusts and distributions of income to the surviving spouse in conformance with applicable local law is applicable to trusts for taxable years ending after January 2, 2004.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

■ **Par. 15.** The authority citation for part 25 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *.

■ **Par. 16.** Section 25.2523(e)–1 is amended by adding a new sentence to the end of paragraph (f)(1) to read as follows:

§ 25.2523(e)–1 Marital deduction; life estate with power of appointment in donee spouse.

* * * * *

(f) * * * (1) * * * In addition, the spouse's interest shall meet the condition set forth in paragraph (a)(1) of this section if the spouse is entitled to income as defined or determined by applicable local law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of § 1.643(b)–1 of this chapter.

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■ **Par. 17.** Section 25.2523(h)–2 is amended by adding a new sentence to the end of the section to read as follows:

§ 25.2523(h)–2 Effective dates.

* * * In addition, the rule in the last sentence of § 25.2523(e)–1(f)(1) regarding the determination of income under applicable local law applies to trusts for taxable years ending after January 2, 2004.

PART 26—GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

■ **Par. 18.** The authority citation for part 26 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *.

■ **Par. 19.** Section 26.2601–1 is amended as follows:

■ 1. The second and third sentences of paragraph (b)(4)(i) are revised to read as follows.

■ 2. Paragraph (b)(4)(i)(D)(2) is amended by adding a new sentence to the end of the paragraph.

■ 3. Paragraph (b)(4)(i)(E) is amended by adding *Examples 11 and 12*.

■ 4. Paragraph (b)(4)(ii) is revised to read as follows.

The additions and revisions read as follows:

§ 26.2601–1 Effective dates.

* * * * *

(b) * * *

(4) * * * (i) * * * 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 generation-skipping transfer 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 section 1001.

* * * * *

(D) * * *

(2) * * * In addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of § 1.643(b)–1 of this chapter.

(E) * * *

Example 11. Conversion of income interest to unitrust interest under state statute. In 1980, Grantor, a resident of State X, established an irrevocable trust for the benefit of Grantor's child, A, and A's issue. The trust provides that trust income is payable to A for life and upon A's death the remainder is to pass to A's issue, per stirpes. In 2002, State X amends its income and principal statute to define income as a unitrust amount of 4% of the fair market value of the trust assets valued annually. For a trust established prior to 2002, the statute provides that the new definition of income will apply only if all the beneficiaries who have an interest in the trust consent to the