

INTERNAL REVENUE SERVICE  
Index No.: 2041.08-00; 2514.00-00;  
2601.03-01  
Number: **199906003**  
Release Date: 2/12/1999

CC:DOM:P&SI:4/PLR-107973-98

October 19, 1998

Re:

Legend:

Donor	=
X	=
Z	=
Trust Agreement	=
Child 2	=
Trust 2	=
Bank 1	=
Bank	=
State	=
Foundation	=
Spouse	=

This is in response to a letter dated March 23, 1998, and subsequent correspondence, in which rulings were requested concerning the gift, estate, and generation-skipping transfer tax consequences of a partial release of a testamentary special power of appointment.

Facts:

Donor executed Trust Agreement on date W, creating an irrevocable trust for the benefit of Donor's two daughters (Child 1 and Child 2) and Grandchild. Article I of Trust Agreement states that on the date of execution Donor transferred to Bank 1, as trustee, X shares of stock in Z.

Article II, Parts A, B, and C provide for the trust estate to be divided into three separate shares, each to be held as a separate trust: 46 percent for Child 1 (Trust 1); 50 percent for Child 2 (Trust 2); and 4 percent for Grandchild. Trust 2 is the subject of this ruling request.

Article II, Part B provides for the quarterly payment for life to Child 2, of all of the net income of Trust 2 as well as any amount of principal the trustee, in its discretion, deems "necessary for [Child 2's] maintenance, care and emergency needs in view of her income and other resources."

Article II, Part B further provides that, at the death of Child 2, the corpus of Trust 2 is to be distributed pursuant to the exercise of Child 2's special power of appointment as follows:

[Trust 2] shall be distributed to such person or persons, other than the beneficiary, her creditors, her estate or creditors of her estate, in such share or shares, in trust or otherwise, as [Child 2] shall by Last Will and Testament appoint.

To the extent that Child 2 fails to exercise this power, Trust 2 is to be distributed at her death to her then living issue or, if none, to the then living issue of the Donor, or, if none, to Child 2's spouse or, if none, to Foundation.

Article II, Part F provides for the termination of any trust created pursuant to a power of appointment under the Trust Agreement as follows:

[I]n the event any trust created hereby or pursuant to a power of appointment hereunder has not terminated it shall in any event terminate not later than the expiration of

twenty-one (21) years from and after the death of the last survivor of Donor, Donor's wife [Spouse], his said daughters and grandson. . .

Upon termination, the principal of any such trust will be distributed outright to the person or persons then entitled to the income from such share.

Article IV, Part C provides that any powerholder may "surrender" any part of any power of appointment by delivering a written instrument to the trustee.

The current trustee of Trust 2 is Bank 2, which is the successor in interest to Bank 1. Article VII of the Trust Agreement provides that any trustee may be removed by Spouse or, if Spouse is deceased, by Child 1 and Child 2 jointly, or if only one child is alive, by that child. Article VII further provides that any trustee must be a corporation with trust powers and a capital and surplus aggregating at least \$40,000,000.

Article IV, Part A contains the powers and duties of the trustee and provides that these powers and duties are subject to the provisions of Article IV, Part B. Article IV, Part B provides for a trust advisor who is to hold powers only in a "fiduciary capacity." If a trust advisor is living and competent, the trustee cannot sell Z stock without the written approval of the trust advisor and must sell Z stock at the written request of the trust advisor if the trustee "finds the price and terms to be reasonable." Further, the trustee cannot sell or invest in any other securities without consulting an existing, competent trust advisor and must consult with such advisor about "any question of discretionary distribution of income or principal." The trust advisor is authorized to designate "independent professional investment counsel" for the trusts, and the trustee must delegate "full investment power" to any such counsel during its designation.

Donor is named as the initial trust advisor, to be succeeded by Spouse, followed by Child 2; however, if only one child of Donor is living, that child will be trust advisor for all trusts. At the present time, Donor, Spouse, Child 1, and Child 2 are all living.

On October 6, 1998, Child 2 partially released her testamentary special power of appointment over Trust 2. Under the partial release, Child 2 retained the testamentary power to appoint the assets of Trust 2 remaining at her death

to such taker or takers, in such share or shares, on such terms and conditions, and in trust or otherwise, among the group consisting of descendants of [Child 2's] parents [Donor and Spouse] (other than [Child 2]), spouses of

such descendants, including any surviving spouse of [Child 2], and qualified charities.

Any appointment to a spouse of a descendant of Donor and Spouse may not confer a beneficial interest that exceeds the payment of income to the spouse for life of amounts sufficient for the spouse's health, maintenance, education, and support at the spouse's standard of living on the date when the spouse first becomes entitled to receive the payments.

You have requested that we rule as follows:

1. Child 2's partial release of her nongeneral power of appointment provided under Trust Agreement will not result in the inclusion, under § 2041, for federal estate tax purposes of the Trust 2 property in Child 2's gross estate.

2. Child 2's partial release of her nongeneral power of appointment provided under Trust Agreement does not constitute a gift by Child 2 under § 2514 for federal gift tax purposes.

3. Child 2's partial release of her nongeneral power of appointment provided under Trust Agreement does not constitute a "constructive addition" to Trust 2 for purposes of the effective date rules of the generation-skipping transfer tax (GSTT) under § 26.2601-1(b)(1)(v), and therefore, Trust 2 continues to be grandfathered from the application of the GSTT.

Law and Analysis:

Issues 1 & 2: §§ 2041 and 2514

Section 2041(a)(2) of the Internal Revenue Code 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) provides that the term "general power of appointment" means a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides that a power of appointment is not a general power if by its terms it is either (a) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate,

or (b) expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate, or the creditors of his estate.

Section 2501 of the Code provides for a gift tax on the transfer of property by gift. Section 2511 provides that the gift tax imposed by section 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.

Under § 2514(b), 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), "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 § 25.2514-1(c)(1), a power of appointment is not a general power if by its terms it is either (a) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate, or (b) expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate, or the creditors of his estate.

Under Article II, Part B of Trust Agreement, Child 2 was given the testamentary power to appoint Trust 2 among any persons, expressly excepting herself, her creditors, her estate, or creditors of her estate. Thus, under § 20.2041-1(c)(1) and § 25.2514-1(c)(1), Child 2's power under Article II, Part B is not a general power of appointment. Under § 2041(a)(2) and § 20.2041-3(d), the release of a nongeneral power of appointment will not cause inclusion in the gross estate of the powerholder of the property subject to the power. Similarly, under § 2514(b) and § 25.2514-3(a), the release of a nongeneral power is not treated as a transfer for gift tax purposes.

Accordingly, we rule that Child 2's partial release of her nongeneral power of appointment provided under Trust Agreement will not result in the inclusion under § 2041, for federal estate tax purposes, of the Trust 2 property in Child 2's gross estate. We further rule that Child 2's partial release of her nongeneral power of appointment provided under Trust Agreement does not constitute a gift by Child 2 under § 2514 for federal gift tax purposes.

Issue 3: § 2601

Section 2601 imposes a tax on each generation-skipping transfer (GST).

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax (GSTT) is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer from a trust if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

Section 26.2601-1(b)(1)(v)(A) provides 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 a special rule for certain powers of appointment. This section provides 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 (1) such power of appointment was created in an irrevocable trust that is not subject to Chapter 13 under § 26.2601-1(b)(1), and (2) in the case of an exercise, such power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years.

Trust 2 was irrevocable when it was created on date W. You represent that there have been no constructive or actual additions to Trust 2 since September 25, 1985. Consequently, based on these representations, we conclude that Trust 2 is currently exempt from the GSTT because Trust 2 was irrevocable on or before September 25, 1985, and because no additions, either actual or constructive, have been made to Trust 2 after that date.

Child 2's power of appointment is a nongeneral power, the release or partial release of which is not taxable under either § 2041 of Chapter 11 or § 2514 of Chapter 12. Accordingly, based on the facts submitted and representations made, we rule that Child 2's partial release of her power of appointment does not constitute a "constructive addition" to Trust 2 for purposes of the effective date rules of the GSTT under § 26.2601-1(b)(1)(v), and, therefore, after that partial release, Trust 2 continues to be exempt from the GSTT (assuming no additions, constructive (within the meaning of § 26.2601-1(b)(1)(v)) or otherwise, are made to the trust).

Except as we have specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code. Specifically, we express no opinion on the estate and gift tax consequences of Child 2's ability to replace the corporate trustee of Trust 2 or of Child 2's becoming trust advisor of Trust 2.

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

Sincerely,

Assistant Chief Counsel  
(Passthroughs and Special  
Industries)

By \_\_\_\_\_  
Katherine A. Mellody  
Assistant to the Chief  
Branch 4

Enclosure:  
Copy for section 6110 purposes