Internal Revenue Service
Index No.: 2041.00-00
2601.04-01
Number: **199912021**
Release Date: 3/26/1999

Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4 - PLR-109750-98
Date: December 22, 1998

Re:

LEGEND:
Grantor =
Taxpayer =

Spouse =
Trust 1 =

Trust 2 =

Trust 3 =

State X =
State X law =

Dear :

This is in reference to the letter dated April 15, 1998, from your authorized representative requesting a ruling regarding the effect of the proposed testamentary exercise of limited powers of appointment on the exempt status of trusts for federal estate tax and generation-skipping transfer (GST) tax purposes.

The Grantor, a grandparent of Taxpayer, died in 1963. During her lifetime, Grantor created Trusts 1 and 2, irrevocable inter vivos trusts. In addition, under the terms of her will, Trust 3 was established for the primary benefit of Taxpayer. The trusts are governed by the law of State X.

The Taxpayer is married and has four daughters.

Trust 1

Grantor established Trust 1 in 1951. Under Article 1 of Trust 1, after all proper expenses and charges are paid, the trustees have absolute discretion to distribute the remaining net income to or for the benefit of Taxpayer's mother and her descendants in such amounts and at such times as the trustees deem advisable in the best interest of the particular beneficiary or beneficiaries, to whom or for whose use income shall be so allocated, distributed, or accumulated. Article 2 states that upon the death of Taxpayer's mother, the trust fund is to be divided into two equal parts, designated as Trust A and Trust B. Trust B is primarily for the benefit of Taxpayer. According to the terms of Article 2(b)(2), after all proper expenses and charges are paid, the trustees have absolute discretion to distribute the remaining net income in Trust B to or for the benefit of Taxpayer and her descendants in such amounts and at such times as the trustees deem advisable in the best interest of the particular beneficiary or beneficiaries, to whom or for whose use income shall be so allocated, distributed, or accumulated.

Article 2(b)(2) of Trust 1 further states that upon the death of the Taxpayer, Trust B with all accumulations therein, shall be distributed to, or for the benefit of the members then or thereafter living of a class composed of the Grantor's issue (except Taxpayer, or her estate or the creditors of her estate), and of the spouses of such issue (including the spouse of Taxpayer), or any one or more of the members of such class, in such proportions and upon such lawful estates, trusts, terms and conditions as Taxpayer may direct or appoint by will. In default of the Taxpayer's exercise of the testamentary power to appoint the trust corpus, the corpus will pass pursuant to Article 2(b)(3) to the Taxpayer's issue, then living, per stirpes. If no such issue exist, then the trust corpus will pass to the persons, excluding Grantor, who would then be entitled thereto under the laws of State X, if the Taxpayer had died the owner thereof intestate and a resident of State X.

Under Article 4(y), neither the Taxpayer, any other income beneficiary, nor the spouse of any income beneficiary who becomes a trustee shall participate in any decision regarding the distribution of income to a beneficiary.

Trust 2

Grantor established Trust 2 in 1955. Under the terms of Article 2, after all proper expenses and charges are paid, the trustees have absolute discretion to distribute the remaining net income to or for the benefit of Taxpayer, her spouse, her descendants and their spouses, her mother, or some one or more of the members of such class in such amounts and at such times as the trustees deem advisable in the best interest of the particular beneficiary or beneficiaries, to whom or for whose use income shall be so allocated, distributed, or accumulated.

Pursuant to Trust 2, Article 3, upon the death of the Taxpayer, Trust 2 with all accumulations therein, shall be distributed to, or for the benefit of the members then or thereafter living of a class composed of the Grantor's issue (except the said Taxpayer, or her estate or the creditors of her estate), and of the spouses of such issue (including the spouse of Taxpayer), or any one or more of the members of such class, in such proportions and upon such lawful estates, trusts, terms and conditions as Taxpayer may direct or appoint by will. Trust 2, Article 4 states that in default of the Taxpayer's exercise of the testamentary power to appoint the trust corpus, the balance of the trust fund will pass to the Taxpayer's issue, then living, per stirpes. If no such issue exist, then to the persons, excluding Grantor, who would then be entitled thereto under the laws of State X, if the Taxpayer had died the owner thereof intestate and a resident of State X.

Under Article 6(y), neither the Taxpayer nor any other income beneficiary who becomes a trustee shall have any power, as trustee, to make any determination regarding the distribution of income to the trust beneficiaries.

<u>Trust 3</u>

Trust 3 is a testamentary trust that was established under Item 7 of Grantor's will. Item 7(a) of the will provides that the trustees have absolute discretion to invest or reinvest the assets of Trust 3 and to divide and distribute the net income to or for the benefit of Taxpayer, her spouse, her issue and their spouses, or some one or more of the members of such class in such amounts and at such times as the trustees deem advisable. The trustees may also in their absolute discretion at one time, or from time to time, in the event of possible emergencies such as serious accident or illness or other event, upon the happening of which her immediate necessities will outweigh considerations of permanency of income, pay to or for the benefit of Taxpayer, free of trusts, such part of the principal of Trust 3. Any such payment or application of principal shall be charged against the principal of such fund in such manner as the trustees may determine.

Pursuant to Trust 3, Article 7(c), upon the death of Taxpayer, Trust 3 shall be distributed to, or for the benefit of, any one or more of the members then or thereafter living, (a) of a "narrow" familial class composed of Taxpayer's spouse and issue, and the spouses of such issue, or (b) if none of her issue shall survive the Taxpayer, then of a "broader" familial class composed of Grantor's issue and the spouses of such issue, to whom the Taxpayer may appoint, in such proportions, and either outright or upon such lawful estates, trusts, terms and conditions, and subject to such lawful powers as Taxpayer may direct or appoint by will. In default of the Taxpayer’s exercise of the testamentary power to appoint the trust corpus, the balance of the trust fund will pass to the Taxpayer’s issue, then living, per stirpes. If no such issue exist, then to the persons, excluding Grantor, who would then be entitled thereto under the laws of State X, if the Taxpayer had died the owner thereof intestate and a resident of State X.

Under Item 8(x), no eligible income beneficiary nor the spouse of such eligible income beneficiary who becomes trustee can participate in any determination regarding the distribution of principal or income to a beneficiary.

Proposed Transaction

The Taxpayer proposes to execute a will in which she will exercise her testamentary powers of appointment over Trusts 1, 2 and 3. Taxpayer will appoint all of the property included in Trusts 1, 2, and 3 at the time of Taxpayer’s death that is subject to and capable of being appointed by Taxpayer’s exercise of each and all of such powers of appointment, to Taxpayer’s trustees, each to be held, in separate trust as follows:

(1) The property constituting Trust 1 shall be held in a separate trust to be known as "Taxpayer Family Trust No. 1";

(2) The property constituting Trust 2 shall be held in a separate trust to be known as "Taxpayer Family Trust No. 2";

(3) The property constituting Trust 3 shall be held in a separate trust to be known as "Taxpayer Family Trust No. 3."

These trusts will collectively be referred to as the "Taxpayer Family Trusts."

Under the proposed terms of Taxpayer’s will, each of Taxpayer’s Family Trusts are to be administered as separate single trusts during the lifetime of Spouse, provided he survives Taxpayer. The trustees will have discretion to pay to or apply for the benefit of Taxpayer’s daughters, or living children of a predeceased daughter, so much or all of the net income from this single trust as the trustees determine is necessary and advisable for their health, maintenance, or support. The trustees will also have discretionary authority to encroach upon principal for the benefit of any of Taxpayer’s daughters, or children of a predeceased daughter, in such sums and in such shares and proportions as the trustees may in their sole discretion determine is necessary and advisable for the health, education, support and maintenance of the daughter or grandchild, after taking into consideration all other income and resources of the daughter known to the trustees. Any encroachment for the benefit of a daughter or grandchild of Taxpayer pursuant to this provision is to be charged against the ultimate distributed share of the beneficiary to whom or for whose benefit the payment is made.

Upon the death of Spouse (or upon Taxpayer’s death, in the event Spouse predeceases Taxpayer), the trust estate of each Taxpayer Family Trust is to be divided into separate trusts so as to provide one separate trust for each then living daughter of Taxpayer and one separate trust for each predeceased daughter of Taxpayer who has issue then living. Each trust set aside for a predeceased daughter who leaves issue then living will be further divided into separate shares within said separate trust, per stirpes, among the issue of such predeceased daughter.

Until the beneficiary reaches age 21, the trustee is to distribute such of the net income from each separate trust or trust share as the trustee sees fit for the use and benefit of, and for the health, education, maintenance, and support of the beneficiary thereof. Any unexpended income is to be accumulated and added to principal. At age 21 and thereafter, during the beneficiary’s lifetime, the entire net income of the separate trust or share is to be paid to the beneficiary at convenient intervals, not less frequently than annually. Whenever in the opinion of the trustee, the net income of the trust estate is insufficient for the proper health, education, maintenance and support of such beneficiary, the trustee will have discretion from time to time to encroach on principal for the benefit of such beneficiary.

Upon the death of a beneficiary, the undistributed balance of the trust or trust share being administered for the benefit of such beneficiary, if any, shall be paid over, conveyed, and distributed outright to or among, or in trust for the benefit of, any of Taxpayer’s then living issue, and no other persons, in such a manner and in such proportions as such deceased beneficiary may appoint in and by the Last Will of such deceased beneficiary, making specific reference to the power of appointment herein conferred. However, any trust created by exercise of the power of appointment granted by Taxpayer in this subsection must terminate and the entire trust estate be distributed free of trust no later than: in the case of Taxpayer Family Trust 1, December 31, 2038; in the case of Taxpayer Family Trust 2, December 31, 2042; and in the case of Taxpayer Family Trust 3, December 31, 2050. The balance of each trust share within each Taxpayer Family Trust in existence shall, at such time, be distributed outright and free of trust to the then living income beneficiary of such share.

In default of the exercise of this power of appointment by the beneficiary, or insofar as any part of such share shall not be effectively appointed, then upon the death of such deceased beneficiary, the undistributed balance of such deceased beneficiary's trust estate, or the part of such trust estate not effectively appointed, shall be divided per stirpes into separate shares for each of such beneficiary's then living issue. If no such issue exist, the trust corpus is to be divided per stirpes into separate shares for each of the then living issue of the parent of such deceased beneficiary who was either the Taxpayer or one of Taxpayer's issue; or in default thereof, then per stirpes into separate shares for each of Taxpayer's then living issue, or in default of any such living issue, to said deceased beneficiary's estate.

Finally, each trust created under the terms of the will, if not terminated earlier, must terminate on the following dates: Family Trust 1 shall terminate on December 31, 2038; Family Trust 2 shall terminate on December 31, 2042; and Family Trust 3 shall terminate on December 31, 2050.

You have requested the following rulings:

1. The testamentary exercise by Taxpayer of the powers of appointment over Trusts 1, 2, and 3 as proposed will not result in any property subject to the powers being includible in the Taxpayer's gross estate under § 2041 of the Internal Revenue Code.

2. The proposed exercise of the power of appointment by Taxpayer over Trusts 1, 2, and 3 will not result in a transfer of property that is subject to the generation-skipping transfer tax.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property with respect to which the decedent possessed a general power of appointment at the time of death.

Section 2041(a)(3) provides that the value of the gross estate includes the value of all property to the extent of any property with respect to which the decedent by will exercises a power of appointment created after October 21, 1942, by creating another power of appointment which, under the applicable local law, can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

Section 2041(b)(1) defines the term "general power of appointment" as 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. 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 is not a general power of appointment.

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.

Under § 20.2041-1(c)(2), a power is limited by an ascertainable standard if the extent of the holder’s duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). The words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life.

Section 20.2041-3(e)(1) provides, in part, that property subject to a power of appointment created after October 21, 1942, which is not a general power, is includible in the holder’s gross estate if the power is exercised by will and if the power is exercised by creating another power of appointment which, under the terms of the instrument creating and exercising the first power and under applicable local law, can be validly exercised so as to: (a) postpone the vesting of any estate or interest in the property for a period ascertainable without regard to the date of creation of the first power, or (b) (if the applicable rule against perpetuities is stated in the terms of suspension of ownership or of the power of alienation, rather than of vesting) suspend the absolute ownership or the power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

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

A generation-skipping transfer 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 trust where the property passes to a skip person with respect to the transferor of the property. 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 § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person.

Section 2613 defines a "skip person" as (1) a natural person who is assigned to a generation which is two or more generations below that of the transferor, (2) a trust in which all the interests are held by skip persons, or (3) a trust where, after that transfer, no trust distributions may be made to a non-skip person.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax 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. 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 the settlor’s gross estate under §§ 2038 or 2042 if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) states 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 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 (the perpetuities period). For purposes of § 26.2601-1(b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

Section 26.2601-1(b)(1)(v)(D), Example 6 describes a situation where prior to the effective date of chapter 13, GP established an irrevocable trust under which the trust income was to be paid to GP's child, C, for life. C was given a testamentary power to appoint the remainder in further trust for the benefit of C's issue. In default of C's exercise of the power, the remainder was to pass to charity. C died on February 3, 1995, survived by a child who was alive when GP established the trust. C exercised the power in a manner that validly extends the trust in favor of C's issue until the later of May 15, 2064 (80 years from the date the trust was created), or the death of C's child plus 21 years. C's exercise of the power is a constructive addition to the trust because the exercise may extend the trust for a period longer than the permissible periods of either the life of C's child (a life in being at the creation of the trust) plus 21 years or a term not more than 90 years measured from the creation of the trust. On the other hand, if C's exercise of the power could extend the trust based only on the life of C's child plus 21 years or only for a term of 80 years from the creation of the trust (but not the later of the two periods) then the exercise of the power would not have been a constructive addition to the trust.

In Example 7 of § 26.2601-1(b)(1)(v)(D), the facts are the same as in Example 6, except local law provides that the effect of C's exercise is to extend the term of the trust until May 15, 2064, whether or not C's child predeceases that date by more than 21 years. C's exercise is not a constructive addition to the trust because C exercised the power in a manner that cannot postpone or suspend vesting, absolute ownership, or power of alienation for a term of years that will exceed 90 years. The result would be the same if the effect of C's exercise is either to extend the term of the trust until 21 years after the death of

C’s child or to extend the term of the trust until the first to occur of May 15, 2064 or 21 years after the death of C’s child.

In the instant case, under the terms of Article 2(b)(2) of Trust 1, the Taxpayer’s testamentary power of appointment over the trust corpus can only be exercised in favor of a class consisting of the spouse of the Taxpayer, the lineal descendants of the Taxpayer, and the spouses of such lineal descendants. Likewise, under the terms of Trust 2, Article 3 and Trust 3, Item 7(c), the Taxpayer’s testamentary power over the corpus may only be exercised in favor of the spouse of the Taxpayer, the lineal descendants of the Taxpayer, and the spouses of such lineal descendants. (Under Trust 3, if Taxpayer is not survived by issue, the power may be exercised in favor of Grantor’s issue "thereafter living.") Since the Taxpayer cannot appoint to herself, her creditors, her estate, or the creditors of her estate, the Taxpayer’s testamentary powers to appoint created under Article 2(b)(2) of Trust 1, Article 3 of Trust 2, and Item 7(c) of Trust 3 are not testamentary general powers of appointment. Accordingly, the exercise of such power as proposed will not result in the value of either Trust 1, 2, or 3 being included in the Taxpayer’s gross estate under § 2041(a)(2).

Trusts 1 and 2 were established as irrevocable trusts in 1951 and 1955, respectively. Trust 3, a residual testamentary trust, was established upon the Grantor’s death in 1963. The Taxpayer proposes to exercise the nongeneral powers of appointment created in Article 2(b)(2) of Trust 1, Article 3 of Trust 2, and Item 7(c) of Trust 3 in favor of Taxpayer Family Trusts 1, 2, and 3, respectively. The terms of the Taxpayer Family Trusts provide that each trust, and any trust created under the terms of the trust must terminate no later than a date which is less than 88 years from the date of the creation of the respective powers of appointment granted to Taxpayer under Trusts 1, 2, and 3. Taxpayer Family Trust 1 will terminate on December 31, 2038. Taxpayer Family Trust 2 will terminate on December 31, 2042. Taxpayer Family Trust 3 will terminate on December 31, 2050. The balance of each trust share in existence shall, at such time, be distributed outright and free of trust to the then living income beneficiary of such share. Taxpayer’s proposed exercise of the limited powers is valid under applicable State X law.

Under the terms of the Taxpayer Family Trusts, the trust property will be distributed outright and free of trust, in all events, within a period measurable from the date of creation of the original powers. Thus, the proposed testamentary exercise of the powers will not create other powers that may be exercised in a manner that postpones the vesting or absolute ownership of any property interest without regard to the date of the creation of the original powers in each of the three trusts.

Consequently, the proposed testamentary exercise of the powers of appointment by the Taxpayer will not result in the value of Trusts 1, 2, or 3 being included in the Taxpayer’s gross estate under § 2041(a)(3).

All three trusts over which the Taxpayer has a testamentary nongeneral power of appointment were irrevocable on September 25, 1985.

As described above, Taxpayer Family Trusts 1, 2, and 3 (including any trusts created under the terms of the trust instruments) must terminate no later than 88 years from the date of the creation of Trusts 1, 2, and 3, respectively. Hence, the Taxpayer’s proposed testamentary exercise of the nongeneral powers under Article 2(b)(2) of Trust 1, Article 3 of Trust 2, and Item 7(c) of Trust 3 in favor of the Taxpayer Family Trusts will not postpone or suspend the vesting, absolute ownership or power of alienation of any interest in trust property for a period beyond a date which is 90 years measured from the date of creation of Trusts 1, 2, or 3.

Consequently, Taxpayer’s proposed testamentary exercise of the nongeneral powers under Article 2(b)(2) of Trust 1, Article 3 of Trust 2, and Item 7(c) of Trust 3 in favor of the Taxpayer Family Trusts will not be constructive additions that will be subject to the generation-skipping transfer tax. <u>See</u> § 26.2601-1(b)(1)(v)(B); § 26.2601-1(b)(1)(v)(D), <u>Example 7</u>.

Except as specifically ruled herein, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code.

This ruling is based on the facts presented and the 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 this ruling take effect, the ruling will have not force or effect.

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

In accordance with the power of attorney on file, we are sending a copy of this letter to your authorized representative.

Sincerely yours,

George Masnik
Chief, Branch 4
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

Enclosure
Copy for section 6110 purposes