

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-126864-01

Date:

November 11, 2001

RE:

Legend:

Grantor	=
R	=
S	=
T	=
U	=
Bank	=
State	=
State Statute	=
Year 1	=
Year 2	=
Year 3	=
Trust 1	=
Trust 2	=
Trust 3	=

Dear _____ :

This letter is in response to your authorized representative's submission, dated April 26, 2001, requesting a ruling on the federal estate tax consequences resulting from the proposed appointment in further trust of certain trust property.

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Grantor died in Year 3. During her lifetime, Grantor created two irrevocable trusts (Trust 1 and Trust 2), and provided for the establishment of a third irrevocable trust (Trust 3) under the terms of her will.

Grantor created Trust 1 in Year 1. R, T, and U are the named trustees of Trust 1. Trust 1 provides that during the lifetime of Grantor's daughter, R, the trustees are to distribute the net income to or for the benefit of the members of a class composed of R and R's descendants in such amounts or proportions and in such manner as the trustees in their discretion determine. Upon the death of R, Trust 1 is to be divided into Trust A and Trust B. Until the death of S, who is the son of R, the trustees of Trust A are to distribute so much of the net income of Trust A (hereinafter referred to as Trust 1) to or for the benefit of the members of the class composed of S and S's descendants in such manner as the trustees in their discretion determine. Upon the death of S, the Trust 1 property is to be distributed to or for the benefit of the members then or thereafter living of a class composed of Grantor's issue (except S, S's estate or the creditor's of S's estate) and the spouses of such issue, including S's spouse, or any one or more of the members of the class, in such proportions and upon such lawful estates, trusts, terms and conditions as S may direct or appoint by will.

In default of the exercise of S's testamentary power of appointment, the Trust 1 property is to pass to the issue of S, then living, per stirpes, or, if none, then to the persons, excluding Grantor, who would then be entitled to the trust property under the laws of State if S had died intestate.

In Year 2, Grantor established Trust 2. R, T and U are the named trustees of Trust 2. Under the terms of Trust 2, during the lifetime of S, the trustees are to divide among and distribute so much of the net income to or for the members of a class composed of S, S's spouse, S's descendants and their spouses, S's mother, or some one or more members of the class in such amounts or proportions, and in such manner as the trustees in their absolute discretion determine to be in the best interest of the particular beneficiary or beneficiaries, to whom income may be allocated. Upon the death of S, the Trust 2 property is to be distributed to or for the benefit of the members then or thereafter living of a class composed of Grantor's issue (except S, S's estate or the creditors of S's estate) and the spouses of such issue (including S's spouse), or any one or more of the members of such class, in such proportions and upon such lawful estates, trusts, terms and conditions as S may direct or appoint by will.

In default of the exercise of S's testamentary power of appointment, the Trust 2 property is to pass to the issue of S, then living, per stirpes, or, if none, then to the persons, excluding Grantor, who would then be entitled to the trust property under the laws of State if S had died intestate.

Under the terms of Grantor's will, the rest, residue and remainder of Grantor's estate, both real and personal, is to be divided into three separate parts: fifty percent is

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to be designated as Fund A; twenty-five percent as Fund B, and the remaining twenty-five percent as Fund C. The named trustees of Fund B, (hereinafter referred to as Trust 3) are R, T, and Bank. Article Sixth of the will provides that, during the lifetime of S, the trustees of Trust 3 are to distribute the income of Trust 3 to or for the benefit of the members that are living of a class composed of S, S's spouse, S's issue, and the spouses of such issue, or some or more of the members of such class in such proportions and in such manner as the trustees in their discretion shall determine. In addition, in the event of possible emergencies such as serious accident or illness or other event, the trustees of Trust 3 may pay to S such part of the principal of Trust 3 as the trustees determine. Upon the death of S, the property of Trust 3 is to be distributed to or for the benefit of any one or more of the members living of a narrow familial class composed of S's spouse and issue, the spouses of such issue, or if none of S's issue survive S, then of a broader familial class composed of Grantor's issue and the spouses of Grantor's issue, as S may appoint in such proportions, either outright or upon such lawful estates, trusts, terms and conditions, and subject to such lawful powers as S may direct or appoint by will.

In default of the exercise of S's testamentary power of appointment, the Trust 3 property is to pass to the issue of S, then living, per stirpes, or, if none, then to the persons who would then be entitled to the trust property under the laws of State if S had died intestate.

S proposes to execute a will in which S will exercise the testamentary non-general powers of appointment granted to him with respect to Trust 1, Trust 2, and Trust 3. The property comprising Trust 1 will be appointed to and held in a separate trust designated the "S Family Trust 1." The property comprising Trust 2 will be appointed to and held in a separate trust designated the "S Family Trust 2." The property comprising Trust 3 will be appointed to and held in a separate trust designated the "S Family Trust 3."

Under the proposed terms of S's will, each of the S Family Trusts will be administered as a separate single trust during the lifetime of S's spouse, if the spouse survives S. The trustees of each of the three family trusts will have the discretion to pay to or for the benefit of S's spouse, S's children and the then living descendants of a predeceased child of S, so much or all of the net income and principal from the family trusts as the trustees determine is necessary or advisable for their health, support, maintenance and education. Any payments of principal made to or for the benefit of a child or a descendant of S pursuant to this provision will be charged against the ultimate distributive share of the child or descendant to whom or for whose benefit the payments are made.

Upon the death of S's spouse (or upon S's death, in the event S's spouse predeceases S), the trust estate of each S Family Trust will be divided into separate trusts so as to provide one separate trust for each then living child of S and one

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separate trust for each deceased child of S with descendants then living. Each trust set aside for a deceased child of S with descendants then living will be further divided into separate shares within the separate trust, per stirpes, among the descendants of such predeceased child of S.

Until a beneficiary attains the age of twenty-one (21) years, the trustees may distribute the net income and principal from each separate trust share for the health, support, maintenance, and education of the beneficiary. Any undistributed income will be accumulated and added to principal at the end of each year. When a beneficiary attains the age of twenty-one (21) years, and thereafter during the beneficiary's lifetime, (or until termination of the trust or trust share, as the case may be), the entire net income of the separate trust or trust share will be paid to the beneficiary in convenient intervals, not less frequently than annually. Whenever in the opinion of the trustees the net income of the separate trust or trust share is insufficient for the health, support, maintenance and education of a beneficiary, the trustees will have discretion to distribute principal to or for the benefit of such beneficiary for such beneficiary's health, support, maintenance and education.

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 S's then living descendants, and no other persons, in such a manner and in such proportions as such beneficiary may appoint by his or her last will and testament, making specific reference to the above described power of appointment. However, any trust created by the exercise of the power of appointment granted by S to a beneficiary must terminate, and the entire trust estate must be distributed free of trust, no later than: 1) in the case of S Family Trust 1, December 31, 2038; 2) in the case of S Family Trust 2, December 31, 2042; and 3) in the case of S Family Trust 3, December 31, 2050. The balance of each trust or trust share within each S Family Trust in existence on the above dates will, at such time, be distributed outright and free of trust to the then living income beneficiary of such trust or trust share (other than S).

In default of the exercise of this power of appointment by a beneficiary, or if any part of a trust or trust share is not effectively appointed, then upon the death of the beneficiary the undistributed balance of such beneficiary's trust or trust share, or the part of such trust or trust share not effectively appointed, shall be divided, per stirpes, into separate shares for such beneficiary's then living descendants. In default of such descendants, such amount will be divided, per stirpes, into separate shares for each of the then living descendants of the parent of such deceased beneficiary who was either S or one of S's descendants, or in default thereof, then, per stirpes, into separate shares for each of S's then living descendants, or in default of such living descendants, to said deceased beneficiary's estate.

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Notwithstanding the above, each S Family Trust, if not terminated earlier, will terminate on the following dates: 1) S Family Trust 1, December 31, 2038; 2) Taxpayer Family Trust 2, December 31, 2042; and 3) S Family Trust 3, December 31, 2050. The balance of each trust or trust share within each S Family Trust in existence on the above dates will, at such time, be distributed outright and free of trust to then living income beneficiaries of such trust or trust share (other than S's spouse).

The following rulings are requested.

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

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

Law and Analysis

Section 2033 provides that a decedent's gross estate shall include the value of all property to the extent of the decedent's interest at the time of death.

Section 2041(a)(2) provides for the inclusion in the gross estate of a decedent any property with respect to which the decedent possesses, at the time of his death, a general power of appointment created after October 21, 1942.

Section 2041(a)(3) provides for the inclusion in the gross estate of a decedent 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)(A) provides that the term "general power of appointment" means 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, except that 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 deemed 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 of appointment if by its terms it is either (a)

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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 creditors of decedent's estate.

Section 20.2041-3(e)(1) provides that property subject to a power of appointment created after October 21, 1942, which is not a general power, is includible in the gross estate of the holder of the power under section 2041(a)(3) if the power is exercised, and if both of the following conditions are met:

(i) If the exercise is (a) by will, or (b) by a disposition which is of such nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate under sections 2035 through 2037, and

(ii) If the power is exercised by creating another power of appointment which, under the terms of the instruments 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 the creation of the first power, or (b) (if the applicable rule against perpetuities is stated in 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.

Under the terms of State Statute, a nongeneral power of appointment or a general testamentary power of appointment is invalid unless the power is irrevocably exercised or terminates within ninety years after its creation.

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act), 1986-3 (Vol. 1) C.B. 1, and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer was not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). Section 26.2601-1(b)(1)(ii) provides that 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 settlor's gross estate under section 2038 or 2042 if the settlor had died on September 25, 1985.

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Section 26.2601-1(b)(1)(v)(A) provides that, except as provided under section 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. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12.

Section 26.2601-1(b)(1)(v)(B) provides a special rule for certain powers of appointment. Under this section, the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in section 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 section 26.2601-1(b)(1); and (2) in the case of an exercise, the 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 plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of section 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. This section also provides that 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

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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 section 26.2601-1(b)(1)(v)(D), the facts are the same as in Example 6, except that 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 present case, S is a beneficiary of Trust 1, Trust 2, and Trust 3, as described above. The provisions of each of the trusts provide S with a testamentary power of appointment over each trust. Because S cannot exercise any such power in favor of himself, his creditors, his estate, or the creditors of his estate, his testamentary powers are not general powers of appointment. S proposes to execute a will in which S will exercise the testamentary powers of appointment granted to him over Trust 1, Trust 2, and Trust 3. The property comprising Trust 1, Trust 2, and Trust 3 will be appointed to and held in a separate trust, respectively, designated as the S Family Trust 1, the S Family Trust 2, and the S Family Trust 3.

Each trust will be held during the life of S's spouse for the benefit of S's spouse, S's children and the then living descendants of a predeceased child of S. Net income and principal from the family trusts may be distributed by the trustees for the beneficiaries' health, support, maintenance and education.

Upon the death of S's spouse (or upon S's death, in the event S's spouse predeceases S), the trust estate of each S Family Trust will be divided into separate trusts so as to provide one separate trust for each then living child of S and one separate trust for each deceased child of S with descendants then living. Upon the death of a beneficiary, each beneficiary will be provided with a testamentary power of appointment exercisable by the beneficiary of each separate trust in favor of S's then living descendants, and no other persons, in such a manner and in such proportions as such beneficiary may determine, making specific reference to the power of appointment. However, any trust created by the exercise of the power of appointment granted by S to a beneficiary must terminate, and the entire trust estate must be distributed free of trust, no later than: 1) in the case of S Family Trust 1, December 31, 2038; 2) in the case of S Family Trust 2, December 31, 2042; and 3) in the case of S Family Trust 3, December 31, 2050. The balance of each trust or trust share within each S Family Trust in existence on the above dates will, at such time, be distributed outright and free of trust to the then living income beneficiary of such trust or trust share (other than S).

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Under the terms of each Family Trust, the property of a respective share will be distributed outright and free of trust within a period measurable from the date of creation of the original power (i.e., S's power). That is, each separate trust established under the terms of each of the proposed Family Trusts must terminate on a specified date, each date being a date that is 87 years after the date of creation of the original power (that was exercised to create the respective Family Trust). Thus, the proposed exercise of S's testamentary limited powers of appointment with respect to Trust 1, Trust 2, and Trust 3, will not create other powers which can be exercised under State law, in a manner that postpones the vesting of any estate or interest or suspends the absolute ownership or power of alienation of the property of any separate trust established under the terms of the respective Family Trusts for a period without regard to the date of the creation of S's original power.

Accordingly, S's exercise of the testamentary powers of appointment over Trust 1, Trust 2, and Trust 3 will not result in any property subject to the powers of appointment being includible in S's estate under section 2041.

S's testamentary powers of appointment were created, respectively, under Trust 1, Trust 2, and Trust 3. Each trust was irrevocable on September 25, 1985, and it is represented that no additions (actual or constructive) were made to the trusts after September 25, 1985.

As described above, S's proposed exercise of his testamentary powers of appointment with respect to Trust 1, Trust 2, and Trust 3 will not create other powers which can be exercised under State law, in a manner that postpones the vesting of any estate or interest in the respective trust, or suspends the absolute ownership or power of alienation of the property of Trust 1, Trust 2, or Trust 3, without regard to the date of creation of the original power created for S in the respective trust.

Consequently, S's exercise of his testamentary non-general powers with respect to Trust 1, Trust 2, and Trust 3 will not result in a transfer in trust of property that is subject to generation-skipping transfer tax.

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

A copy of this letter should be attached to any gift, estate, or GST tax returns that you may file relating to this matter.

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 the appropriate party. While this office has not verified any part of the material submitted in support of the request for rulings, it is subject to verification and examination.

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Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

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.

Sincerely yours,

Lorraine E. Gardner
Acting Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy of letter for section 6110 purposes