Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Refer Reply To:
CC:PSI:B04 – PLR-164326-01
Date: March 10, 2004

Re:

LEGEND:

Decedent	=
Spouse	=
Child A	=
Child B	=
Grandchild A	=
Grandchild B	=
Grandchild C	=
Grandchild D	=
Local Court	=
Trust	=
Marital Trust	=
Family Trust	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Trustee A	=
Trustee B	=
$x	=
State	=
State Statute	=
Cite 1	=

Cite 2 =

Cite 3 =
Cite 4 =

Dear :

This is in reply to your January 6, 2003 letter and other correspondence in which you request rulings on the application of the generation-skipping transfer tax.

Decedent created the Trust, a revocable trust, on Date 1. The Trust was last amended on Date 2, after September 26, 1985. The Trust became irrevocable at Decedent's death on Date 3. Pursuant to Article XI of the Trust , the Trust is to be construed and administered according to the laws of State. Child A, Trustee A, and Trustee B are presently serving as the trustees.

Article II, paragraph A, of the Trust provides that, at Decedent's death, the sum of $x is to be set aside in the Marital Trust, a separate trust for the benefit of Spouse, Decedent's surviving spouse. On Spouse's death, the remaining principal of the Marital Trust is to be distributed to or for Decedent's grandchildren. Spouse survived Decedent but has since died.

Article V provides that the property remaining in the Trust after the creation of the Marital Trust is to be distributed to the Family Trust. Under Article V, paragraph A, the trustees are to pay the net income of the Family Trust in equal shares to Decedent's children, Child A and Child B, and, after the death of one of them, to the survivor of them for life.

Article V, paragraph B, provides that Child A and Child B, during their respective lives, shall have the right annually to appoint from the principal of the Family Trust outright or in trust to each of his or her living children from time to time an amount equal to the maximum annual exclusion then available to each child.

Article V, paragraph C, provides that, on the death of each of Decedent's children, Child A or Child B, each such child shall have the right to appoint a fractional portion of the remaining trust principal. The fraction is based on the number of such child's children who are living or deceased with living descendants in relation to the total number of Decedent's grandchildren who are living or who are deceased with living descendants.

Such appointment may be outright or in trust in such amounts or proportions, "to one or more of the deceased child's descendants or to his or her estate and may be by a lifetime or testamentary appointment exercised in the manner described in Article I, paragraph C, subparagraph (3)." In default of appointment in whole or in part, the portion not appointed will be distributed per stirpes to the descendants then living of the Decedent's deceased child and each such share or part of a share will be distributed to each such descendant in the manner provided for in Article IV , paragraph A. In the event there are no descendants of a Decedent's child living at the death of the child who fails to exercise the power of appointment, the then remaining principal and any undistributed income of the portion of the trust subject to that child's power of appointment is to be distributed to Decedent's descendants then living in equal shares, per stirpes.

Article I, paragraph C, subparagraph (3) provides that the power of appointment may be exercised either by a writing duly acknowledged and filed with the attorneys for the trustees, or by will. Any such instrument in the form of an acknowledged writing may be revoked at any time. The acknowledged writing or will which bears the latest date and which has not been revoked shall be effective and controlling.

Child A currently has one child, Grandchild A. Child B has three children, Grandchild B, Grandchild C, and Grandchild D. The trustees represent that there is an ambiguity in Article V, subparagraph C, concerning the permissible appointees of an exercise of Child A's and Child B's powers of appointment, effective at death. Specifically, the trustees represent that the phrase "to one or more of the deceased child's descendants or to his or her estate" can be read to mean either: (1) that Child A and Child B can appoint the trust property to his or her descendants or to the estate of a descendant who has died, or (2) that Child A and Child B can appoint the trust property to his or her descendants or to his (Child A's) or her (Child B's) own estate. The trustees assert that Decedent intended the latter, and that Child A and Child B may exercise their powers in favor of their own estates.

To resolve the ambiguity, the trustees filed a petition in the Local Court for a proper construction of the phrase "to one or more of the deceased child's descendants or to his or her estate." The petition stated that the language "to his or her estate" was drafted into the trust after discussion with Decedent, and the language was included in the trust agreement with Decedent's full knowledge and approval. The language was intended to grant Child A and Child B general powers of appointment to ensure that the corpus would not be subject to generation-skipping transfer tax. On Date 4, the court issued an order concluding that the power to appoint "to one or more of the deceased child's descendants or to his or her estate" is construed as authorizing Child A and Child B to exercise his or her respective power of appointment in favor of his or her respective estate.

You have asked us to rule on the generation-skipping transfer tax consequences of the exercise by Child A or Child B of the special power granted in Article V, paragraph B, if that child is a holder of the power, granted in Article V, paragraph C, over the remainder of the trust principal allocable to his or her share.

Section 2001 of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2041(a) 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 a general power of appointment is exercised by the decedent.

Section 2041(b)(1) 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.

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2503(b)(1) provides that, in the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first $ 10,000 of such gifts to such person shall not be included in the total amount of gifts made during the year.

Section 2511 provides that the gift tax applies whether the transfer is in trust or otherwise, direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 2514(b) provides that, for gift tax purposes, the exercise or release of a general power of appointment shall be deemed a transfer of property by the individual possessing the power. Under § 2514(c), a general power is defined in the same manner as in § 2041(b)(1).

Section 25.2514-1(b)(2) provides that no provision of §§ 25.2514-1 through 25.2514-3 is to be construed as limiting the application of any other section of the Internal Revenue Code or the applicable regulations. Thus, the power of the owner of property to dispose of his interest, and nothing more, is not a power of appointment and the transfer of the interest is includible in taxable gifts under § 2511. The regulation provides an example of this principle, as follows. A trust created by S provides for payment of the income to A for life with power in A to appoint, during A's life, the entire property to A's children, and a further power to dispose of the entire corpus by will to anyone, including A's estate. The regulation provides that if A exercises the inter vivos power in favor of A's children, A has necessarily made a transfer of A's income interest

which constitutes a taxable gift under § 2511(a), without regard to § 2514. This transfer also results in the relinquishment of A's general power of appointment by will, which constitutes a transfer under § 2514. See also, Rev. Rul. 79-327, 1979-2 C.B. 342.

Section 2601 provides that a tax is imposed on every generation-skipping transfer, made by a "transferor" to a "skip person" with respect to the transferor.

Section 2611(a) provides that the term "generation-skipping transfer" means a taxable distribution, a taxable termination, and a direct skip. 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). Section 2612(c) provides that the term "direct skip" means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person. Section 2613(a) provides that the term "skip person" means a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor.

Section 2652(a)(1) provides that the term "transferor" means, in the case of any property subject to the tax imposed by chapter 11, the decedent, and in the case of any property subject to the tax imposed by chapter 12, the donor. Section 26.2652-1(a) of the Generation-skipping Transfer Tax Regulations provides that the individual with respect to whom property was most recently subject to Federal estate or gift tax is the transferor of that property for purposes of Chapter 13. An individual is treated as transferring any property with respect to which the individual is the transferor.

Section 26.2612-1(f), Example 5, considers a situation in which T establishes a testamentary trust under which the income is to be paid to T's surviving spouse, S, for life and the remainder is to be paid to a grandchild of T and S. T's executor elects to treat the trust as a qualified terminable interest property under § 2056(b)(7). The transfer to the trust is not a direct skip because S, a person who is not a skip person, holds a present right to receive income from the trust. Upon S's death, the trust property is included in S's gross estate under § 2044 and passes directly to a skip person. The GST occurring at that time is a direct skip because it is a transfer subject to chapter 11. The fact that the interest created by T is terminated at S's death is immaterial because S becomes the transferor at the time of the transfer subject to chapter 11.

State Statute provides that a power of appointment is a general power to the extent that the power is exercisable wholly in favor of the holder of the power, his estate, his creditors or the creditors of his estate. All other powers of appointment are special powers.

Under State law, a trustee may petition the appropriate court for an order to

construe the terms of a trust. See Cite 1; Cite 2. The prime consideration in a construction proceeding is the intention of the testator or settler as expressed in the instrument. All rules of interpretation are subordinated to the requirement that the testator's or settlor's actual purpose be sought and effectuated as far as is consonant with principles of law and public policy. Cite 3. If the court discerns a dominant purpose or plan , the individual parts of the will must be read in relation to that purpose and given

effect accordingly. This is true despite the fact that a literal reading of the portion under construction might yield an inconsistent or contradictory meaning because of the use of awkward language inadvertently or carelessly chosen. Cite 4.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court held that where the issue involved is the determination of property interests for federal tax purposes, and the determination is based on state law, the highest court of the state is the best authority on its own law. The Service, however, is not bound by a lower court decision. If there is a decision by a lower court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal authority may be said, in effect, to be sitting as a state court.

In this case, the court construed Child A's and Child B's power, effective at death, to appoint "to one or more of the deceased child's descendants or to his or her estate" to be general powers of appointment under State law. As such, these powers are exercisable by Child A and Child B in favor of his or her own estate. We conclude that this construction is consistent with applicable state law. See also, Rev. Rul. 73-142, 1973-1 C.B. 405. Accordingly, the powers constitute general powers of appointment for purposes of §§ 2041 and 2514.

In the instant case, Child A and Child B each currently hold: (1) a right to one-half of the income from the Family Trust during their respective lives; (2) a contingent right to receive the other one-half of the trust income for such time as each survives the other; (3) a special power to appoint trust principal to a child annually in an amount equal to the maximum annual exclusion then available to him or her, and (4) a general power to appoint trust principal, effective at death, to his or her estate.

As is the case in the example contained in § 25.2514-(1)(b)(2), the exercise by Child A or Child B of his or her inter vivos special power of appointment will result in a transfer by Child A or Child B, for gift tax purposes under § 2511, of his or her right to receive the income from the distributed property. The exercise of the special power will also result in the release of his or her general power, taking effect at death, to appoint the distributed property and the release will constitute a transfer by Child A or Child B that is subject to gift tax under § 2514. In accordance with § 2652(a)(1) and § 26.2652-

1(a), Child A or Child B, as the case may be, will be the transferors of these distributions for generation-skipping transfer tax purposes. Since these distributions can only be made to or for the benefit of Child A's and Child B's respective children, the distributions will not be made to skip persons with respect to Child A or Child B, as defined in § 2613. Accordingly, the transfers will not be subject to generation-skipping transfer tax.

The ruling contained in this letter is 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 ruling, it is subject to verification on examination.

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,

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

Enclosures
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