

Internal Revenue Service

Department of the Treasury

Number: **200124006**
Release Date: 6/15/2001
Index Number: 2041-00.00
2601-00.00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-106497-00

Date:

March 12, 2001

Re:

LEGEND:

- Taxpayer =
- Spouse =
- Settlor =
- Revocable Trust =

- Trust 1 =

- Share 1 =

- Continuation Share 1 =

- Trust 2 =
- Share 2 =

- Continuation Share 2 =

- Trust 3 =
- Share 3 =

- Continuation Share 3 =

- Corporate Trustee =
- Individual Trustee =
- Foundation =
- Organization 1 =
- Organization 2 =
- Date 1 =
- Date 2 =
- Date 2A =
- Date 3 =
- State Statute =

Dear :

This is in response to the October 13, 2000 letter and other

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correspondence requesting rulings on the application of sections 2041 and 2601 of the Internal Revenue Code to the proposed transaction.

Facts:

The facts submitted and representations made are as follows:

Trust 1, Trust 2 and Trust 3 were created and funded by Settlor before September 25, 1985. Settlor, who was Taxpayer's grandparent, died before September 25, 1985. It is represented that no additions (constructive or otherwise) were made to these trusts after September 25, 1985.

Trust 1 was executed on Date 1 and amended and restated on Date 1A. Under the terms of Trust 1, at Settlor's death, Trust 1 was divided into nine equal separate trusts. One such trust, Share 1, was established for Taxpayer. Corporate Trustee and Individual Trustee were designated as trustees. The governing provisions of Share 1 are contained in Paragraphs 4(a), (b), (c), (d), and (e) of Trust 1.

Under Paragraph 4(a), the trustees are to pay Taxpayer and his descendants, or any one or more of them, such part or all of the Share 1 income and principal at such time or times and in such equal or unequal proportions as Corporate Trustee believes desirable for the best interests and welfare of Taxpayer and his descendants, in that order and as a group, considering the desirability of supplementing their respective incomes or assets and all other circumstances and factors Corporate Trustee believes pertinent. Any undistributed income is to be added to principal.

Under Paragraph 4(b), if Taxpayer dies before complete distribution of the Share 1 property, the remaining property is to be distributed to or for the benefit of such persons or organizations in such proportions and subject to such trusts, powers and conditions as Taxpayer may appoint by will, except that Taxpayer may not appoint to or for his benefit, his estate, or the creditors of either.

Under Paragraph 4(c), any part of Share 1 not effectively appointed by Taxpayer is to be divided on the death of the last to die of Taxpayer and Settlor per stirpes among the then living descendants of Taxpayer, if any; otherwise, per stirpes among the then living descendants of the nearest lineal ancestor of Taxpayer who also was a descendant of Settlor and of whom one or more descendants then are living, or, if none, per stirpes among Settlor's then living descendants. Property allocated to a person who is a beneficiary of a separate trust under Trust 1 is to be added to that separate trust, and property

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allocated to any other beneficiary is to be retained in trust as a separate trust named for him or her and disposed of under the terms of Share 1.

Under Paragraph 4(d), when each great-grandchild or more remote descendant of Settlor for whom a trust is held reaches age 40, the trustee is to distribute to him or her the principal of that trust.

Under Paragraph 4(e), if not terminated sooner, Share 1 is to terminate 21 years after the last to die of Settlor's descendants living on Date 1, and the trust property is to be distributed to the beneficiary for whom the trust is held.

Trust 2 was created on Date 2. Upon creation, Trust 2 was divided into nine equal separate trusts. One such trust, Share 2, was established for Taxpayer. Corporate Trustee was designated as trustee. The governing provisions for Share 2 are contained in Paragraphs 2(a), (b), (c), (d), and (e) of Trust 2.

The provisions of Paragraphs 2(a) and 2(b) are identical to the provisions of Paragraphs 4(a) and 4(b) of Trust 1. Paragraph 2(c) is identical to Paragraph 4(c) with one exception: If any part of Share 2 is not appointed pursuant to Taxpayer's power of appointment and there are no living descendants of Settlor at the time of Taxpayer's death, Share 2 is to be distributed outright to Foundation.

Paragraph 2(d) is identical to Paragraph 4(d) of Trust 1, except distribution of principal is to be made to a great-grandchild or more remote descendant of Settlor when he or she reaches age 30.

Under Paragraph 2(e), no property may be retained in trust longer than 21 years after the death of the last to die of Settlor's descendants living on Date 2, at which time the trustee must distribute the property to the beneficiary for whom the trust is held.

Trust 3 was created on Date 3. Upon creation, Trust 3 was divided into six equal separate trusts. One such trust, Share 3, was established for Taxpayer. Corporate Trustee was designated as trustee. The governing provisions for Share 3 are contained in Paragraphs 2(a), (b), (c), (d), and (e) of Trust 3.

The provisions of Paragraphs 2(a) and 2(b) are identical to the provisions of Paragraphs 4(a) and 4(b) of Trust 1 and Paragraphs 2(a) and 2(b) of Trust 2.

Paragraph 2(c) is identical to Paragraph 4(c) of Trust 1 and Paragraph

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2(c) of Trust 2 with one exception: If any part of Share 3 is not appointed pursuant to Taxpayer's power of appointment and there are no living descendants of the nearest lineal ancestor of Taxpayer who was also a descendant of Settlor at the time of Taxpayer's death, Share 3 is to be distributed per capita among Settlor's then living grandchildren, if any; otherwise, in equal shares among Settlor's then living children, or, if none, outright one-half to Organization 1 and one-half to Organization 2. If any grandchild of Settlor is deceased leaving living descendants, the share payable to the grandchild is to be divided among those descendants.

Paragraph 2(d) is identical to Paragraph 4(d) of Trust 1 and Paragraph 2(d) of Trust 2, except distribution of principal is to be made to a great-grandchild or more remote descendant of Settlor when he or she reaches age 35.

Under Paragraph 2(e), no property may be retained in trust longer than 21 years after the death of the last to die of Settlor's descendants living on Date 3, at which time the trustee must distribute the property to the beneficiary for whom the trust is held.

Taxpayer has drafted his will. Under Article 2 of his will, Taxpayer proposes to exercise the powers of appointment given him by Settlor over the property in Share 1, Share 2, and Share 3 by appointing the trusts' assets to Continuation Share 1, Continuation Share 2, and Continuation Share 3, respectively. The new trusts are to be governed by the terms of a revocable trust (Revocable Trust), which was created by Taxpayer and his spouse (Spouse).

Under Section 6.7(a) of the Revocable Trust, if any issue of Taxpayer and Spouse survive Taxpayer, Continuation Share 1 will be divided into shares to be allocated among the then living issue of Taxpayer and Spouse in accordance with State Statute. Each share will be administered as a separate trust for that issue. Under Section 6.7(c), the beneficiary of Continuation Share 1 is to be a child or another issue of Taxpayer and Spouse for whom a share is allocated. The beneficiary, and not that beneficiary's issue, will be the primary beneficiary of each trust. Under Section 6.7(b), if there are no surviving issue of Taxpayer and Spouse, the property will be distributed outright to Taxpayer's heirs.

Under Section 6.7(d), during the beneficiary's life, the trustee will pay to the beneficiary and the beneficiary's issue as much income and principal as is necessary for proper health, education, support, and maintenance.

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Under Section 6.7(e), after the beneficiary's death, the trustee will distribute the balance of the principal of Continuation Share 1 to any entities or persons, other than the beneficiary's estate, the beneficiary's creditors, and the creditors of the beneficiary's estate, as the beneficiary may direct by will.

Under Section 6.7(f), if the beneficiary does not exercise the power, the Continuation Share 1 property will be divided into shares for the beneficiary's issue in the manner provided in State Statute. Each such share will be held in trust for that issue and administered as described above for Continuation Share 1. If the beneficiary has no living issue, the property will be divided into shares for the issue of Taxpayer and Spouse in accordance with State Statute, and each share will be retained in trust for that issue and administered as described above for Continuation Share 1. If there are no living issue of Taxpayer and Spouse, the property will be distributed outright to Taxpayer's heirs.

Under Section 6.7(g), if not terminated sooner, every share administered under Continuation Share 1 or created by the exercise of any power of appointment under its provisions will terminate no later than 21 years after the death of the last survivor of the issue of Settlor who were alive on Date 1. If a trust is so terminated, the trustee will distribute all of the property to the income beneficiaries of the trust in the proportion in which they are entitled (or eligible, in the case of discretionary payments) to receive income immediately before the termination.

Taxpayer proposes to exercise the power of appointment for Share 2 to pass the Share 2 property to Continuation Share 2, created in Section 6.8 of the Revocable Trust. The provisions for Continuation Share 2 are identical to those of Continuation Share 1 except that, under Section 6.8(g), every trust administered under the provisions of Section 6.8 or created by the exercise of any power of appointment under its provisions will terminate no later than 21 years after the death of the last to die of Settlor's issue living on Date 2.

Taxpayer proposes to exercise the power of appointment for Share 3 to pass the Share 3 property to Continuation Share 3, created in Section 6.9 of the Revocable Trust. The terms for Continuation Share 3 are identical to those of Continuation Share 1, except that under Section 6.9(g), every trust administered under the provisions of Section 6.9 or created by the exercise of any power of appointment under its provisions will terminate no later than the date next preceding the end of 21 years after the death of the last to die of Settlor's issue living on Date 3.

Requested rulings:

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(1) Taxpayer's testamentary exercise of his powers of appointment with respect to Share 1, Share 2, and Share 3 will not result in the inclusion in his gross estate of the property passing by those appointments.

(2) Taxpayer's testamentary exercise of his powers of appointment with respect to Share 1, Share 2 and Share 3 will not result in the generation-skipping transfer tax becoming applicable to the property passing pursuant to those appointments to Continuation Share 1, Continuation Share 2, and Continuation Share 3 or to any subsequent transfer from them.

(3) When a person who is an issue of Taxpayer exercises the power of appointment which that person may come to hold under Continuation Share 1, Continuation Share 2, or Continuation Share 3, the exercise of that power will not result in the inclusion of the property in his or her gross estate.

(4) When any person who is an issue of Taxpayer does not exercise a testamentary power of appointment which that person may come to hold under Continuation Share 1, Continuation Share 2, or Continuation Share 3, the failure to exercise the power will not result in the inclusion of the property in his or her gross estate.

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 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.

Section 2041(a)(3) 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 by will exercises a power of appointment by creating another power of appointment which, under 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.

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

Section 20.2041-3(e)(1) provides that property subject to a power of appointment 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 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 every generation-skipping transfer (GST), which is defined under § 2611 as a taxable termination, a taxable distribution, or a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (Act), the generation-skipping transfer tax (GSTT) is generally applicable to generation-skipping transfers made after October 22, 1986. Section 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping transfer tax does not apply to a transfer from a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of principal added to the trust after September 25, 1985 (or out of income attributable to principal so added). Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor held a power with respect to the trust that would have caused the value of the trust to be included in the settlor’s gross

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estate for Federal estate tax purposes by reason of § 2038 or by reason of § 2042 if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided in § 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 that 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 § 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 § 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

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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 present case, Taxpayer is a beneficiary of Share 1, Share 2, and Share 3 established, respectively, under the trust agreements creating Trust 1, Trust 2, and Trust 3. Each agreement provides Taxpayer with a testamentary power of appointment over his separate share created in that agreement. Because Taxpayer cannot exercise any such power to or for himself or his benefit, his estate, his creditors, or the creditors of his estate, his testamentary powers of appointment are not general powers of appointment.

Taxpayer will exercise his testamentary power with respect to Share 1 to create Continuation Share 1 which will be divided into separate shares representing each child of Taxpayer or the child's issue and held accordingly. Taxpayer will exercise his testamentary power in the same way for Share 2 and Share 3. For each such share of a Continuation Share, Taxpayer will create a testamentary power of appointment exercisable by the beneficiary of that share in favor of entities or persons other than the beneficiary's estate, creditors, or the creditors of his or her estate.

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Under the terms of each Continuation Share, the property of a respective Continuation Share will be distributed outright and free of trust within a period measurable from the date of creation of the original power (i.e., Taxpayer's power). That is, every Share administered under a Continuation Share or established by an exercise of a power of appointment under a Continuation Share must terminate no later than the day next preceding the end of 21 years (or, in the case of Share 2, no later than 21 years) after the death of the last survivor of the Settlor's issue living on the date of the creation of the respective Trust 1, Trust 2, or Trust 3 in which the Taxpayer's original power (that he exercised to establish the Continuation Share) was created. Thus, the proposed testamentary exercise of Taxpayer's limited power of appointment with respect to Share 1, Share 2, and Share 3 will not create another power which can, under State law, be exercised 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 the respective Share for a period without regard to the date of the creation of Taxpayer's original power.

Accordingly, Taxpayer's testamentary exercise of the powers of appointment created in Trust 1, Trust 2, and Trust 3 will not cause the property of Share 1, Share 2, or Share 3 to be included in his gross estate under section 2041(a)(2) or (3). Likewise, a beneficiary's exercise or non-exercise of the testamentary power of appointment created for him or her with respect to a Share of Continuation Share 1, Continuation Share 2, or Continuation Share 3 will not cause the property of that respective Continuation Share to be included in the beneficiary's gross estate under section 2041(a)(2) or (3).

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

As discussed above, under the facts presented, Taxpayer's proposed testamentary exercise of a limited power of appointment with respect to a Share will not create another power which can, under State law, be exercised in a manner that postpones the vesting of any estate or interest in the respective Share, or suspends the absolute ownership or power of alienation of the property of the Share without regard to the date of the creation of the original power created for Taxpayer for the respective Share.

Consequently, Taxpayer's testamentary exercise of his powers with respect to Share 1, Share 2, and Share 3 will not result in the generation-skipping transfer tax becoming applicable to the property passing pursuant to

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those appointments to Continuation Share 1, Continuation Share 2, and Continuation Share 3 or to any subsequent transfer from them.

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 of the material submitted in support of the request for rulings, it is subject to verification on examination. 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.

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

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,
KATHERINE A. MELLODY
Senior Technician Reviewer, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
copy for 6110 purposes