

Internal Revenue Service

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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-119784-01
Date: February 08, 2002

Re:

Legend:

Decedent =

Spouse =

Son =

Daughter =

Grandchild 1 =

Grandchild 2 =

Date 1 =

Decedent's Will =

Trust =

Date 2 =

A =

Great Grandchild =

Daughter's Spouse =

Date 3 =

Daughter's Will =

State =

Statute =

Dear :

This is in response to a letter dated March 12, 2001, and subsequent correspondence, requesting rulings regarding the federal estate and generation-skipping transfer (GST) tax consequences of the proposed exercise of a power of appointment.

Facts

The facts submitted and representations made are as follows. Decedent died before September 25, 1985, on Date 1, survived by Spouse, Son, Daughter, and Daughter's children, Grandchild 1 and Grandchild 2.

Article V of Decedent's Will provides that Decedent's residuary estate passes in trust for the benefit of Spouse. Spouse is to receive the trust income for life and, at death, may appoint the remaining trust estate as Spouse chooses. If Spouse fails to exercise this power of appointment, the remaining trust estate will be divided into two equal parts, one part to be held in trust for the benefit of Son, the other part to be held in trust for the benefit of Daughter.

Spouse died prior to September 25, 1985, on Date 2. He did not exercise his testamentary power of appointment. Therefore, at Spouse's death, one-half of the remainder of his trust passed to a separate trust for Daughter, hereinafter referred to as Trust. It is represented that there have been no additions, constructive or otherwise, to Trust since September 25, 1985.

Under the terms of Trust, during her life, Daughter is to receive the net income of Trust. At her death, Daughter may appoint by will the remaining assets of Trust among a class consisting of her descendants, the spouses of her descendants, and her spouse, in any proportions. If Daughter fails to exercise this power, one-third of Trust will be distributed outright to Daughter's surviving spouse, and two-thirds of Trust (or all of Trust if there is no surviving spouse) will be distributed outright to Daughter's issue, per stirpes, or, if none, to Daughter's surviving spouse; or if no spouse or issue survive Daughter, Trust will be distributed to Decedent's heirs under the State law of intestacy.

The trustees are authorized to withdraw any amount of principal from a trust held for a beneficiary as the trustees in their sole discretion deem necessary for the "comfortable support, maintenance and education," the "reasonable funeral expenses," and the "reasonable expenses of the last illness" of the respective beneficiary. In

addition, the trustees may withdraw from a trust held for a beneficiary sums the trustees deem “expedient” for purchasing annuities or life insurance for the respective beneficiary. However, in each calendar year, the trustees may not withdraw more than 5 percent of the aggregate value of the corpus of a trust to make such payments for the respective beneficiary of that trust.

Spouse, Son, Daughter's Spouse, and A (who is not related to the Decedent or Daughter) are named in Decedent's Will as co-trustees. Upon the death, resignation, or incapacity of a trustee, the remaining trustees may appoint any person or banking corporation as successor or co-trustee. In default of such appointment, the adult life beneficiaries may appoint successor trustees. Grandchild 1 and A are currently serving as co-trustees.

Currently, Daughter has two living adult children, Grandchild 1 and Grandchild 2, and Grandchild 1 has a child, Great Grandchild, a minor. Daughter's Spouse died on Date 3.

Under State Statute, in general, a trustee who is also the beneficiary of a trust cannot exercise a power to make discretionary distributions of principal for the trustee's own benefit.

Daughter now proposes to execute a Second Codicil to her Will, amending and modifying Article IV, Section B of her Will captioned “Exercise of Power of Appointment.”

Under the terms of the proposed Second Codicil, Section B, subsection (2) provides that Daughter exercises the power of appointment granted her under Article V of Decedent's Will by directing that the entire remaining principal and accumulated income of Trust will be retained in further trust by the trustees of Trust under the dispositive provisions of subsections (3) through (10) of new Section B.

Section B, subsection (3) provides that all of the appointed property will be divided into one equal share for each of Daughter's then living children and one equal share for the issue, collectively, of each of Daughter's then deceased children. The share of a child who predeceases Daughter without surviving issue will be distributed equally among the shares for Daughter's other children. Each share will be administered as a separate trust.

Under Section B, subsections (4) and (5) until the termination of each separate trust, the trustees will distribute annually 80 percent of the income of that trust to the child for whom the trust was established, or per stirpes to the issue of a then deceased child, including a child who dies after Daughter, unless otherwise appointed under subsection (8) by the deceased child. In addition, the trustees will distribute principal from the trust for the “proper health, education, maintenance, and support” of the beneficiary (or beneficiaries) of the trust, including the issue of a child who dies after Daughter, unless the trust was appointed by a deceased child.

Under Section B, subsection (8), each beneficiary for whom a trust is established under subsection (3) has a special power to appoint, by will or by a written directive during the beneficiary's life, any part of the beneficiary's trust to any person or charitable organization, excluding the power holder, creditors of the power holder, estate of the power holder, and creditors of the estate of the power holder. The power may be exercised to create trusts and to grant additional powers. However, no power can be exercised over any property over which a power has been previously exercised to cause or permit the vesting of any property or interest in property, or the termination of any trust, to be postponed for a period beyond the perpetuities period applicable to the grantor of the first power exercised. Each of the issue of a child of Daughter has a power to appoint only a per stirpes share of the trust in which the individual has an interest.

Under Section B, subsection (9), all trusts or portions of trusts held under Section B and attributable to trusts initially established by Decedent must terminate no later than the day before 21 years after the death of the last survivor of the issue of Decedent living at Decedent's death. Upon termination, the remainder will be distributed per stirpes to the then living issue of the child of Daughter for whom the trust was, or was intended to be, established. If a child of Daughter dies without issue, the child's share will be proportionally divided among the other then existing shares. If none of Daughter's issue, who would otherwise be beneficiaries, exist at any time or if the term expires without any such issue of Daughter surviving, the trust will be disposed of under the State rules of intestacy as if Daughter had then died.

Under Section B, subsection (10), except upon termination at the end of the applicable perpetuities period, the trustees may refrain from making any mandatory distribution of income or principal to any beneficiary, whenever the trustees determine that unusual circumstances exist under which so refraining would be in a beneficiary's best interests.

We have been asked to rule as follows:

1. The power granted Daughter under Decedent's Will to appoint Trust is not a general power of appointment under § 2041 of the Internal Revenue Code.
2. Under the terms of the proposed Second Codicil, Daughter's exercise of her power to appoint Trust will not result in the inclusion of any property subject to the power in Daughter's gross estate for federal estate tax purposes under § 2041(a)(2).
3. Under the terms of the proposed Second Codicil, Daughter's exercise of her power to appoint Trust will not result in the inclusion of any property subject to the power in Daughter's gross estate for federal estate tax purposes under § 2041(a)(3).
4. Trust is exempt from generation-skipping transfer (GST) tax, because Trust was irrevocable on or before September 25, 1985, and because no additions, either actual or constructive, were made to trust after that date.

5. Under the terms of the proposed Second Codicil, Daughter's exercise of her power to appoint Trust will not constitute a constructive addition to Trust subject to GST tax under Chapter 13.

6. The existence, exercise, or partial or complete release of the powers of appointment granted to Grandchild 1, Grandchild 2, and Great Grandchild under the proposed Second Codicil will not result in the inclusion of the value of any assets of Trust in the gross estate of Grandchild 1, Grandchild 2, and Great Grandchild for federal estate tax purposes under §§ 2041(a)(2) or 2041(a)(3).

Law

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 created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(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.

Section 2041(b) provides that the term "general power of appointment" means a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. Under § 2041(b)(1)(A), a power to consume, invade, or appropriate property for the benefit of the decedent which 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 2601 imposes a tax on each generation-skipping transfer made by a transferor to a 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 his or her gross estate under §§ 2038 or 2042, if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided under § 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or 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.

Analysis

In the present case, Trust was created under Decedent's Will effective on Decedent's date of death on Date 1. Thus, Trust was irrevocable before September 25, 1985. You represent that there have been no constructive or actual additions to Trust since September 25, 1985.

Daughter's testamentary power of appointment over Trust cannot be exercised in favor of herself, her estate, her creditors, or the creditors of her estate. Accordingly, her testamentary power of appointment is not a general power of appointment as described in § 2041.

Under the proposed Second Codicil to Daughter's Will, Daughter will exercise her testamentary power over Trust by directing that the Trust assets continue to be held by the trustees of Trust under the dispositive provisions contained in the proposed

Second Codicil. Under these provisions, each trust administered under the terms of the proposed Second Codicil, or established by an exercise of a power of appointment under the proposed Second Codicil and attributable to trusts established under the Decedent's Will must terminate no later than the day next preceding the end of 21 years after the death of the last survivor of the Decedent's issue living on the Decedent's date of death. Thus, under the codicil, Daughter's power is not being exercised in a manner that may postpone or suspend vesting of the Trust corpus for a period measured from the date of creation of the Trust extending beyond any life in being plus 21 years.

Further, the proposed testamentary exercise of Daughter's limited power of appointment under the Second Codicil 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 any trust held under the terms of the proposed Second Codicil for a period without regard to the date of the creation of Daughter's power and of Trust.

Finally, in the event a beneficiary (such as Grandchild 1) becomes a trustee of a trust created under Section B, subsection (3), the trustee will have no discretionary power to pay income, and any discretionary power to pay corpus possessed by the trustee would be limited by an ascertainable standard relating to the health, maintenance, support and education of the beneficiary as described in § 20.2041-1(c)(2). Further, under State Statute, the trustee would be precluded from participating in the exercise of the power for his or her own benefit, in any event. Accordingly, the power would not be a general power of appointment for purposes of § 2041.

Accordingly, based on the facts submitted and representations made, we rule as follows:

1. The power granted Daughter under Decedent's Will to appoint Trust is not a general power of appointment under § 2041 of the Internal Revenue Code.
2. Daughter's exercise of her power to appoint Trust under the terms of the proposed Second Codicil will not result in the inclusion of any property subject to the power in Daughter's gross estate for federal estate tax purposes under § 2041(a)(2).
3. Daughter's exercise of her power to appoint Trust under the terms of the proposed Second Codicil will not result in the inclusion of any property subject to the power in Daughter's gross estate for federal estate tax purposes under § 2041(a)(3).
4. Trust is exempt from generation-skipping transfer (GST) tax, because Trust was irrevocable on or before September 25, 1985, and because no additions, either actual or constructive, were made to trust after that date.
5. Under the terms of the proposed Second Codicil, Daughter's exercise of her power to appoint Trust will not constitute a constructive addition to Trust subject to GST tax under Chapter 13.

6. The existence, exercise, or partial or complete release of the powers of appointment granted to Grandchild 1, Grandchild 2, and Great Grandchild under the proposed Second Codicil will not result in the inclusion of the value of any assets of Trust in the gross estate of Grandchild 1, Grandchild 2, and Great Grandchild for federal estate tax purposes under §§ 2041(a)(2) or 2041(a)(3).

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

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

Sincerely yours,

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

Enclosure
Copy for section 6110 purposes

cc: