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Person To Contact:
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Date:
November 04, 2009

Donor 1 =
Donor 2 =
Trust 1 =

Date 1 =
\$X =
Property
Trust 2 =
Children =

Dear :

This responds to your submission dated April 23, 2009, and subsequent correspondence, requesting rulings concerning the generation-skipping tax (GST) consequences of the exercise of a power of appointment.

Donor 1 and Donor 2 are husband and wife. On Date 1, Donor 1 and Donor 2 created Trust 1, an irrevocable trust for the benefit of their Children and their issue. Trust 1 was funded with \$X in cash to which donors timely allocated an equal amount of GST exemption. No additional contributions have been made to Trust 1 and it is represented that Trust 1 has an inclusion ratio of zero.

Under the terms of Trust 1, income and principal is distributable during Donors' lifetimes, in the discretion of the trustees, for the health, education and support of Children and their issue. On the death of the last of Donors to die, after setting aside an amount sufficient to maintain Property during Children's lifetimes, the remaining trust principal is divided into three shares, one for each child. Income and principal is distributable, in the discretion of the trustees, for the health, education and support of the child and the child's issue. Notwithstanding the foregoing, during Donors' lifetimes Children may unanimously exercise a power to appoint the entire trust principal outright or in further trust for the benefit of Donors' issue. This power is expressly not

exercisable in favor of Children, their estates, their creditors or the creditors of their estates.

On the death of the last of Donors to die, it is represented that Trust 1 may purchase Property. Children propose to exercise the power to appoint the entire principal of Trust 1 in favor of Trust 2, a trust that will maintain Property for the benefit of their issue. Trust 2 contains no powers of appointment, and will not be funded until the death of the last of Children to die.

Donors seek rulings that Children will not become the transferors of Trust 2 for GST tax purposes by virtue of the exercise of the power, with the result that Trust 2 will have a GST inclusion ratio of zero.

Section 2601 of the Internal Revenue Code imposes a tax on every 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 2613 defines a skip person, in part, as a natural person assigned to a generation which is two or more generations below the generation assignment of the transferor.

Section 2602 provides that the amount of the tax is the taxable amount multiplied by the applicable rate. Section 2641(a) defines the applicable rate as the product of the maximum estate tax rate and the inclusion ratio with respect to the transfer.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the applicable fraction. The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator of which is the value of the property transferred to the trust or involved in the direct skip.

Section 2631(a), as effective in the year that includes Date 1, provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 (adjusted for inflation under § 2631(c)) which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a) provides that any allocation by an individual of his or her GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Section 26.2632-1(b)(4)(i) of the Generation-skipping Transfer Tax Regulations provides, in part, that an allocation of GST exemption to property transferred during the transferor's lifetime, other than in a direct skip, is made on Form 709. The allocation must clearly identify the trust to which the allocation is being made, the amount of GST exemption allocated to it, and if the allocation is late or if an inclusion ratio greater than zero is claimed, the value of the trust assets at the effective date of the allocation. With respect to a timely allocation, an allocation of GST exemption becomes irrevocable after the due date of the return.

Section 2642(b)(1) provides, in relevant part, that if the allocation of the GST exemption to any transfers of property is made on a timely filed gift tax return or is deemed to be made under § 2632(b)(1) or (c)(1), the value of such property for purposes of determining the inclusion ratio shall be its value as finally determined for gift tax purposes and such allocation shall be effective on and after the date of such transfer.

Section 2652(a)(1)(A) provides that, generally, 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)(1) provides, in part, that, generally, 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. Thus, an individual may be the transferor even though there is no transfer of property under local law at the time the federal estate and gift tax applies.

Section 2031(a) provides that the value of the gross estate of the decedent shall be determined by including to the extent provided in §§ 2033 through 2044 the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

Section 2041(a)(2) 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 has at the time of his 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, the property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) 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 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.

Sections 20.2041-1(c)(1)(a) and (b) of the Estate Tax Regulations provide that a power of appointment is not a general power if by its terms it is 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 it is expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate or the creditors of his estate.

Section 2501(a)(1) imposes a gift tax on the transfer of property by gift. Section 2511(a) provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. Under § 2514(c)(1), a power to consume, invade, or appropriate property for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor shall not be deemed a general power of appointment.

Sections 25.2514-1(c)(1)(a) and (b) of the Gift Tax Regulations provide that a power of appointment is not a general power if by its terms it is 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 it is expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate or the creditors of his estate.

Here, under the express terms of the power of appointment provided in Trust 1, Children may not appoint the assets of Trust 1 to themselves, their estates, their creditors or the creditors of their estates, with the result that the power is not a general power of appointment for purposes of §§ 2041 and 2514. Thus, the exercise of the power will not result in the inclusion of the property subject to the power in Children's gross estates, nor will it be treated as a gift by Children. Accordingly, Children will not become the transferors of the property subject to the power for purposes of § 2652. Rather, Donors remain the transferors of the assets transferred to Trust 2 for purposes of § 2652, with the result that Trust 2 has an inclusion ratio of zero.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

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 an 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

LORRAINE E. GARDNER
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

Copy for § 6110 purposes (1)