Internal Revenue Service

Number: **202228006**
Release Date: 7/15/2022

Index Number: 2601.00-00, 2518.00-00, 2501.00-00, 2041.00-00, 2038.00-00, 2037.00-00, 2036.00-00, 1001.00-00, 61.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-121263-21

Date:
April 12, 2022

Re:

Legend

Settlor	=
Settlor's Spouse	=
Son	=
Son's Spouse	=
Trust	=
Trustee	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
Grandchild 4	=
Grandchild 5	=
Great Grandchild 1	=
Great Grandchild 2	=
Great Grandchild 3	=
Great Grandchild 4	=
Great Grandchild 5	=
Great Grandchild 6	=
Great Grandchild 7	=
Great Grandchild 8	=
Great Grandchild 9	=
Great Grandchild 10	=
Great Grandchild 11	=
Great Grandchild 12	=
Great Grandchild 13	=
Great Grandchild 14	=
Great Grandchild 15	=
Great Grandchild 16	=

Great-Great Grandchild 1	=
Great-Great Grandchild 2	=
Great-Great Grandchild 3	=
Great-Great Grandchild 4	=
Great-Great Grandchild 5	=
Great-Great Grandchild 6	=
Great-Great Grandchild 7	=
Great-Great Grandchild 8	=
Great-Great Grandchild 9	=
Great-Great Grandchild 10	=
Great-Great Grandchild 11	=
Great-Great Grandchild 12	=
Great-Great Grandchild 13	=
Great-Great Grandchild 14	=
Great-Great Grandchild 15	=
Great-Great Grandchild 16	=
Great-Great Grandchild 17	=
Great-Great Grandchild 18	=
Great-Great Grandchild 19	=
Great-Great Grandchild 20	=
Great-Great Grandchild 21	=
Great-Great Grandchild 22	=
Great-Great Grandchild 23	=
Great-Great Grandchild 24	=
Great-Great Grandchild 25	=
Great-Great Grandchild 26	=
Great-Great Grandchild 27	=
Great-Great Grandchild 28	=
Great-Great Grandchild 29	=
Great-Great Grandchild 30	=
Great-Great Grandchild 31	=
Great-Great Grandchild 32	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
State	=
Court	=
State Statute 1	=
State Statute 2	=
State Statute 3	=
State Statute 4	=
x	=
A	=

Dear :

This letter responds to your authorized representative's letter dated September 28, 2021, and subsequent correspondence, requesting federal tax rulings on certain proposed transactions involving Trust.

The facts and representations submitted are summarized as follows:

On Date 1, Settlor and Settlor's Spouse (collectively, the "Settlors") created an irrevocable trust, Trust, for the benefit of Son (generally referred to in the trust instrument as the "Beneficiary"). Date 1 is a date prior to October 21, 1942. Trust is governed by the laws of State.

Article III, Section 1 of Trust provides that the Beneficiary has no right to the corpus of Trust and does not have a right to partition, divide, or dissolve Trust. The Beneficiary has no right with respect to Trust other than to receive distributions of net earnings awarded him by the trustee with the consent of Trust's Advisory Board and the right to distribution of the trust estate made by the trustee at the termination of Trust.

Article III, Section 2 provides that the death, insolvency or bankruptcy of the Beneficiary hereunder, or the transfer of his interest in any manner, or by descent or otherwise, during the continuance of Trust, shall not operate as a dissolution of, nor terminate Trust, nor shall it have any effect whatever upon the trust estate, its operation or mode of business, nor shall it entitle his heirs or assigns or representatives to take any action in the courts of law or equity against the estate, its trustees or property or its business operations of any kind, all of which shall remain intact and undistributed thereby; but shall succeed only to the rights of the original Beneficiary.

Article III, Section 3 provides that at the time of the death of the Beneficiary, his equitable interest in the trust estate, unless disposed of otherwise by said Beneficiary, shall pass to and vest in his heirs in accordance with the laws of descent and distribution then in force, applicable to the equitable interest of such Beneficiary in the trust estate. Section 3 further provides that the term "Beneficiary" applies not only to Son but to all of his successors to beneficial interests under Trust.

Article IV, Section 3 provides that Trust will continue until the death of Son, and for twenty-one years after Son's death. At the expiration of that period, the trustee is to distribute the trust corpus among the then existing beneficiaries.

Article IV, Section 4 provides that the Beneficiary may receive from time to time a portion of the net profits accruing from time to time to the trust estate, as the trustee, acting with the advice and consent of the Advisory Board, may see fit to pay over and deliver to the Beneficiary. No duty is imposed upon the trustee to make distributions of net profits, but the power is conferred upon the trustee, acting with the advice and consent of the Advisory Board. In exercising this discretion, the trustee and Advisory Board will give full consideration to the interest of both the Beneficiary and the trust estate.

By order dated Date 2 (Date 2 Order), Court modified the terms of Trust and approved a completely restated trust agreement. In the Date 2 Order, Court made several significant findings and holdings with respect to Trust. Specifically, Court found that Trust expressly provides that the term “Beneficiary” applies not only to Son but to all his successors to beneficial interests under Trust. The Court further found that the heirs of Son who succeed to his equitable interest in Trust will be referred to as “Successor Beneficiaries.” In addition, Court found that,

(i) upon Son’s death, Son’s equitable interest in Trust will pass to and vest in Son’s heirs in accordance with the laws of descent and distribution of State then in force, applicable to his equitable interest in Trust;

(ii) upon Son’s death, Trust will be divided into separate shares for each of his heirs; if Son’s Spouse survives him, one-third of Trust will be allocated to a share for Son’s Spouse and the other two-thirds will be divided into shares for the children and descendants of Son, in accordance with the laws of descent and distribution of State then in force; and

(iii) each such share for Son’s heirs will be separate, and the Successor Beneficiaries of Trust will not become common beneficiaries of an undivided trust. Consequently, the interests and powers of a Successor Beneficiary with respect to his or her share extend only to that Successor Beneficiary’s respective share and not to any share held for any other Successor Beneficiary.

Trust is administered by Trustee and a three-person Advisory Board. An individual serving as a trustee is also a member of the Advisory Board. In the event Trustee should fail or cease to serve, the remaining members of the Advisory Board will appoint a new member to fill the vacancy on the board. Then the Advisory Board will appoint one of its members or a Qualified Family Trust Company to serve as trustee. The Beneficiary and individuals related and subordinate to the Beneficiary within the meaning of § 672(c) of the Internal Revenue Code (Code) may serve on the Advisory Board but may not serve as a trustee.

Currently, Son is married to Son’s Spouse and they have five children (Grandchildren 1 through 5), sixteen Grandchildren (Great Grandchildren 1 through 16), and thirty-two Great Grandchildren (Great-Great Grandchildren 1 through 32).

Under Article III, Section 3, as construed by Court (discussed below), Son is determined to possess a testamentary general power of appointment over Trust. Son intends to allow his power of appointment over Trust to lapse at his death. Further, one or more of the Successor Beneficiaries plans to irrevocably and unqualifiedly disclaim, in accordance with State Statute 1 and § 2518 of the Code, in a writing delivered to Trustee, all or an undivided portion of his or her beneficial interest in Trust no later than nine months after Son's death. A Successor Beneficiary disclaiming his or her interest in Trust will not (i) accept an interest in or any benefits from the property subject to the disclaimer; or (ii) voluntarily assign, convey, encumber, pledge or transfer the interest in property subject to the disclaimer or contract to do any of the foregoing. As a result of the disclaimer, the disclaimed interest will pass without any direction from the Successor Beneficiary disclaiming his or her interest in Trust, and the interest will pass to someone other than the Successor Beneficiary disclaiming his or her interest in Trust. Finally, a Successor Beneficiary disclaiming his or her interest in Trust will not serve on the Advisory Board or as a trustee of Trust.

On Date 3, Trustee filed in Court a petition for construction and modification of terms of Trust. Trustee proposes to make certain modifications to Trust in order to facilitate the administration of Trust after the death of Son. Trust currently provides that Trust will terminate twenty-one years after Son's death and will then be distributed outright to the Successor Beneficiaries. It is represented that the amounts distributed upon termination of Trust will be substantial, and that if a Successor Beneficiary is under the age of x, it would not be in his or her best interest to receive his or her share outright. Son and the Successor Beneficiaries have consented to the proposed modifications.

State Statute 1 provides that if an interest in property passes because of the death of a decedent, a disclaimer of the interest takes effect as of the time of the decedent's death, and relates back for all purposes to the time of the decedent's death.

State Statute 2 provides that on the petition of a trustee or a beneficiary, a court may order that the terms of the trust be modified if, because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust.

State Statute 3 provides that the court may not take the action permitted by State Statute 2 unless all beneficiaries of the trust have consented to the order or are deemed to have consented to the order. Further, a minor, incapacitated, unborn, or unascertained beneficiary is deemed to have consented if a person representing the beneficiary's interest has consented or if a guardian ad litem appointed to represent the beneficiary's interest consents on the beneficiary's behalf.

State Statute 4 provides that when distributing trust property or dividing or terminating a trust, a trustee may make distributions in divided or undivided interests, and allocate particular assets in proportionate or disproportionate shares.

On Date 4, Court issued an order ("Court Order") approving the following construction and modification of Trust ("Trust Construction and Modification"), subject to a favorable private letter ruling from the Internal Revenue Service.

Trust Construction

In Court Order, Court ruled as follows:

(1) Upon Son's death, Trust shall be divided into separate trusts (hereinafter, "Successor Trusts") for each Successor Beneficiary, and that upon the subsequent death of a Successor Beneficiary during the twenty-one year term following Son's death, the Successor Trusts of which the deceased Successor Beneficiary was an income beneficiary shall be similarly divided into separate Successor Trusts.

(2) Trust grants Son a general power of appointment with respect to Trust and Successor Beneficiaries hold the same general power of appointment with respect to his or her Successor Trust.

(3) After Son's death, each Successor Beneficiary will have three separate beneficial interests in his or her Successor Trust: (i) a discretionary income interest for twenty-one years after Son's death; (ii) a remainder interest which vests in possession twenty-one years after Son's death; and (iii) a general power of appointment. Each of the beneficial interests may be disclaimed independently of the others.

(4) The class of a disclaiming Successor Beneficiary's descendants who are heirs of Son shall remain open to new members born to such disclaiming Successor Beneficiary during the twenty-one years after the death of Son, including descendants born to a disclaiming Successor Beneficiary who has no children or other descendants living on the death of Son.

(5) Upon a Successor Beneficiary's disclaimer of a beneficial interest in his or her Successor Trust, the following will apply:

(i) If a Successor Beneficiary disclaims an interest in Trust and survives Son, the disclaimed interest will pass, at Son's death, to Son's heirs (which would exclude a Successor Beneficiary's spouse) determined as though the disclaiming beneficiary did not survive Son (*i.e.*, to the beneficiary's descendants who survive Son).

(ii) If a Successor Beneficiary disclaims an interest in Trust, survives Son but dies within twenty-one years after Son's death, the disclaimed interest will not be affected by the Successor Beneficiary's death.

(iii) If a Successor Beneficiary survives Son but dies within twenty-one years after Son's death, the Successor Beneficiary's retained interest in Trust will pass to Successor Beneficiary's heirs at law, which include Successor Beneficiary's spouse.

(6) Successor Trust shall be divided and funded in the following manner:

(i) Where no disclaimers are made, the separate trusts created for Successor Beneficiaries will hold equal percentages of income and remainder interests and the undistributed income produced by a particular portion will be added to principal of that particular portion.

(ii) Where a Successor Beneficiary disclaims an equal portion of his or her income and remainder interests, the retained and disclaimed interests would be administered similarly, and the undistributed income produced by a particular portion will be added to principal of that particular portion.

(iii) Where a Successor Beneficiary disclaims a greater percentage of the remainder interest than an income interest, at least two trusts will be created for the disclaimant. Under one trust, the disclaimant will be both the income and remainder beneficiary of the trust. Under the second trust, the disclaimant will have an income interest in the trust but no remainder interest. The remainder interest in the second trust will belong to the heirs of the beneficiary immediately preceding the disclaimant in interest (that is, the "prior beneficiary") who are descendants of the disclaiming beneficiary, determined as if the disclaiming beneficiary predeceased the prior beneficiary.

(7) When Trustee divides Trust into separate trusts after Son's death, or after the death of one of the Successor Beneficiaries, Trustee shall create the least number of trusts under each family branch of a particular child of Son (Grandchild 1 through 5) that can be established with only one income beneficiary of each trust.

(8) If an income beneficiary of a separate trust dies within twenty-one years after Son's death with an heir at law who is already an income beneficiary of a separate trust, then such heir's share of the deceased income beneficiary's trust shall be added to his or her existing trust of which he or she is the income beneficiary in conformance with the general rule in Construction #7.

(9) If, during the twenty-one year term after Son's death, a new beneficiary is born into the class of beneficiaries who are lineal descendants of the disclaimant (the "Disclaimant Class") and a trust or trusts are in existence with members of the Disclaimant Class as income beneficiaries, a new trust is created for the new beneficiary.

(10) The terms "net earnings" and "net profits" as they appear in Trust are construed to mean trust "income" under State Trust Code and State law.

Trust Modification

In Court Order, Court modified Trust as follows:

(1) A new Section 6 of Article IV of Trust is added to provide that when Trust terminates twenty-one years after the death of Son, any share distributable to a beneficiary who is then under the age of x (a "Continuing Beneficiary") shall be held in a trust (a "Continuing Trust") until such Continuing Beneficiary attains the age of x. If the Continuing Beneficiary survives Son but dies before reaching the age of x, he or she shall have a general testamentary power of appointment over his or her Continuing Trust. Any Continuing Trust shall terminate when the Continuing Beneficiary attains x years of age or dies, whichever event occurs first. At that time, the trustee shall deliver all remaining property in Continuing Trust to the Continuing Beneficiary, or if not living,

as the Continuing Beneficiary may appoint by will (including to the Continuing Beneficiary's estate or the creditors of the Continuing Beneficiary or the creditors of the Continuing Beneficiary's estate). If the Continuing Beneficiary dies before reaching age x and does not exercise his or her general testamentary power of appointment, the Continuing Trust is distributed to the Continuing Beneficiary's estate. Equitable title to the property held in the Continuing Beneficiary's Continuing Trust shall be vested in the Continuing Beneficiary and shall be alienable. No power shall be exercised so as to violate any rule against perpetuities or rule against restraint against alienation. (Modification #1)

(2) A new Section 7 of Article IV of Trust is added governing the succession of trustees with respect to each Continuing Trust as described under new Section 6. A Continuing Beneficiary will have the power to remove the trustee of his or her Continuing Trust and replace the trustee with a trustee of his or her choosing, other than the Continuing Beneficiary. Until a Continuing Beneficiary attains the age of eighteen, the Continuing Beneficiary's parent or legal guardian will hold this power. (Modification #2)

(3) Section 10 of Article I of Trust provides that as near as possible after the close of each calendar year, Trust must have the books and records of Trust audited by a certified public accountant (the "Audit Requirement"). After Son's death, the trust estate will be divided into several Successor Trusts and the Audit Requirement will be burdensome and costly given the number of separate trusts subject to the Audit Requirement. Accordingly, Section 10 of Article I of Trust is modified to eliminate the Audit Requirement for separate trusts with assets under $A and make the Audit Requirement optional for trusts whose beneficiaries were not an adult party to the petition filed on Date 3 and with assets under $A. (Modification #3)

It is represented that no actual or constructive additions within the meaning of § 26.2601-1(b) of the Generation-Skipping Transfer Tax Regulations have been made to Trust after September 25, 1985.

You have requested the following rulings:

1. Trust is exempt from chapter 13 pursuant to § 2601.

2. Trust grants Son and each Successor Beneficiary of Trust a power of appointment that is a general power of appointment created before October 21, 1942, under §§ 2041(a)(1) and 2514(a), so that the lapse or complete release of the power of appointment will not subject any portion of Trust to federal estate, gift, or generation-skipping transfer (GST) tax.

3. The proposed disclaimer by any one or more of the Successor Beneficiaries of Trust will (a) be a qualified disclaimer under § 2518; (b) not result in a taxable gift by any of Successor Beneficiaries disclaiming his or her interest in Trust, and will not subject any portion of Trust to federal estate tax in the gross estate of a Successor Beneficiary

disclaiming his or her interest; and (c) not result in a loss of GST exempt status with respect to any portion of Trust.

4. The assets of a Continuing Trust created pursuant to Modification #1 after Son's death will be includible in the gross estate of any Continuing Beneficiary of such Continuing Trust under § 2041(a)(2) if the Continuing Beneficiary dies before the Continuing Trust terminates.

5. Trust Construction and Modification will not cause Trust or any Successor Trust to be subject to GST tax pursuant to chapter 13.

6. Trust Construction and Modification will not result in any Successor Beneficiary of Trust making a taxable gift.

7. Trust Construction and Modification will not result in inclusion of any asset of, or interest in Trust or any Successor Trusts in the gross estate of any Successor Beneficiary whose death occurs prior to the termination of Trust under § 2036, 2037 or 2038.

8. The non-pro rata distribution of assets from Trust to one or more Successor Trusts created for the benefit of any Successor Beneficiaries will not be treated as a pro rata distribution of assets followed by a taxable sale and exchange of assets between the Successor Trusts.

LAW AND ANALYSIS

<u>Ruling #1</u>

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations provide that the GST tax shall not apply to any GST under a trust that was irrevocable on September 25, 1985, but shall apply to the extent that the transfer is 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)(i) provides that a trust qualifies for transitional rule relief from the provisions of chapter 13 if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.
Section 26.2601-1(b)(1)(iv) provides that an addition made after September 25, 1985, to an irrevocable trust will subject to the provisions of chapter 13 a proportionate amount of distributions from, and terminations of interest in, property held in the trust.

In this case, Trust was in existence and irrevocable prior to September 25, 1985. Additionally, it is represented that no actual or constructive additions within the meaning of § 26.2601-1(b) have been made to Trust after September 25, 1985. Therefore, based upon the facts submitted and representations made, we conclude that Trust is exempt from the application of chapter 13 pursuant to § 2601.

Ruling #2

Section 2041(a)(1) provides, in part, that the value of the gross estate includes the value of all property to the extent of any property with respect to which a general power of appointment created on or before October 21, 1942, is exercised by the decedent by will; but the failure to exercise such a power or the complete release of such a power is not deemed an exercise thereof. *See* § 20.2041-2(d) of the Estate Tax Regulations.

Section 2041(b)(1) provides that, for purposes of § 2041(a), the term “general power of appointment” means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Section 20.2041-1(b) provides that a power of appointment includes all powers that are in substance and effect powers of appointment, regardless of the nomenclature used in creating the power.

Section 20.2041-1(e) provides that a power of appointment created by an inter vivos instrument is considered created on the date the instrument takes effect. The power is not treated as created at a future date merely because the power is not exercisable on the date the instrument takes effect or because the identity of the powerholder is not ascertainable until a later date.

Example 3 of § 20.2041-1(e) provides an illustration of the above rule. In the example, F creates an irrevocable inter vivos trust created before October 21, 1942, providing for payment of income to G for life with the remainder as G appoints by will, but in default of G’s appointment, the trust will pass with income to H for life and the remainder as H shall appoint by will. If G dies after October 2, 1942, without exercising the power of appointment, H’s power is considered a power created on or before October 21, 1942, even though H’s power of appointment was only a contingent interest until G’s death.

Section 20.2041-2(d) provides that a failure to exercise a general power of appointment created on or before October 21, 1942, or a complete release of the power is not an exercise of the power. The phrase “a complete release” means a release of all powers over all or a portion of the property subject to the power of appointment, as distinguished from a reduction of a power of appointment to a lesser power. Thus, if the decedent completely relinquished all powers over one-half of the property subject to a power of appointment, the power is completely released as to that one-half.

Section 2514(a) provides that an exercise of a general power of appointment created on or before October 21, 1942, is deemed a transfer of the property by the individual possessing such power for gift tax purposes, but the failure to exercise such power or the complete release of such power is not deemed an exercise thereof.

Section 25.2514-2(c) of the Gift Tax Regulations provides that a failure to exercise a general power of appointment created on or before October 21, 1942, or a complete release of such power is not considered to be an exercise of a general power of appointment. The phrase “complete release” means a release of all powers over all or a portion of the property subject to the power of appointment, as distinguished from the reduction of a power of appointment to a lesser power. Thus, if the possessor completely relinquished all powers over one-half of the property subject to a power of appointment, the power is completely released as to that one-half.

Section 26.2601-1(b)(1)(v)(A) provides that where any portion of a trust remains in 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 will be treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

In this case, Trust was executed on a date prior to October 21, 1942. Article III, Section 3 of Trust provides that at the time of the death of the Beneficiary, his equitable interest in Trust, unless disposed of otherwise by such Beneficiary, shall pass to and vest in his heirs in accordance with the laws of descent and distribution then in force, applicable to the equitable interest of such Beneficiary in the trust estate. The language of Trust indicates that Settlors intended for Son to have the power to dispose of his equitable interest, without limitation. Further, Trust indicates that the Settlors intended each Successor Beneficiary to have the same rights with respect to his or her share of Trust as Son, including a general power of appointment over such Successor Beneficiary’s interest in his or her Successor Trust. In the Court order, Court construed Trust as granting Son and Successor Beneficiaries a testamentary power of appointment to appoint such beneficiary’s interest in Trust to any appointee. Trust was executed prior to October 21, 1942, hence Son’s power of appointment is a power created before October 21, 1942. Successor Beneficiaries of Trust possess a general power of appointment that is contingent on surviving Son’s death. As in the case of *Example 3* of § 20.2041-1(e), the power of appointment held by Successor Beneficiaries is considered a power created before October 21, 1942. Accordingly, based upon the facts submitted and representations made, we conclude that Son and each Successor Beneficiary possess a general power of appointment created before October 21, 1942.

Son proposes to allow his testamentary general power of appointment to lapse. Under §§ 2041(a)(1) and 2514(a), the lapse or complete release of Son’s general power of appointment will not cause Son to be treated as making a taxable gift or cause any portion of Trust to be included in Son's gross estate for federal estate tax purposes. Therefore, based upon the facts submitted and representations made, we conclude that the lapse (or complete release) of Son's general power of appointment will not subject any portion of Trust to federal estate or gift tax under §§ 2041(a)(1) and 2514(a).

If one or more Successor Beneficiaries allow his or her power to lapse or completely releases his or her power of appointment, under §§ 2041(a)(1) and 2514(a), the lapse or complete release of a Successor Beneficiary's general power of appointment will not cause a Successor Beneficiary to be treated as making a taxable gift or cause any portion of Trust to be included in a Successor Beneficiary's gross estate for federal estate tax purposes. Therefore, based upon the facts submitted and representations made, we conclude that the lapse (or complete release) of a Successor Beneficiary's general power of appointment will not subject any portion of Trust to federal estate or gift tax under §§ 2041(a)(1) and 2514(a).

Finally, in this case, Trust was irrevocable prior to September 25, 1985. It is represented that there have been no additions (actual or constructive) to Trust after September 25, 1985. The lapse or complete release of a general power of appointment by Son or a Successor Beneficiary will not be a taxable lapse or release of a general power of appointment because the power of appointment was created prior to October 21, 1942. Therefore, based upon the facts submitted and the representations made, we conclude that the lapse or complete release of a general power of appointment by Son or a Successor Beneficiary will not be treated as a constructive addition to Trust and will not result in a loss of GST exempt status with respect to any portion of the trust over which such powers lapsed or were released.

Ruling #3

Section 2046 provides that for estate tax purposes, disclaimers of property interests passing upon death are treated as provided in § 2518.

Section 2518(a) provides that if a person makes a qualified disclaimer with respect to any interest in property, subtitle B shall apply with respect to such interest as if the interest had never been transferred to such person.

Section 2518(b) provides that the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if (1) the refusal is in writing; (2) the writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date that is nine months after the later of (A) the date on which the transfer creating the interest in the person is made, or (B) the day on which the person attains age 21; (3) the person has not accepted the interest or any of its benefits; and (4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either (A) to the spouse of the decedent, or (B) to a person other than the person making the disclaimer.

Section 2518(c)(1) provides that a disclaimer with respect to an undivided portion of an interest which meets the requirements of § 2518(b) shall be treated as a qualified disclaimer of such portion of the interest. Section 2518(c)(2) provides that a power over property is to be treated as an interest in that property.

Section 25.2518-1(b) provides, in relevant part, that if a person makes a qualified disclaimer as described in § 2518(b) and § 25.2518-2, for purposes of the federal estate, gift, and GST provisions, the disclaimed interest in property is treated as if it had never been transferred to the person making the qualified disclaimer. Instead, it is considered as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer. Accordingly, a person making a qualified disclaimer is not treated as making a gift. Similarly, the value of a decedent's gross estate for purposes of the federal estate tax does not include the value of property with respect to which the decedent, or the decedent's executor or administrator on behalf of the decedent, has made a qualified disclaimer.

Section 25.2518-2(c)(3) provides, in relevant part, that the nine-month period for making a disclaimer generally is to be determined with reference to the transfer creating the interests in the disclaimant. With respect to inter vivos transfers, a transfer creating an interest occurs when there is a completed gift for federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift. With respect to transfers made by a decedent at death or transfers that become irrevocable at death, the transfer creating the interest occurs on the date of the decedent's death, even if an estate tax is not imposed on the transfer.

Section 25.2518-2(c)(3) further provides that if a person to whom an interest in property passes by reason of the exercise, release, or lapse of a general power of appointment desires to make a qualified disclaimer, the disclaimer must be made within a nine-month period after the exercise, release, or lapse regardless of whether the exercise, release, or lapse is subject to estate or gift tax. A person who receives an interest in property as the result of a qualified disclaimer of the interest must disclaim the previously disclaimed interest no later than nine months after the date of the transfer creating the interest in the preceding disclaimant. Thus, if A were to make a qualified disclaimer of a specific bequest and as a result of the qualified disclaimer the property passed as part of the residue, the beneficiary of the residue could make a qualified disclaimer no later than nine months after the date of the testator's death.

Section 25.2518-3(a)(1)(i) provides that if the requirements of the section are satisfied, the disclaimer of all or an undivided portion of any separate interest in property may be a qualified disclaimer, even if the disclaimant has another interest in the same property.

Under 25.2518-3(a)(1)(iii), a power of appointment with respect to property is treated as a separate interest in such property and such power of appointment with respect to all or an undivided portion of such property may be disclaimed independently from any other interests separately created by the transferor in the property. Further, a disclaimer of a power of appointment with respect to property is a qualified disclaimer only if any right to direct the beneficial enjoyment of the property which is retained by the disclaimant is limited by an ascertainable standard.

Section 25.2518-3(a)(2) provides that a disclaimer of an undivided portion of an interest in a trust may be a qualified disclaimer. Under § 25.2518-3(b), the disclaimer of an undivided portion of a disclaimant's separate interest in property will be a qualified disclaimer if the undivided portion consists of a fraction or percentage of each and every substantial interest or right owned by the disclaimant in the property and extends over the entire term of the disclaimant's interest in the property. A disclaimer of some specific rights while retaining other rights with respect to an interest in property is not a qualified disclaimer of an undivided portion of the disclaimant's interest in the property.

In this case, as construed by Court, Son's power of appointment under Trust was created before October 21, 1942, and is a general power of appointment as described in §§ 2041(a)(1) and 2514(a). Under the terms of Trust, Son's heirs cannot succeed to any interests in Trust until Son's death. If Son lets his power lapse at his death, as proposed, the lapse will create various interests, including a testamentary general power of appointment, in Trust for Successor Beneficiaries. *See* § 2518(c)(2). For purposes of § 2518, these powers will be considered as created on the date of Son's death, the date when Son's general power of appointment lapses.

One or more of the Successor Beneficiaries propose to disclaim an undivided portion of or all of the interest in Trust to which he or she may be entitled to at Son's death. A disclaiming Successor Beneficiary will not accept an interest in or any benefit from the property subject to the disclaimer or voluntarily assign, convey, encumber, pledge, or transfer the interest or property subject to the disclaimer. Further, each disclaimer will be irrevocable and in writing delivered to the trustee. As a result, the proposed disclaimer will pass without any direction from the disclaiming Successor Beneficiary and the interest will pass to someone other than the disclaiming Successor Beneficiary. Finally, a disclaiming Successor Beneficiary will be prohibited from serving on the Advisory Board of Trust or as a trustee of Trust.

Accordingly, based on the facts submitted and representations made, we conclude that the proposed disclaimer by any one or more Successor Beneficiary will not result in a taxable gift by the disclaimant and will not subject any portion of Trust to estate tax in the gross estate of the disclaimant. Under § 25.2518-1(b), the disclaimed interest in property is treated as if it had never been transferred to the person making the qualified disclaimer. Instead, it is considered as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer. Therefore, the disclaimant is not a transferor, as defined in § 2652 and is not treated as making a constructive addition to Trust. Accordingly, we conclude that a proposed disclaimer by any one or more Successor Beneficiary will not result in Trust losing GST exempt status.

Ruling #4

Section 2041(a)(2) provides that 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 which 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.

Trust currently provides for outright distribution to the Successor Beneficiaries on Trust's termination. Under Modification #1, any share upon Trust's termination distributable to a Successor Beneficiary under the age of x is to be held in a Continuing Trust until that Continuing Beneficiary reaches the age of x. If the Continuing Beneficiary survives Son but dies before reaching age x, Continuing Trust grants the Continuing Beneficiary a general power of appointment to appoint the assets of his or her Continuing Trust to any appointee, including the Continuing Beneficiary's estate or the creditors of the Continuing Beneficiary or the creditors of the Continuing Beneficiary's estate. Thus, if the Continuing Beneficiary survives the twenty-one year term following Son's death but dies before the termination of Continuing Trust, the remaining assets in the Continuing Trust are includible in the gross estate of the Continuing Beneficiary under § 2041(a)(2).

Based upon the facts submitted and representations made, we conclude that the assets of a Continuing Trust created pursuant to Modification #1 after Son's death will be includible in the gross estate for federal estate tax purposes of any Continuing Beneficiary of such Continuing Trust under § 2041(a)(2) if the Continuing Beneficiary dies before the Continuing Trust terminates.

Ruling #5

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from GST tax under § 26.2601-1(b)(1), (2), or (3) will not cause the trust to lose its exempt status. The rules in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST purposes. The rules do not apply, for example, in determining whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(C) provides that judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument will not cause an exempt trust to be subject to the provisions of chapter 13 if the judicial action involves a bona fide issue and the construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(i)(D)(*1*) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extent the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(i)(D)(*2*) provides that a modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), *Example 10* considers the following situation. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13.

In this case, Trust Construction by Court resolves ambiguities in the terms of the trust instrument. The judicial action involved bona fide issues regarding whether Son and the Successor Beneficiaries possess general powers of appointment and whether such powers were created before October 21, 1942. Trust Construction is consistent with applicable state law that would be applied by the highest court of the state. Further, Modification #1 grants each beneficiary of a Continuing Trust a general power of appointment which will cause the assets of a Continuing Trust to be includible in the gross estate of such beneficiary under § 2041(a)(2). Therefore, Modification #1 does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Modification #2 and #3 relate to the appointment and replacement of successor trustees in Continuing Trust and the application of the Audit Requirement after Trust is divided into separate trusts. Modifications #2 and #3 are administrative in nature and under § 26.2601-1(b)(4)(i)(D)(*2*), will not be considered to shift a beneficial interest to a lower generation in the trust or extend the time for vesting of any beneficial interest in the trust beyond the period provided for in Trust. *See Example 10* of § 26.2601-1(b)(4)(i)(E). Therefore, based upon the facts submitted and representations made, we conclude that Trust Construction and Modification by Court will not cause Trust or any Successor Trusts to be subject to GST tax pursuant to chapter 13.

<u>Ruling #6</u>

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

Section 2511(a) provides that the tax imposed by § 2501 will 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 on intangible.

Section 25.2511-1(c) provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift and is included in computing the amount of gifts made during the calendar year.

In this case, Trust Construction and Modification by Court do not change the beneficial interests in Trust. Accordingly, based upon the facts submitted and representations made, we conclude that the Trust Construction and Modification will not cause Son or any of the Successor Beneficiaries to have made a taxable gift for purposes of § 2501.

<u>Ruling #7</u>

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death: (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if: (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds five percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In order for §§ 2036, 2037 and 2038 to apply, a decedent must have made a transfer of property of any interest therein (except in case of a bona fide sale for adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property.
In this case, Trust Construction and Modification do not constitute transfers within the meaning of §§ 2036, 2037 and 2038. Accordingly, based upon the facts submitted and representations made, we conclude that Trust Construction and Modification by Court will not result in inclusion of any asset of, or interest in Trust or any Successor Trusts in the gross estate of any beneficiary whose death occurs prior to the termination of Trust under § 2036, 2037 or 2038.

<u>Ruling #8</u>

Section 61(a) defines gross income as "all income from whatever source derived." Under section 61(a)(3), gross income includes "[g]ains derived from dealings in property."

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent is treated as income or as loss sustained.

Under § 1.1001-1(h), the severance of a trust, occurring on or after August 2, 2007, is not an exchange of property for other property differing materially either in kind or in extent, if (i) an applicable state statute or the governing instrument authorizes or directs the trustee to sever the trust; and (ii) any non-pro rata funding of the separate trusts resulting from the severance, whether mandatory or in the discretion of the trustee, is authorized by an applicable state statute or the governing instrument.

In the present case, the Trust will be severed into multiple trusts, Successor Trusts, on a non-pro rata basis. Trustees represent that the contemplated trust severance is authorized by the agreement governing Trust. Trustee further represents that the non-pro rata funding of Successor Trusts is authorized under State Statute 4 which allows a trustee to make distributions in divided or undivided interest and to allocate assets in proportionate or disproportionate shares.

The proposed transaction is consistent with the criteria set forth in § 1.1001-1(h)(1). Accordingly, based upon the facts submitted and representations made, we conclude that the severance of the Trust and non-pro rata funding of the Successor Trusts should not be treated as pro rata distributions followed by a taxable sale and exchange of assets between the Successor Trusts and, therefore, will not be subject to recognition of gain or loss from a sale or other disposition of property under § 1001.
In accordance with the Powers of Attorney on file with this office, we have sent copies of this letter to your representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers accompanied by penalty of perjury statements executed by the appropriate parties. While this office has not verified the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6100(k)(3) provides that it may not be used as precedent.

Sincerely,

Leslie H. Finlow

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure
Copy for § 6110 purposes

cc: