

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4-119146-97
Date:
November 28, 1998

Re:

LEGEND

Decent =

Trust =

Grandchild 1 =

Trust 2 =

Grandchild 2 =

Trust 3 =

Grandchild 3 =

Daughter 1 =

Grandchild 4 =

Grandchild 5 =

Dear Sir or Madam:

This is in response to an October 27, 1998 letter, and prior correspondence, from your authorized representative requesting gift, estate, and generation-skipping transfer tax rulings concerning a proposed transaction.

Decedent died testate on February 29, 1956. In a codicil to her will dated August 6, 1955, Decedent created a trust for the benefit of each of her grandchildren and their respective descendants. The trusts created under Articles First, Third, and Fourth are the subject of this ruling.

Grandchild 1 and his descendants are the beneficiaries of the trust created under Article First (Trust 1). Grandchild 2 and her descendants are the beneficiaries of the trust created under Article Third (Trust 2). Grandchild 3 and his descendants are the beneficiaries of the trust created under Article Fourth (Trust 3). Except for the primary beneficiary, the terms of each of the trusts are identical. The Trusts are to terminate on the death of the last to die of Grandchild 4 and Grandchild 5. (It has been represented that Trust 3 contains a scrivener's error in that one of the measuring lives specified is a composite of the first name and middle initial of Grandchild 4 and the last name of Daughter 1. For purposes of this ruling, we are assuming that the trust would be construed under applicable state law to the effect that Trust 3 is to terminate on the death of the last to die of Grandchild 4 and Grandchild 5.)

With respect to Trusts 1, 2, and 3, Paragraph A of each trust provides that, during the period from the beginning of the trust until the 31st day of December of the year during which any child of the grandchild attains the age of 1 year, the trustee, shall distribute, in his discretion, the income for the grandchild's education, support, and maintenance. Any unexpended income may be used and applied by the trustees during any subsequent years.

Under Paragraph B, beginning on January 1st of the year following the year in which a child of the grandchild attains the age of 1 year, net income is to be paid to the descendants of the grandchild who shall be living from time to time, per stirpes, it being intended that the class of descendants of the grandchild shall increase and decrease from time to time with the birth or death of any such descendant.

Paragraph D provides that, if no descendant of the grandchild is living after the net income becomes payable to a descendant of the grandchild, the net income shall be used and applied by the Trustees for the grandchild's benefit, as provided in Paragraph A, if he is living. If the grandchild is not living, the net income shall be divided into as many equal shares as there shall be living brothers and sisters of the grandchild and deceased brothers and sisters leaving a descendant or descendants then living. One share shall be paid to the descendants, per stirpes, of any brother or sister of the grandchild whether or not such brother or sister is living, and one share shall be paid to any living brother or sister who has no descendants. If the net income becomes payable for the benefit of the grandchild by reason of the terms of Paragraph D, the income will be payable for the grandchild's benefit only until December 31st of the year during which any child of the grandchild attains the age of one year, after which time the net income shall again be paid as provided in Paragraph B.

Paragraph E provides that, upon the termination of the trust, the principal will be paid to the grandchild, if he or she is living, or if not, to one or more members of a class consisting of the descendants of Decedent other than the grandchild who is the primary beneficiary of the trust, in the manner and to the extent appointed by the grandchild in his or her will. Any part of the principal not disposed of by the exercise of the power of appointment shall be paid to the then living descendants of the grandchild, per stirpes, or, in default thereof, to the descendants of the grandchild's mother, then living, per stirpes, or, in default thereof, to the descendants of the other family line then living, per stirpes, or, in default thereof, to the executors or administrators of the grandchild's estate, to be disposed of as a part thereof.

Grandchild 1, Grandchild 2, and Grandchild 3 all have children who have attained the age of 1 prior to 1997, and accordingly, the respective grandchild's children are the current income beneficiaries of each of the trusts. Therefore, each grandchild has the following interest in his or her respective trust:

1. A contingent right to income that takes effect any time during the trust term when there is no living descendant of the grandchild (Paragraph D).

2. A remainder interest contingent upon the grandchild surviving the trust term (Paragraph E).

3. A contingent remainder interest in the grandchild's estate (Paragraph E).

4. A testamentary special power to appoint the assets of his or her trust, exercisable only if the grandchild dies prior to the termination of the trust.

Each grandchild intends to transfer their respective contingent income interest, their respective contingent remainder interest, and their respective estate's contingent remainder interest to his or her descendants. Also, each grandchild proposes to exercise the testamentary power of appointment by appointing the interests to a trust (Special Power of Appointment Trust) for the benefit of the respective grandchild's descendants. Each of these trusts will provide that the trust will terminate no later than 21 years after the death of the last to die of the descendants of Decedent who were living at the death of the Decedent. Each trust will prohibit the exercise of any power of appointment granted thereunder, in a manner that may extend the vesting of the trust property beyond such date.

Each grandchild has requested the following rulings:

1. The grandchild's retention and exercise of the special power of appointment over the trust established for his or her family will not cause the assets of Trusts 1, 2, or 3 to be included in the respective grandchild's gross estate under Chapter 11 of the Internal Revenue Code.

2. Chapter 14 of the Code will not apply to the transfer by the grandchild.

3. The value of the contingent remainder transferred is determined by calculating the fair market value of the contingent remainder interest under § 7520 of the Internal Revenue Code.

4. The grandchild's exercise of the Special Power will not cause Trust 1, 2, or 3 or the Special Power of Appointment Trusts to be subject to Chapter 13 of the Code.

Issue 1

Section 2033 provides for the inclusion in the gross estate of any property in which the decedent had an interest at the time of his death.

Section 2035(a) provides that if: (1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of the property (or an interest therein) would have been included in the decedent's gross estate under § 2036, 2037, 2038, and 2042 if the transferred interest or relinquished power had been retained by the decedent on the date of death, the value of the gross estate shall include the value of any property (or interest therein) that would have been so included.

Sections 2036, 2037, and 2038 provide for the inclusion in the gross estate of property transferred by the decedent if the decedent has either retained an interest in, or a power over, the property transferred.

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 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.

Section 2041(b)(1) defines the term "general power of appointment" as a power exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or creditors of the decedent's estate.

In this case, each grandchild has a contingent remainder interest in the trust established for his or her family. The trust corpus will pass to the grandchild if he or she survives the two individuals who are the measuring lives of his or her respective family trust. In addition, each grandchild has a contingent income interest in their respective family trust that will pass to the grandchild if he or she should survive their

children who are the current income beneficiaries of the trust. Finally, the estate of each grandchild has a contingent remainder. This interest will take effect only if a grandchild dies before his or her family's trust terminates, the power of appointment noted below is not exercised, and all other members of the Decedent's family subsequently die. Each grandchild intends to transfer these contingent interests to their respective descendants.

Further, each grandchild possesses a special power to appoint the trust established for his or her family among the descendants of Decedent. The power takes effect only if the grandchild predeceases one or both the individuals who are measuring lives of his or her family trust. Each grandchild will exercise the testamentary special power of appointment by appointing the assets of their respective family trust to a new trust, the Special Power of Appointment Trust. The special power of appointment will take effect only if the grandchild dies during the term of the trust.

We conclude that, after the transfers discussed above, the retained special power of appointment will not cause the corpus of Trust 1, 2 or 3 to be included in the respective gross estates of Grandchild 1, Grandchild 2 or Grandchild 3.

Issue 2

Section 2501(a)(1) provides for the imposition of a gift tax on the transfer of property by gift.

Section 2511(a) provides that the gift tax applies to a transfer by way of gift 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 25.2511-1(h), Example 6, of the Gift Tax Regulations, describes a situation where A possesses a vested remainder interest in property, subject to divestment only in the event A should fail to survive one or more individuals or the happening of some other event. The example concludes that A's irrevocable assignment of all or any part of A's interest would result in a completed transfer for federal gift tax purposes.

Section 25.2511-2(b) provides that the gift is complete as to any property of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another.

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

Section 2702(a)(1) provides that solely for purposes of determining whether a transfer of an interest in trust to (or for the benefit of) a member of the transferor's

family is a gift (and the value of the transfer), the value of any interest in the trust retained by the transferor or any applicable family member (as defined in § 2701(e)(2)) shall be determined as provided in § 2702(a)(2).

Section 2701(e)(2) provides that the term "applicable family member" means, with respect to any transferor--(A) the transferor's spouse, (B) an ancestor of the transferor or the transferor's spouse, and (C) the spouse of any such ancestor.

Section 25.2702-2(a)(4) provides that an interest in trust includes a power with respect to a trust if the existence of the power would cause any portion of a transfer to be treated as an incomplete gift.

In this case, each grandchild will transfer his or her contingent income interest and his or her (or the estate's) contingent remainder interest in the trust created for the family to their respective descendants. The transfers of such interests are completed gifts for federal gifts tax purposes. Section 25.2511-1(h), Example 6.

Each grandchild will retain the right to appoint the property if he or she should die before the trust established for the benefit of their respective family terminates. The retained special power to appoint trust property contingent on the grandchild predeceasing the termination of the trust, will not cause any portion of the transfer to be treated as an incomplete gift for purposes of Chapter 12. In this situation, neither the respective grandchild nor any applicable family member will retain an interest in the trust for the benefit of his or her family for purposes of § 2702. See § 25.2702-2(a)(4). Accordingly, we conclude that Chapter 14 will not apply to the transfer by the beneficiary, and therefore, the value of the gift made by a grandchild for gift tax purposes upon the transfer will be the sum of the values of the interests actually transferred.

Issue 3

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

Section 25.2512-5(d)(2) provides that, in general, if the donor assigns or relinquishes an annuity, life estate, remainder, or reversion that the donor holds by virtue of a transfer previously made by the donor or another, the value of the gift is the value of the interest transferred.

Under § 7520(a)(1), the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest shall be determined under tables prescribed by the Secretary. See § 25.7520-1(c).

In the present case, each grandchild has a contingent remainder interest in their respective family trust. Each grandchild holds this interest as a result of the transfer made by Decedent when she died. Under these circumstances, the value of the remainder interest is determined based on § 7520 and the applicable regulations, including § 25.7520-1(c).

Issue 4

Section 2601 imposes a tax on every generation-skipping transfer made by the "transferor" to a "skip person." Section 2611 defines a generation-skipping transfer as a taxable termination, a taxable distribution, or a direct skip.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 1, and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of principal added to the trust after September 25, 1985 (or out of income attributable to principal so added).

Section 26.2601-1(b)(1)(v)(A) provides that where any portion of a trust remains in the trust after the 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 an addition to the trust. 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. In the latter case, the transferor for purposes of Chapter 11 or Chapter 12 is the transferor for purposes of Chapter 13.

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 s 2041(b)) will not be treated as an addition to a trust if, (1) the power of appointment was created in an irrevocable trust that is not subject to Chapter 13 because it was irrevocable on September 25, 1985, 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. If a power is exercised by creating another power, it will be deemed to be exercised to whatever extent the second power may be exercised.

In this case, Trust 1, Trust 2, and Trust 3 created for the benefit of each of Decedent's grandchildren and the respective grandchild's descendants were irrevocable

on September 25, 1985, and the trustee of the trusts has represented that there have been no additions (constructive or otherwise) to the trusts after September 25, 1985.

Further, each grandchild has a testamentary limited power to appoint the corpus of their respective trust that will take effect if the respective grandchild predeceases the other members of the family who are the measuring lives of their respective trust. Each grandchild proposes to exercise his or her limited power of appointment over their respective trust by appointing the property to a trust (Special Power of Appointment Trust) for the benefit of their descendants. Each grandchild's testamentary power was created under a trust that is not subject to the generation-skipping transfer tax because the trust was irrevocable on September 25, 1985.

The proposed exercise of the testamentary power will not postpone or suspend vesting of the corpus beyond the permissible perpetuities period specified in the regulations. The Special Power of Appointment Trusts will terminate no later than 21 years after the death of the last to die of the descendants of Decedent who were living at the death of the Decedent. Under these circumstances, the exercise of the special power of appointment will not be treated as a constructive addition to Trust 1, 2, and 3. Therefore, exercise of the special power will not cause Trust 1, 2, or 3, or the Special Power of Appointment Trust to be subject to Chapter 13 of the Code.

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(s) requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

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 yours,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Chief, Branch 4