

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Date:

September 21, 2016

### Legend

Date =

Grantor =

Spouse =

Trust =

State 1 =

State 2 =

Child 1 =

Child 2 =

Trustee =

Power of  
Appointment  
Committee =

X =

Y =

Appointer =

Dear :

This responds to a letter dated March 23, 2016, and subsequent correspondence, requesting rulings under the Internal Revenue Code.

### Facts

The information and representations submitted are as follows. On Date, Grantors (Grantor and Spouse) created an irrevocable trust (Trust) for the benefit of Grantors' issue and charities (Beneficiaries). Trust is sited in State 1 and, pursuant to the Trust agreement, is governed by the laws of State 1. A corporate trustee (Trustee) is the sole trustee of Trust. Grantors are married and reside in State 2, a community property state. Trust provides that all transferred property to Trust is community property or will be transmuted into community property. Moreover, any and all property transferred to Trust prior to the death of the first Grantor to die (Predeceased Grantor) is and shall retain its character as community property.

Until the death of the survivor of Grantors (Surviving Grantor), Trustee may distribute to Beneficiaries, such amounts of the net income or principal of the Trust as the Trustee determines. Any net income not distributed by Trustee will be accumulated and added to principal. Trust provides that at all times the Trustees of all trusts created under Trust must be Independent Trustees who are not members of Grantors' Family. "Independent Trustee" is defined as any bank or individual who is not either of the Grantors and who is not related or subordinate, within the meaning of § 672(c) of the Internal Revenue Code, to either of the Grantors. "Grantors' Family" is defined to include: Grantors, Grantors' issue, the issue of each of the Grantors' grandparents, and all Charities (as defined in the Trust).

In addition, the Appointer, acting in a fiduciary capacity, may appoint to any one or more of the Beneficiaries, such amounts of the principal (including the whole thereof) as the Appointer deems advisable. The Appointer cannot be related or subordinate as defined in § 672(c) to either of Grantors.

In addition to distributions to be made by the Trustee and/or Appointer, the Power of Appointment Committee, acting in a non-fiduciary capacity, may distribute amounts of the net income to any one or more of the Beneficiaries as the Power of Appointment Committee deems advisable. Any appointment by the Power of Appointment Committee requires the written consent of the Appointer plus a majority of the then

serving members of the Power of Appointment Committee plus the consent of either or both of the Grantors (Grantor's Consent Power).

Trust provides that at all times the Power of Appointment Committee must consist of at least two members. The Power of Appointment Committee shall cease to exist upon the first to occur of the date of death of the Surviving Grantor or the date on which the Power of Appointment Committee is reduced to one member. The Power of Appointment Committee initially consists of X and Y, who are acting as guardians for Child 1 and Child 2, respectively. As each minor child reaches his or her majority, he or she becomes a member of the committee and his or her guardian ceases to serve on the committee.

Each Grantor has the power, in a non-fiduciary capacity, at any time and from time to time to appoint such amounts of principal (including the whole thereof) to any one or more of the Beneficiaries as either deems advisable to provide for the health, education, maintenance, or support of the Beneficiaries (Grantor's Sole Power). Grantors have consented to the exercise of Grantor's Sole Power by the other.

All distributions of the net income and principal from Trust to a Beneficiary prior to the death of the Predeceased Grantor will be funded equally from Grantors' respective shares of community property held in Trust. At the time of the death of the Predeceased Grantor, you have represented that the Predeceased Grantor will have a one-half community property interest in Trust.

Upon the death of the Predeceased Grantor, Trustee shall distribute the Predeceased Grantor's entire interest in any income accumulated and principal of Trust to or for the benefit of any person or persons or entity or entities, other than the Predeceased Grantor's estate, the Predeceased Grantor's creditors, or the creditors of Predeceased Grantor's estate, as the Predeceased Grantor may appoint by will (Predeceased Grantor's Testamentary Power).

Upon the death of the Predeceased Grantor, any property remaining of the Predeceased Grantor's entire one-half interest in Trust that has not been effectively appointed by Will shall be distributed, *per stirpes*, to the Grantors' issue who are living, or if none of the Grantors' issue are then living, the trust property is to be divided into two equal parts. The first part shall be distributed to the individuals and in the proportions that the property of the Predeceased Grantor would be distributed according to the applicable laws, as if the Predeceased Grantor died intestate at that designated time, domiciled in State 1, unmarried and survived by no issue. The second part shall be distributed to individuals and in the proportions that the property of Surviving Spouse would be distributed according to the applicable laws, as if Surviving Spouse died intestate at that designated time, domiciled in State 1, unmarried and survived by no issue. If none of the individuals designated as distributes is living, the trust property is to be distributed to any one or more charities that Trustee designates.

Upon the death of the Surviving Grantor, Trustee shall distribute the balance of any accumulated income to or for the benefit of any person or persons, entity or entities, other than the Surviving Grantor's estate, the Surviving Grantor's creditors, or the creditors of the Surviving Grantor's estate, as the Surviving Grantor may appoint by will (Surviving Grantor's Testamentary Power).

Upon the death of the Surviving Grantor, any remaining property held in Trust that has not been effectively appointed by will shall be distributed, *per stirpes*, to the Grantors' issue who are living, or if none of the Grantors' issue are then living, the trust property is to be divided into two equal parts. The first part shall be distributed to the individuals and in the proportions that the property of the Surviving Grantor would be distributed according to the applicable laws, as if the Surviving Grantor died intestate died intestate, unmarried and survived by no issue. The second part shall be distributed to individuals and in the proportions that the property of Predeceased Grantor would be distributed to according to the applicable laws, as if Predeceased Grantor died intestate, unmarried and survived by no issue. If none of the individuals designated as distributes is living, the trust property is to be distributed to any one or more charities that Trustee designates.

No distribution by Trustee to a beneficiary, and distributions to a beneficiary pursuant to the exercise of a power of appointment granted hereunder, shall discharge any individual's legal obligation to support the beneficiary.

You requested the following rulings:

1. No portion of the items of items of income, deductions, and credits against tax of Trust shall be included in computing under § 671 the taxable income, deductions, and credits of Grantors;
2. The contribution of property to Trust by Grantors will not be a completed gift subject to federal gift tax;
3. The basis of all community property in Trust on the date of death of the Predeceased Grantor will receive an adjustment in basis to the fair market value of such property at the date of death of the Predeceased Grantor.

### Law and Analysis

#### Ruling 1

Section 671 provides that where it is specified in subpart E of part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust,

there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 672(a) provides, for purposes of subpart E, the term “adverse party” means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust.

Sections 673 through 677 specify the circumstances under which the grantor is treated as the owner of a portion of a trust.

Section 673(a) provides that the grantor shall be treated as the owner of any portion of a trust in which the grantor has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds five (5) percent of the value of such portion.

Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(b) provides that § 674(a) shall not apply to the powers described in § 674(b) regardless of whom held.

Section 674(b)(3) provides that § 674(a) shall not apply to a power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(b)(5) provides that § 674(a) shall not apply to a power to distribute corpus to or for a beneficiary, provided that the power is limited by a reasonably definite standard.

Section 674(c) provides that § 674(a) shall not apply to a power exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor (1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, or (2) to pay out corpus to or for a beneficiary or beneficiaries or to a class of beneficiaries (whether or not income beneficiaries).

Under § 675 and applicable regulations, the grantor is treated as the owner of any portion of a trust if, under the terms of the trust agreement or circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiary of the trust.

Section 676(a) provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of part I, subchapter J, chapter 1, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

Section 677(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Based solely on the facts and representations submitted, we conclude an examination of Trust reveals none of the circumstances that would cause Grantors to be treated as the owner of any portion of Trust under §§ 673, 674, 676, or 677.

We further conclude that an examination of Trust reveals none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of Grantors under § 675. Thus, the circumstances attendant on the operation of Trust will determine whether Grantors will be treated as the owner of any portion of Trust under § 675. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office with responsibility for such examination.

## Ruling 2

Section 2501(a)(1) provides for the imposition of a gift tax for each calendar year on the transfer of property by gift during such calendar year by any individual. Section 2511(a) provides that the gift tax applies 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 25.2511-2(b) of the Gift Tax Regulations provides that a gift is complete as to any property, or part thereof or interest therein, with respect to which the donor has so parted with dominion and control as to leave the donor with no power to change the disposition of the property, whether for the donor's own benefit, or for the benefit of another. But if upon a transfer of property (whether in trust or otherwise) the donor

reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

Section 25.2511-2(b) provides an example, where the donor transfers property in trust to pay the income to the donor, or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among the donor's descendants. The regulation concludes that no portion of the transfer is a completed gift. However, if the donor had not retained a testamentary power of appointment, but had instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift.

Section 25.2511-2(c) provides that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself or herself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

Under § 25.2511-2(e), a donor is considered as possessing a power if it is exercisable by the donor in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. A trustee, as such, is not a person having an adverse interest in the disposition of the trust property or its income.

Section 25.2511-2(f) provides that the relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by death of the donor, is regarded as the event which completes the gift and causes the gift tax to apply.

Section 25.2511-2(f) provides that the relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by death of the donor, is regarded as the event which completes the gift and causes the gift tax to apply.

Section 25.2511-2(g) provides that if a donor transfers property to himself as trustee (or to himself and some other person, not possessing a substantial adverse interest, as trustees), and retains no beneficial interest in the trust property and no power over it except fiduciary powers, the exercise or nonexercise of which is limited by a fixed or ascertainable standard, to change the beneficiaries of the transferred property, the donor has made a completed gift.

Section 25.2511-2(e) does not define "substantial adverse interest." Section 25.2514-3(b)(2) provides, in part, that a taker in default of appointment under a power has an interest that is adverse to an exercise of the power. Section 25.2514-3(b)(2) also provides that a co-holder of a power is considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate.

In *Estate of Sanford v. Commissioner*, 308 U.S. 39 (1939), the taxpayer created a trust for the benefit of named beneficiaries and reserved the power to revoke the trust in whole or in part, and to designate new beneficiaries other than himself. Six years later, in 1919, the taxpayer relinquished the power to revoke the trust, but retained the right to change the beneficiaries. In 1924, the taxpayer relinquished the right to change the beneficiaries. The Court stated that the taxpayer's gift is not complete, for purposes of the gift tax, when the donor has reserved the power to determine those others who would ultimately receive the property. Accordingly, the Court held that the taxpayer's gift was complete in 1924, when he relinquished his right to change the beneficiaries of the trust. A grantor's retention of a power to change the beneficial interests in a trust causes the transfer to the trust to be incomplete for gift tax purposes, even though the power may be defeated by the actions of third parties. *Goldstein v. Commissioner*, 37 T.C. 897 (1962). See also *Estate of Goelet v. Commissioner*, 51 T.C. 352 (1968).

In this case, each Grantor retained the Grantor's Consent Power over the income of Trust. This power is exercised in conjunction with the agreement of a majority of the Power of Appointment Committee members and the Appointer. Under § 25.2511-2(e), a donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. The Power of Appointment Committee members are not takers in default for purposes of § 25.2514-3(b)(2). They are merely coholders of the power. Under § 25.2514-3(b)(2), a coholder of a power is only considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. In this case, the Power of Appointment Committee ceases to exist upon the death of the last Grantors to die. Accordingly, the Power of Appointment Committee members do not have interests adverse to either Grantor under § 25.2514-3(b)(2) and for purposes of § 25.2511-2(e).

Similarly, the Appointer does not have any beneficial interest in the trust. The Appointer is not a taker in default. The Appointer is merely a coholder of the power who may not exercise his power after both Grantors die in favor of himself, his estate, his creditors, or the creditors of his estate. Accordingly, the Appointee does not have an interest adverse to either Grantor under § 25.2514-3(b)(2) and for purposes of § 25.2511-2(e).



The Trustee has the power to distribute income to a beneficiary. However, the Trustee's power is not a condition precedent to each Grantor's Consent Power. Each Grantor's Consent Power over income is presently exercisable and not subject to a condition precedent. Thus, the Trustee's power to distribute income does not cause the transfer of property to be complete with respect to the income interest in Trust for federal gift tax purposes. Therefore, each Grantor is considered as possessing the power to distribute income to any beneficiary himself or herself because he or she retained the Grantor's Consent Power.

Each Grantor also retained the power to appoint such amounts of principal (including the whole thereof) to any one or more of the Beneficiaries (Grantor's Sole Power). Under § 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. In this case, the Grantor's Sole Power gives each Grantor the power to change the interests of the beneficiaries. Finally, each Grantor consented to allow the other Grantor to exercise the Grantor's Sole Power alone. Even though each Grantor's Power is limited by an ascertainable standard, i.e., health, education, maintenance and support, Grantors' powers are not fiduciary powers. The Trustee and Appointee, in their fiduciary capacity, also have the power to distribute principal to one or more beneficiaries. Trustee is a corporate trustee and, under the terms of the trust instrument, the Appointee cannot be related or subordinated within the meaning of § 672(c) to the Grantors. The powers of the Trustee and Appointer are not conditions precedent to the Grantors powers. Each Grantor's Sole Power over principal is presently exercisable and not subject to a condition precedent. Accordingly, each Grantor retains dominion and control over the principal of Trust until either the Trustee or the Appointer exercises his or her power to appoint principal. See *Goldstein v. Commissioner*, 37 T.C. 897 (1962). Thus, the Trustee's and Appointee's powers to distribute principal do not cause the transfer of property to be complete with respect to the remainder in Trust for federal gift tax purposes. Accordingly, the retention of Grantor's Consent Power and Grantor's Sole Power causes the transfer of property to Trust to be wholly incomplete for federal gift tax purposes.

Further, each Grantor retained either a Predeceased Grantor's Testamentary Power or the Surviving Grantor's Testamentary Power (depending on the order of the deaths of Grantor and Spouse), to appoint property in Trust to any person or persons or entity or entities, other than his or her respective estate, his or her respective creditors, or the creditors of his or her respective estate. Under § 25.2511-2(b)(2), the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, the retention of this power causes the transfer of property to Trust to be incomplete with respect to the remainder in Trust for federal tax purposes.

Accordingly, based on the facts submitted and the representations made, we conclude that the contribution of property to Trust by the Grantors' will not be completed gift subject to federal gift tax. However, any distribution made from Trust to a beneficiary is a completed gift at the time of the distribution made one-half by each Grantor. Further, upon either Grantor's death, the fair market value of his or her interest in the property in Trust is includible in his or her respective gross estate for federal estate tax purposes.

### Ruling 3

Section 1014(a) provides, in part, that, except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent will, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person be the fair market value of the property at the date of the decedent's death.

Section 1014(b)(6) provides that, in the case of decedents dying after December 31, 1947, property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State, is considered, for purposes of section 1014(a), to have been acquired from or to have passed from the decedent if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate.

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 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 2038(a)(1) provides that the value of the decedent's 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 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 (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (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 three-year period on the date of the decedent's death.

Grantor and Spouse reside in State 2, a community property state. Trust provides that all transferred property to Trust is community property or is being transmuted into community property. Moreover, any and all property transferred to Trust prior to the death of the Predeceased Grantor is and shall retain its character as community property. As concluded above, upon the death of each of Grantor and Spouse, his or her respective interest in Trust as either the Predeceased Grantor or the Surviving Grantor will be includible in his or her respective gross estate for federal estate tax purposes.

Accordingly, based upon the facts submitted and representations made, we conclude that the basis of all community property in Trust on the date of death of the Predeceased Grantor will receive an adjustment in basis to the fair market value of such property at the date of death of the Predeceased Grantor.

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. Specifically, we express no opinion on the trust provisions permitting Trustee to distribute income or principal to trustees of other trusts (decanting) or any other trust provisions not referenced in this provisions not referenced in this private letter ruling.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, copies of this letter are being sent to the taxpayer's authorized representative.

Sincerely,

Faith P. Colson

Faith P. Colson  
Senior Counsel, Branch 1  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this Letter.  
Copy for § 6110 purposes