

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:PSI:02

PLR-100909-10

Date:

June 15, 2010

Taxpayer =

Trust =

Date 1 =

x =

Dear :

This is in response to a letter dated December 31, 2009, and subsequent correspondence, submitted by your authorized representative, requesting rulings under §§ 671, 678 and 2041 of the Internal Revenue Code.

The information submitted states that Taxpayer is the trustee and beneficiary of the Trust, an irrevocable trust dated Date 1, which Taxpayer's father created and funded. Trust is bifurcated into two subtrusts, Subtrust A and Subtrust B. Subtrust B is represented as being a qualified subchapter S trust (QSST).

With respect to Subtrust A, Trust provides, in part that:

During each of the first [x] taxable years of this trust ending after the date of this agreement the trustee shall distribute annually to [Taxpayer] all or any portion of the income of the Trust Estate as [Taxpayer], acting alone, shall direct. The right to withdraw income under this [section of Trust] shall be noncumulative and shall lapse as to each taxable year on the last day of the taxable year to which the right of withdrawal applies.

During the term of this trust the trustee may also distribute to or for the benefit of Taxpayer and the issue of the Settlor, or any of them, . . . such amounts from income or principal of the Trust Estate as the trustee determines to be necessary for the health, education, support or maintenance of the recipient.

[U]pon the death of Taxpayer, the Trustee shall divide and distribute the Trust Estate as Taxpayer shall appoint by . . . will. . . . The power of appointment hereby granted to Taxpayer may only be exercised in favor of any or all of the issue of the Settlor or one or more organizations described in [§] 501(c)(3) of the Internal Revenue Code of 1986, as amended.

With respect to Subtrust A, Trust provides, in part that:

Income not distributed within fifteen months of receipt thereof shall be added to the principal of the trust to which the income is allocated.

Based on the above facts, Taxpayer requests rulings regarding (1) whether Taxpayer is the owner of the income portion of Subtrust A under §§ 671 and 678 for the first x taxable years of Trust's existence, and (2) to what extent that the corpus of Subtrust A will be includable in Taxpayer's gross estate under § 2041.

#### Issue 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 678(a) provides, in general, that a person other than a grantor shall be treated as the owner of any portion of a trust with respect to which (1) such person has a power exercisable solely by himself to vest the corpus or the income there from in himself, or (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of §§ 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

Based solely on the facts and representations submitted, we conclude that Taxpayer is the owner of the income portion of Subtrust A under §§ 671 and 678 for the first x taxable years of Trust's existence.

Issue 2:

Section 2036(a) of the Internal Revenue Code provides, in part, 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, the possession or enjoyment of, or the right to the income from, the property, or 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, in part, 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 (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 3-year period ending on the date of the decedent's death.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) defines a general power of appointment as one that exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power, is considered a release of the power to the extent that the property that could have been appointed by the exercise of the lapsed power exceeds the greater of \$5,000 or 5 percent of the aggregate value, at the time of such lapse, of the assets out of which the exercise of the lapsed power could have been satisfied.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that the term "power of appointment" includes all powers that are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations. For example, if a trust instrument provides that the beneficiary may appropriate or consume the principal of the trust, the power to consume or appropriate is a power of appointment. Similarly, a power given to a decedent to affect the beneficial enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust is a power of appointment. Further, a power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment.

Section 20.2041-3(d)(1) provides, in part, that property subject to a general power of appointment created after October 21, 1942, is includable in the gross estate of a decedent even though he does not have the power at the date of his death, if during his life he exercised or released the power under circumstances such that, if the property subject to the power had been owned and transferred by the decedent, the property would be includable in the decedent's gross estate under §§ 2035, 2036, 2037, or 2038. Further, § 2041(b)(2) provides that the lapse of a power of appointment is considered to be a release of the power to the extent set forth in § 20.2041-3(d)(3). The principles set forth in § 20.2041-2 for determining the application of the pertinent provisions of §§ 2035 through 2038 to a particular exercise of a power of appointment are applicable for purposes of determining whether or not an exercise or release of a power of appointment created after October 21, 1942, causes the property to be included in a decedent's gross estate under § 2041(a)(2).

Section 20.2041-2(c)(Example 2) provides that S created a trust in 1930 to pay the income to A for life, remainder as B appoints by an instrument filed with the trustee during B's lifetime, and in default of appointment remainder to C. B exercised the power in 1955 by directing that after A's death the income be paid to himself for life with remainder to C. If B dies after A, the entire value of the trust property would be included in B's gross estate, since such a disposition if it were a transfer of property owned by B would cause the property to be included in his gross estate under § 2036(a)(1). If B dies before A, the value of the trust property less the value of A's life estate would be included in B's gross estate for the same reason.

Section 20.2041-2(c)(Example 3) provides, in part, that S created a trust in 1940 to pay the income to A for life, remainder as A appoints by an instrument filed with the trustee during A's lifetime. A exercised the power in 1955, five years before his death, reserving the right of revocation. The exercise, if not revoked before death, will cause the property subject to the power to be included in A's gross estate under § 2041(a)(1), since such a disposition if it were a transfer of property owned by A would cause the property to be included in his gross estate under § 2038.

Section 20.2041-3(d)(3) provides, in part, that the failure to exercise a power of appointment created after October 21, 1942, within a specified time, so that the power lapses, constitutes a release of the power. However, § 2041(b)(2) provides that such a lapse of a power of appointment during any calendar year during the decedent's life is treated as a release for purposes of inclusion of property in the gross estate under § 2041(a)(2) only to the extent that the property which could have been appointed by exercise of the lapsed power exceeds the greater of (i) \$5,000 or (ii) 5 percent of the aggregate value, at the time of the lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed power could have been satisfied. For example, assume that A transferred \$200,000 worth of securities in trust providing for payment of income to B for life with remainder to B's issue. Assume further that B was given a noncumulative right to withdraw \$10,000 a year from the principal of the trust fund (which neither increased nor decreased in value prior to B's death). In such case, the failure of B to exercise his right of withdrawal will not result in estate tax with respect to the power to withdraw \$10,000 which lapses each year before the year of B's death. At B's death there will be included in his gross estate the \$10,000 which he was entitled to withdraw for the year in which his death occurs less any amount which he may have taken during that year. However, if in the above example B had possessed the right to withdraw \$15,000 of the principal annually, the failure to exercise such power in any year will be considered a release of the power to the extent of the excess of the amount subject to withdrawal over 5 percent of the trust fund (in this example, \$5,000, assuming that the trust fund is worth \$200,000 at the time of the lapse). Since each lapse is treated as though B had exercised dominion over the trust property by making a transfer of principal reserving the income therefrom for his life, the value of the trust property (but only to the extent of the excess of the amount subject to withdrawal over 5 percent of the trust fund) is includable in B's gross estate (unless before B's death he has disposed of his right to the income under circumstances to which §§ 2035 through 2038 would not be applicable).

Section 20.2041-3(d)(4) provides, in part, that the purpose of § 2041(b)(2) is to provide a determination, as of the date of the lapse of the power, of the proportion of the property over which the power lapsed which is an exempt disposition for estate tax purposes and the proportion which, if the other requirements of §§ 2035 through 2038 are satisfied, will be considered as a taxable disposition. Once the taxable proportion of any disposition at the date of lapse has been determined, the valuation of that proportion as of the date of the decedent's death (or, if the executor has elected the alternate valuation method under § 2032, the value as of the date therein provided), is to be ascertained in accordance with the principles which are applicable to the valuation of transfers of property by the decedent under the corresponding provisions of §§ 2035 through 2038. For example, if the life beneficiary of a trust had a right exercisable only during one calendar year to draw down \$50,000 from the corpus of a trust, which he did not exercise, and if at the end of the year the corpus was worth \$800,000, the taxable portion over which the power lapsed is \$10,000 (the excess of \$50,000 over 5 percent of the corpus), or 1/80 of the total value. On the decedent's death, if the total value of

the corpus of the trust (excluding income accumulated after the lapse of the power) on the applicable valuation date was \$1,200,000, \$15,000 (1/80 of \$1,200,000) would be includable in the decedent's gross estate. However, if the total value was then \$600,000, only \$7,500 (1/80 of \$600,000) would be includable.

Section 20.2041-3(d)(5) provides, in part, that if the failure to exercise a power, such as a right of withdrawal, occurs in more than a single year, the proportion of the property over which the power lapsed that is treated as a taxable disposition will be determined separately for each such year. The aggregate of the taxable proportions for all such years, valued in accordance with the above principles, will be includable in the gross estate by reason of the lapse. The includable amount, however, shall not exceed the aggregate value of the assets out of which, or the proceeds of which, the exercise of the power could have been satisfied, valued as of the date of the decedent's death (or, if the executor has elected the alternate valuation method under § 2032, the value as of the date therein provided).

As noted above, during each of the first x years of the Trust term, Taxpayer has the right to withdraw such portion of the income as Taxpayer may direct. During the entire term of Trust, Taxpayer has the right to receive such amounts as the trustee determines to be necessary for Taxpayer's health, education, support or maintenance. Taxpayer has the testamentary power to appoint the Trust remainder among the settlor's issue and charity. Taxpayer is trustee of Trust.

The gross estate includes the value of all property with respect to which the decedent has at the time of death a general power of appointment. Section 2041(a)(2). Taxpayer's power to direct the distribution of annual income to herself for an x-year period constitutes a general power of appointment within the meaning of § 2041(b)(1). Section 20.2041-1(b)(1). Accordingly, should Taxpayer's death occur during the x-year term of the general power of appointment, the gross estate will include the Trust income attributable to the taxable year in which death occurs less any amount of income which may have been withdrawn during that year. Section 20.2041-3(d)(3); Estate of Dietz v. Commissioner, T.C. Memo. 1996-471.

Section 2041(a)(2) also includes in the gross estate the value of all property with respect to which the decedent at any time released a general power of appointment by a disposition that, were it a transfer of property owned by the decedent, would be includable in the gross estate under §§ 2035 to 2038, but only to the extent that the value of the property that could have been appointed exceeds the greater of \$5,000 or 5 percent of the assets subject to the power.

Taxpayer's power to direct the distribution of annual income to Taxpayer for an x-year period constitutes a general power of appointment within the meaning of § 2041(b)(1). A transfer of property owned by Taxpayer to Trust would be includable in Taxpayer's gross estate under §§ 2036 and 2038. Accordingly, regardless of

Taxpayer's date of death, the gross estate will include the lapse of any annual income withdrawal right during the x-year term to the extent of the excess of the income not withdrawn over the greater of \$5,000 or 5 percent of the income. Section 20.2041-3(d)(3); Estate of Noland v. Commissioner, T.C. Memo. 1984-209.

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

Pursuant to a Power of Attorney on file, a copy of this letter is being sent to your authorized representative.

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

Sincerely,

Bradford R. Poston  
Acting Chief, Branch 2  
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter  
Copy for Section 6110 purposes

cc: