

## Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:Br.7-PLR-110707-98

Date:

MAY 7, 1999

## Legend

Taxpayer:

A:

Taxpayer's Spouse:

Date 1:

Date 2:

State:

x:

:

In a letter dated \_\_\_\_\_, \_\_\_\_\_, your authorized representative requested several rulings on your behalf concerning the proposed testamentary exercise of a limited power of appointment granted to you as the beneficiary of trust that is currently exempt from the generation-skipping transfer tax. This letter is in response to that request and several subsequent submissions from your authorized representative.

The facts and representations submitted are summarized as follows:

On Date 1, A, a parent of Taxpayer, executed an irrevocable trust agreement establishing the A Trust. Under Article II of the A Trust Agreement, the trust corpus was divided into equal separate trust shares to provide one share for each of A's children living on Date 1.

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Paragraph E of Article II of the A Trust Agreement provides that upon the death of each child of A, the assets remaining in the separate share trust held for his or her benefit are to be distributed to, or held for the benefit of, one or more persons of the group consisting of the issue and/or surviving spouse of such child of A, and/or A's then living lineal descendants, and in such amounts and proportions and upon such terms, trusts and conditions, as such child of A appoints by a will that specifically refers to the powers in the A Trust Agreement given to such child of A. In default of a valid appointment by will, the A Trust Agreement provides for the disposition of each separate share trust to the then living issue (as a group) of such child of A, or in default of such issue, such trust share shall be divided and apportioned per stirpes, among A's then living lineal descendants.

Taxpayer, a beneficiary of a separate share trust established under Article II of the A Trust Agreement, proposes to create an irrevocable trust called the Taxpayer Trust. Taxpayer proposes to appoint, by will, the balance of the separate share trust held for his benefit under Article II of the A Trust Agreement to the Taxpayer Trust.

Article II, section 2.1, paragraph A of the Taxpayer Trust Agreement provides that the Trustee may pay to, or apply for the benefit of, Taxpayer's Spouse during her lifetime such amounts of the net income and/or principal of the trust as the Trustee, in Trustee's discretion, may determine to be necessary to provide for the support and maintenance of Taxpayer's Spouse if in the judgment of the Trustee, Spouse's income and means of support from trust and from other sources is not sufficient for such purposes. Further, paragraph B of that section of the Taxpayer Trust Agreement provides that, during the lifetime of Taxpayer's Spouse, Taxpayer's Spouse has the unrestricted right during January of each calendar year to demand cash and/or property from the trust estate equal to the greater of \$5,000 or five percent of the value of the trust estate.

Article II, section 2.1, paragraph C of the Taxpayer Trust Agreement provides that, subject to Article VII of the Taxpayer Trust Agreement, upon the death of Taxpayer's Spouse, the then remaining trust assets shall be distributed to, or held for the benefit of, such of the then living issue of A, in such amounts and proportions, and for such estates and interests, and upon such terms, trusts, conditions, and limitations as Taxpayer's Spouse shall appoint by a will that specifically refers to the power given in the Taxpayer Trust Agreement to Spouse. Any such appointment, however, shall not postpone the vesting, absolute ownership, or power of alienation of an interest in the Taxpayer Trust beyond Date 2, the Trust Termination Date (defined in Article IV of the Taxpayer Trust Agreement).

Paragraph C of section 2.1 of Article II of Taxpayer Trust Agreement also provides that, to the extent that there are any assets not subject to the limited power of appointment, or Taxpayer's Spouse fails to exercise the limited power of appointment by will, the then remaining trust assets shall be divided into as many shares as

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Taxpayer has children then living, treating as a then living child, the living issue of any child who is then deceased. One share is to be held for each such living child and one share shall be divided and held per stirpes for the issue of each such deceased child.

Subject to Article VII of the Taxpayer Trust Agreement, after each child attains the age of fifty or upon the death of each such child, the child's share of the then remaining trust assets shall be distributed to, or held for the benefit of, such of the then living issue of A, other than Taxpayer, each such child, the estate of each such child or the creditors of the estate of each such child, in such amounts and proportions, for such estates and interests, and upon such terms and conditions as the child designates by a writing to the Trustee or by a will that specifically refers to the power given in the Taxpayer Trust Agreement to such child. Any such appointment, however, shall not postpone the vesting, absolute ownership, or power of alienation of an interest in the Taxpayer Trust beyond Date 2, the Trust Termination Date.

Article II, section 2.2. paragraph C of the Taxpayer Trust Agreement provides that, upon the death of a child of Taxpayer or the death of Taxpayer's spouse, if a child of Taxpayer is not then living, any trust share or portion thereof not appointed pursuant to the exercise of the limited power of appointment, shall be divided into as many equal subshares as he or she has children then living, treating as a then living child, the living issue of any child who is then deceased. One subshare shall be held for the benefit of each such living child and one subshare shall be divided and held per stirpes for the issue of each such deceased child subject to the terms in Article II, section 2.2, paragraph C.

Paragraph C of section 2.2 of Article II of Taxpayer Trust Agreement also provides for the distribution and disposition of any assets held in Taxpayer Trust for the benefit of Taxpayer's grandchildren. Upon the death of each such grandchild of Taxpayer, subject to Article VII of the Taxpayer Trust Agreement, the share of each grandchild of Taxpayer shall be distributed to or held for the benefit of such of Taxpayer's living issue (other than such grandchild, the estate of such grandchild, or the creditors of the estate of such grandchild) in such amounts and proportions, and upon such terms and conditions as such deceased grandchild may designate by his or her will to receive the share (provided that in no event shall any such appointment postpone the vesting, absolute ownership, or power of alienation of an interest in the Taxpayer Trust beyond Date 2, the Trust Termination Date).

To the extent that there are any assets not subject to the limited power of appointment, Article II, section 2.2. paragraph C of the Taxpayer Trust Agreement provides that the remaining trust estates shall be divided into as many equal subshares as grandchild has children then living, treating as a then living child, the living issue per stirpes of any child who is then deceased. One subshare is to be held for each such living child and one subshare is to be divided and held per stirpes for the issue of each such deceased child.

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Taxpayer Trust Agreement also provides for the distribution and disposition of any assets held in Taxpayer Trust for the benefit of Taxpayer's great grandchildren. The provision for distribution and disposition of Taxpayer Trust assets is consistent with the requirements of the A Trust Agreement.

Article VII of the Taxpayer Trust Agreement provides that nothing in the Taxpayer Trust is to be construed to postpone the vesting of the trust estate beyond Date 2, the Trust Termination Date. Date 2 is a date that does not exceed 90 years from the date of creation of the A Trust. Further, section 7.2 of Article II of the Taxpayer Trust Agreement provides that no power of appointment set forth in the Taxpayer Trust Agreement shall be exercised in any manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property in the Taxpayer Trust estate for a period beyond Date 2.

Article VII of the Taxpayer Trust Agreement also provides that Taxpayer has elected out of the section x of the State Revised Code.

It is represented that the only assets that will be held in the Taxpayer Trust will be assets transferred to Taxpayer Trust pursuant to Taxpayer's proposed exercise of the power of appointment granted to Taxpayer under the terms of the A Trust.

You have requested the following rulings:

(1) Taxpayer's proposed testamentary exercise of the limited power of appointment granted to Taxpayer under the terms of the A Trust, will not cause any property subject to the power of appointment to be included in Taxpayer's gross estate;

(2) Taxpayer's proposed testamentary exercise of the limited power of appointment granted to Taxpayer under the terms of the A Trust, will not constitute a taxable transfer and, therefore, Taxpayer will not be treated as the transferor of such portion of the A Trust under § 2652;

(3) Taxpayer's proposed testamentary exercise of the limited power of appointment granted to Taxpayer under the terms of the A Trust, the A Trust will continue to be exempt from the generation-skipping transfer tax under chapter 13 of the Code.

(4) After the proposed testamentary exercise by Taxpayer of the power of appointment granted to Taxpayer under the terms of the A Trust, Taxpayer Trust will be exempt from the generation-skipping transfer tax under chapter 13 of the Code.

Section 2033 provides that a decedent's gross estate shall include the value of all property to the extent of the decedent's interest at the time of his death.

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Section 2035(a) provides, except as provided in § 2035(b), the value of a decedent's gross estate shall include the value of all property to the extent of any interest therein that the decedent has at any time made a transfer, by trust or otherwise during the 3-year period ending on the date of the decedent's death.

Sections 2036 through 2042 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(a)(3) 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 by will exercises a power of appointment created after October 21, 1942, by creating another power of appointment which, under the applicable local law, can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

Section 2041(b)(1) defines the term "general power of appointment" as a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate. A power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not a general power of appointment.

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides that a power of appointment is not a general power if by its terms it is either (a) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate, or (b) expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate, or the creditors of his estate.

Under § 20.2041-1(c)(2), a power is limited by an ascertainable standard if the extent of the holder's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). The words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life.

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Section 20.2041-3(e)(1) provides, in part, that property subject to a power of appointment created after October 21, 1942, which is not a general power, is includible in the holder's gross estate if the power is exercised by will and if the power is exercised by creating another power of appointment which, under the terms of the instrument creating and exercising the first power and under applicable local law, can be validly exercised so as to: (a) postpone the vesting of any estate or interest in the property for a period ascertainable without regard to the date of creation of the first power, or (b) (if the applicable rule against perpetuities is stated in the terms of suspension of ownership or of the power of alienation, rather than of vesting) suspend the absolute ownership or the power of alienation of the property for a period ascertainable without regard to the date of the creation of the first power.

Section 2601 imposes a tax on every generation-skipping transfer. Section 2611 defines a generation-skipping transfer as a taxable termination, a taxable distribution, or a direct skip.

Section 2612(a) provides that the term "taxable termination" means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in trust unless—(A) immediately after such termination a non-skip person has an interest in such property or (B) at no time after such termination may a distribution be made from such trust to a skip person.

Section 2612(b) provides that the term "taxable distribution" means any distribution from a trust to a skip person other than a taxable termination or a direct skip.

Under § 2612(c)(1), a "direct skip" is a transfer subject to federal estate or gift tax made by a transferor to a skip person. Under §2612(c)(2), however, for purposes of determining whether a transfer is a direct skip, if an individual is a grandchild of the transferor (or the transferor's spouse or former spouse), and as of the time of the transfer, the parent of such individual who is a lineal descendant of the transferor (or the transferor's spouse or former spouse) is dead, such individual shall be treated as if such individual were a child of the transferor and all of that grandchild's children shall be treated as if they were grandchildren of the transferor.

Section 2613 defines a "skip person" as (1) a natural person who is assigned to a generation which is two or more generations below that of the transferor, (2) a trust in which all the interests are held by skip persons, or (3) a trust where, after that transfer, no trust distributions may be made to a non-skip person.

Under § 1433(a) of the Tax Reform Act of 1986, 1986-3 C.B. (Vol. 1) 1, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986. Section 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provide

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that the generation skipping transfer tax does not apply to a transfer from a trust, if the trust 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).

Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in the settlor's gross estate under §§ 2038 or 2042 if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided under § 26.2601-1(b)(1)(v)(B), where any portion of a trust remains in the 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. 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 a special rule for certain powers of appointment. This section provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) will not be treated as an addition to a trust if: (1) such power of appointment was created in an irrevocable trust that is not subject to Chapter 13 under § 26.2601-1(b)(1); and (2) in the case of an exercise, such 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 (the perpetuities period). For purposes of § 26.2601-1(b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

Section 26.2601-1(b)(1)(v)(D), Example 6 describes a situation where prior to the effective date of chapter 13, GP established an irrevocable trust under which the trust income was to be paid to GP's child, C, for life. C was given a testamentary power to

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appoint the remainder in further trust for the benefit of C's issue. In default of C's exercise of the power, the remainder was to pass to charity. C died on February 3, 1995, survived by a child who was alive when GP established the trust. C exercised the power in a manner that validly extends the trust in favor of C's issue until the later of May 15, 2064 (80 years from the date the trust was created), or the death of C's child plus 21 years. C's exercise of the power is a constructive addition to the trust because the exercise may extend the trust for a period longer than the permissible periods of either the life of C's child (a life in being at the creation of the trust) plus 21 years or a term not more than 90 years measured from the creation of the trust. On the other hand, if C's exercise of the power could extend the trust based only on the life of C's child plus 21 years or only for a term of 80 years from the creation of the trust (but not the later of the two periods) then the exercise of the power would not have been a constructive addition to the trust.

In Example 7 of section 26.2601-1(b)(1)(v)(D), the facts are the same as in Example 6, except local law provides that the effect of C's exercise is to extend the term of the trust until May 15, 2064, whether or not C's child predeceases that date by more than 21 years. C's exercise is not a constructive addition to the trust because C exercised the power in a manner that cannot postpone or suspend vesting, absolute ownership, or power of alienation for a term of years that will exceed 90 years. The result would be the same if the effect of C's exercise is either to extend the term of the trust until 21 years after the death of C's child or to extend the term of the trust until the first to occur of May 15, 2064 or 21 years after the death of C's child.

In this case, Taxpayer is a beneficiary of a separate share trust established under the A Trust Agreement. Under the A Trust Agreement, Taxpayer has a testamentary power of appointment over his separate share of the A Trust corpus. Taxpayer's testamentary power of appointment over his separate share of the A Trust corpus can only be exercised in favor of one or more persons of the class consisting of the issue and/or surviving spouse of Taxpayer, and/or A's then living lineal descendants. Because Taxpayer's testamentary power of appointment over his separate share of the A Trust corpus cannot be exercised in favor of himself, his creditors, his estate, or the creditors of his estate, Taxpayer's testamentary power of appointment created under the A Trust is not a testamentary general power of appointment. Accordingly, the exercise of the testamentary power of appointment as proposed will not cause any property subject to the power of appointment to be included in Taxpayer's gross estate under § 2041(a)(2).

Taxpayer proposes to exercise his limited testamentary power of appointment created under the A Trust in favor of the Taxpayer Trust. Article VII of the Taxpayer Trust provides that the trust is to be construed so that the Taxpayer Trust terminates and the Taxpayer Trust estate vests on Date 2, a date that does not exceed 90 years from the date of creation of the A Trust. Further, the exercise of any power of appointment set forth in the Taxpayer Trust Agreement may not postpone the vesting,



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absolute ownership or power of alienation of an interest in the Taxpayer Trust estate beyond Date 2.

Under the terms of the Taxpayer Trust, the trust property will be distributed outright and free of trust, in all events, within a period measurable from the date of creation of the original powers. Thus, the proposed testamentary exercise of the limited power of appointment will not create other powers that may be exercised in a manner that postpones the vesting or absolute ownership of any property interest without regard to the date of the creation of the original powers in the A Trust. Consequently, Taxpayer's proposed testamentary exercise of the limited power of appointment will not result in the value of the Taxpayer's share of the A Trust being included in the Taxpayer's gross estate under section 2041(a)(3).

Taxpayer's testamentary limited power of appointment was created under the A Trust. The A Trust was irrevocable on September 25, 1985, and, it is represented that no additions (constructive or otherwise) to the A Trust have been made after September 25, 1985. Taxpayer proposes to exercise his limited testamentary power of appointment created under the A Trust in favor of the Taxpayer Trust.

Under the Taxpayer Trust Agreement, the Taxpayer Trust will terminate no later than Date 2. Hence, the Taxpayer's proposed testamentary exercise of the limited powers under the A Trust in favor of the Taxpayer Trust will not postpone or suspend the vesting, absolute ownership or power of alienation of any interest in trust property for a period beyond a date which is 90 years measured from the date of creation of the A Trust. Under these facts, the proposed testamentary exercise of the limited power of appointment will not be treated as a constructive addition to the A Trust. Therefore, exercise of the limited power of appointment will not cause the A Trust or the Taxpayer's Trust to be subject to the Generation-Skipping Transfer Tax under Chapter 13 of the Code.

Based on the information submitted and the representations made we conclude as follows:

(1) Taxpayer's proposed testamentary exercise of the limited power of appointment granted to Taxpayer under the terms of the A Trust will not cause any property subject to the power of appointment to be included in Taxpayer's gross estate under § 2041.

(2) Taxpayer's proposed testamentary exercise of the limited power of appointment granted to Taxpayer under the terms of the A Trust, will not constitute a taxable transfer and, therefore, Taxpayer will not be treated as the transferor of such portion of the A Trust;

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(3) After Taxpayer's proposed testamentary exercise of the limited power of appointment granted to Taxpayer under the terms of the A Trust, the A Trust will continue to be exempt from the generation-skipping transfer tax under chapter 13 of the Code.

(4) After Taxpayer's proposed testamentary exercise of the limited power of appointment granted to Taxpayer under the terms of the A Trust, the Taxpayer Trust will be exempt from the generation-skipping transfer tax under 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(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, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury

statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Christine E. Ellison  
Chief, Branch 7  
Assistant Chief Counsel (P&SI)