Internal Revenue Service

Number: **200631009** Release Date: 8/4/2006 Index Number: 2601.00-00 Department of the Treasury

Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B04 - PLR-145149-04

Date: APRIL 28, 2006

Re:

Legend:

Date 1 Date 2 = Grantor = Trust Son 1 = Son 2 Son 3 Child 1 = Child 2 \$X = Bank County State State Statute 1 State Statute 2 =

Dear :

This is in response to correspondence, dated April 12, 2006, and prior correspondence, requesting rulings regarding the estate, gift, and generation-skipping transfer (GST) tax consequences of a proposed exercise of a limited power of appointment.

The facts submitted and representations made are as follows. Grantor died on Date 1, a date prior to September 25, 1985. Under Section 5 of Grantor's Will, Grantor created four irrevocable testamentary trusts for the benefit of the Grantor's children. The Will provided that the initial trustees were Son 1, Son 2, and Son 3. Upon the death of the second to die of the co-trustees, a bank was to become co-trustee of the trusts with the remaining individual trustee. It is represented that the situs of the trusts is State.

Section 5(h) of the Will provides that at any time during the term of the respective trusts for a child of Grantor's and with the consent and approval of the trustees, the share allotted to such child, or any part thereof, may be distributed to the then spouse and living descendants of such child in the proportions as such child shall direct.

Section 5(i) of the Will provides that in the event of the death of a child of Grantor's prior to the complete distribution of the share designated for such child, then upon such child's death or upon Grantor's death, if subsequent, such share or the remainder thereof, shall be distributed to the surviving spouse and the then living descendants of such child in the manner and proportions as such child shall have by written appointment or by will designated, and if such appointment shall not have been made by such child, then the same shall be distributed per stirpes to then living descendants, if any, of such child, or, if none, then to the heirs-at-law of such child.

One of the trusts (Trust) was created for the benefit of Son 1. On Date 2, Son 1 executed and filed in the real property records of County a Partial Release of Power of Appointment renouncing any power to appoint or direct the disposition of any life insurance now owned or hereafter acquired by Trust and further renounced any right to appoint any property of any kind held in Trust to his spouse.

Trust is currently valued at \$X and Son 1 and Son 2 are trustees and Bank is a custodian.

Son 1 proposes to execute an Appointment of Property (Proposed Appointment) pursuant to the special power of appointment granted under Section 5(i) of Grantor's Will. Pursuant to section 1 of the Proposed Appointment, upon Son 1's death, Trust will be divided into two separate trusts, one for each of Son 1's children, Child 1 and Child 2 (each Primary Beneficiary) and his/her descendants. These trusts are referred to as Exempt Descendant's Trusts. Bank is nominated as trustee of all trusts created under the Appointment.

Section 2(B) provides that the trustee in its sole discretion may make distributions out of income and principal to the Primary Beneficiary for the health, education, maintenance and support of such person. Additionally, the trustee in its sole judgment may make distributions out of income and principal to descendants of the

Primary Beneficiary, who were living at the date of death of Son 1, for health, education, maintenance and support, provided that the Primary Beneficiary gives his or her consent to such distributions.

Section 2(C) grants each Primary Beneficiary a special power of appointment to appoint, outright or in trust, all or part of the property in his or her trust to any one or more of the descendants of Son 1, other than the appointing Primary Beneficiary, that may be exercised during life or at the Primary Beneficiary's death. Under State Statute 1, in exercising a power of appointment, a donee may make appointments that create in the objects of the power additional powers of appointment.

Pursuant to section 2(C), no power shall be exercised over any property over which a power has been previously exercised to cause or permit the vesting of any property or interest in property, or the termination of any trust, to be postponed for a period beyond the perpetuities period applicable to the Grantor of the original trust under the Will.

Section 2(D) provides that, except as otherwise provided herein, each trust held and administered under section 2 shall continue for the lifetime of its Primary Beneficiary as a single trust until the Primary Beneficiary's death. Upon the death of the Primary Beneficiary, the trust estate shall be distributed in accordance with the Primary Beneficiary's properly exercised special power of appointment. If the Primary Beneficiary fails to exercise such power, or if the power fails to dispose of the entire trust estate, all of the remaining unappointed property of the trust shall be allocated, per stirpes, among the Primary Beneficiary's then living descendants who were also living at Son 1's death, or in the event the Primary Beneficiary is not a child of Son 1, and if no descendant of the Primary Beneficiary is then living, such property shall be allocated, per stirpes, among the then living descendants of the nearest lineal ancestor of the Primary Beneficiary who is also a descendant of Son 1 and who has descendants then living and who were also living at Son 1's death. If none of Son 1's descendants are then living, such property shall be distributed to Son 1's heirs at law who were also living at Son 1's death.

Pursuant to section 2(D), each share of the unappointed property of the trust which is allocated to a descendant of Son 1 under the preceding sentence shall remain in trust, and such share shall be administered by the trustee as a separate Exempt Descendant's Trust under section 2 for the benefit of the descendant to whom it is allocated; provided, however, that any share allocable to a person who is the Primary Beneficiary of a trust then being held and administered under section 2 shall be added to the principal of such existing trust and held and administered as a part thereof.

Pursuant to section 4, a Primary Beneficiary may become a trustee. Under State Statute 2, a trustee is prevented from making unreasonable distributions to himself, outside the limits placed by an ascertainable standard.

Pursuant to section 5, notwithstanding any other provision in the document, each trust created hereunder, whether by Son 1's exercise of his power of appointment granted to him under Grantor's Will, or by exercise of a power of appointment granted to the Primary Beneficiary of each Exempt Descendant's Trust shall, unless earlier terminated, continue for not longer than the eleventh day preceding the date which is twenty-one years after the death of the last to die of the descendants of Grantor who were living at the time of his death. All of the remaining unappointed property shall immediately vest in and be distributed outright to the Primary Beneficiary of the Trust.

Pursuant to section 6, the appointment made by Son 1 shall be effective at Son 1's death.

You have requested the following rulings:

- 1. The Trust is exempt from generation-skipping tax, because it was irrevocable on or before September 25, 1985, and because no additions, either actual or constructive, were made to trust after that date.
- 2. Son 1's exercise of the Proposed Appointment will not cause the property to be includible in his estate under § 2041 of the Internal Revenue Code.
- 3. Assets appointed from the Trust to the Exempt Descendant's Trusts under the Proposed Appointment will continue to be exempt from GST tax under § 2601.
- 4. The power of appointment granted to each Primary Beneficiary of a trust created under the Proposed Appointment qualifies as a special power of appointment as defined in applicable regulations under § 2041and § 2514.
- 5. The existence, exercise, or partial or complete release of the special powers of appointment granted to the Primary Beneficiaries under the Proposed Appointment will not result in the inclusion of the value of any assets of the trusts created thereunder in the gross estates of any of the Primary Beneficiaries under §§ 2041(a)(2) or 2041(a)(3).
- 6. The existence, exercise, or partial or complete release of the special powers of appointment granted to the Primary Beneficiaries under the Proposed Appointment will not constitute a transfer by any Primary Beneficiary of any of the trusts created thereunder that will be subject to federal gift tax under § 2501.

- 7. Trusts created by the exercise or failure to exercise the Primary Beneficiary's special power of appointment granted in the Proposed Appointment will be exempt from GST tax under § 2601.
- 8. Trusts continued or held in further trust pursuant to the provisions set forth in the Proposed Appointment will be exempt from GST tax under § 2601.

Issues ## 2, 4, 5, and 6

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 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, or by a disposition which 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, 2036, or 2037, exercises a power of appointment created after October 21, 1942, by creating another power of appointment which under 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 2501 imposes a tax for each calendar year on the transfer of property by gift by an individual.

Section 2511 provides that the tax imposed by section 2501 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 2514(b) provides that, for gift tax purposes, the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing the power.

Sections 2041(b)(1) and 2514(c)(1) provide that the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. Sections 2041(b)(1)(A) and 2514(c)(1) provide that a power to consume, invade or appropriate property for the benefit of the possessor that is limited by an ascertainable standard

relating to the health, education, support or maintenance of the possessor is not a general power of appointment.

Section 20.2041-1(c)(1) of the Estate Tax Regulations and § 25.2514-1(c)(1) of the Gift Tax Regulations provide 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 possessor or his creditors, or the possessor's estate or the creditors of his estate, or (b) expressly not exercisable in favor of the possessor or his creditors, or the possessor's estate or the creditors of his estate.

The power of appointment granted to Son 1 under section 5(i) of Grantor's Will is exercisable only in favor of Son's living descendants. Thus, under § 2041(b) and § 2514(b) Son 1's power of appointment is not a general power of appointment. Accordingly, we conclude that Son 1's exercise of the Proposed Appointment will not cause the property in Trust to be included in his estate under § 2041.

Pursuant to the Proposed Appointment, at Son 1's death, the assets in Trust will be appointed to two trusts for his children, the Exempt Descendant's Trusts. Each Primary Beneficiary of the Exempt Descendant's Trust is granted a power of appointment over the assets in his/her respective trust. These powers of appointment are exercisable only in favor of Son 1's descendants, excluding the powerholder. We conclude that these powers are not general powers of appointment under §§ 2041(b) and 2514(b) and, accordingly, the existence, exercise, or partial or complete release of the special powers of appointment granted to the Primary Beneficiaries under the Proposed Appointment will not result in the inclusion of the value of any assets of the trusts created thereunder in the gross estates of the Primary Beneficiaries under § 2041 and will not constitute a transfer by any Primary Beneficiary of any of the trusts created thereunder that will be subject to federal gift tax under § 2501.

Issues ## 1, 3, 7 and 8

Section 2601 imposes a tax on each generation skipping transfer. Under §1433(b)(2)(A) of the Tax Reform Act of 1986 Act and § 26.2601-1(b)(1)(I) of the Generation-Skipping Transfer Tax Regulations, 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 corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in § 26.2601-1(b)(1)(ii)(B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

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 § 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 the trust 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.

Trust was irrevocable on or before September 25, 1985 and it is represented that there have been no additions (constructive or otherwise) to Trust after September 25, 1985. Accordingly, Trust is exempt from the generation-skipping transfer tax.

The power of appointment granted to Son 1 under Trust was created in an irrevocable trust that is not subject to chapter 13 because it was irrevocable on September 25, 1985. Son 1's power of appointment is not a general power of appointment under § 2041. Son 1 proposes to exercise his special power of appointment over Trust by appointing the property to two trusts (Exempt Descendant's Trusts) one to benefit Child 1 and his/her descendants and one to benefit Child 2 and his/her descendants. The Exempt Descendant's Trusts will terminate no later than twenty-one years after the death of the last to die of the descendants of Decedent who were living at the death of Decedent. The proposed exercise of Son 1's power of appointment will not 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 Trust, extending beyond any life in being at the date of creation of Trust plus a period of twenty-one years. Therefore, the release, exercise, or lapse of Son 1's power of appointment will not constitute a constructive addition to Trust. Accordingly, we conclude that the assets appointed from Trust to the Exempt Descendant's Trusts under the Proposed Appointment will continue to be exempt from GST tax under § 2601. In

addition, we conclude that Trusts continued or held in further trust pursuant to the provisions set forth in the Proposed Appointment will be exempt form GST tax under § 2601.

Each Primary Beneficiary is granted a power of appointment in the Proposed Appointment. These powers of appointment are exercisable only in favor of Son 1's descendants, not including the appointing Primary Beneficiary. Further, these powers cannot be exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in each Exempt Descendant's Trusts for a period, measured from the date of creation of Trust, extending beyond any life in being at the date of creation of Trust plus a period of twenty-one years. Accordingly, we conclude that the trusts created by exercise of the special power of appointment granted to the Primary Beneficiaries in the Proposed Appointment will be exempt from GST tax under § 2601.

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.

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

Sincerely yours,

Lorraine E. Gardner Senior Counsel, Branch 4 Office of Associate Chief Counsel (Passthroughs and Special Industries)

Enclosure

Copy for section 6110 purposes