

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4/PLR-137213-01

Date:

February 26, 2002

In Re:

Legend:

- Decedent -
- Son -
- Taxpayer -

- Trust -

- Child 1 -
- Child 2 -
- Child 3 -
- Child 4 -
- Partnership -
- LLC -
- Date 1 -
- Date 2 -

Dear :

This is in reference to your December 20, 2001 letter, and prior correspondence, requesting rulings regarding the effect for federal generation-skipping transfer tax purposes of the proposed exercise of a power of appointment.

The facts submitted are as follows:

Decedent died testate on Date 1, survived by four children, Son and three daughters. One of the children, Son, was the executor of Decedent's estate. Pursuant to Paragraph EIGHTH (4)(a) of Decedent's will, the residue of Decedent's estate was divided into three trusts, one each for the benefit of each of Decedent's three daughters. Taxpayer is one of Decedent's daughters. Trust, one of the three trusts described in Paragraph EIGHTH (4)(a) of Decedent's will, was established by the appropriate local court on Date 2 for the benefit of Taxpayer. Trust was funded with an interest in Partnership. Pursuant to personal and business reasons, Partnership was converted to a limited partnership, which, in turn, was converted to three limited liability companies, one of which is LLC. Currently, Trust holds a 50 percent interest in LLC, which in turn, holds the interests that were held by the limited partnership for the benefit of Taxpayer and one of Taxpayer's siblings. Son was the initial trustee of Trust. After

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Son's death, Child 1 was appointed by the appropriate local court to serve as trustee of Trust. Child 1 is an adult child of Taxpayer and is the current trustee of Trust.

Under Paragraph EIGHTH (5), the trustee shall pay to or apply for the benefit of Taxpayer all of the net income realized from the corpus. In addition, the trustee may, within his uncontrolled discretion, from time to time and in addition to the payment of income, pay to or apply for the benefit of Taxpayer, any amount of corpus that the trustee, may desire or determine.

Paragraph EIGHTH (10)(a) states that Trust shall continue until the primary beneficiary (Taxpayer) deceases, at which time the trust estate, including principal and any accrued and undistributed income, shall be distributed to such one or more of the group consisting of Taxpayer's spouse, issue, brothers, sisters, lineal descendants, or any educational or charitable institution, either outright or in trust, as Taxpayer may from time to time appoint, provided that:

1. In no event may such appointment be, directly or indirectly, to the primary beneficiary, her creditors, her estate, or the creditors of her estate, or in any way discharge any legal obligation of herself or her estate; and
2. Such primary beneficiary may exercise her power by appointing an interest, outright or in trust, subject to lawful conditions or restraints designated by the primary beneficiary, exercise the power by creating new powers of appointment in the objects of the power, and confer any administrative powers and discretions upon the trustee. However, no interest, power or conditions shall be created that would benefit anyone not an object of the power being exercised.

Paragraph EIGHTH (10)(b) provides that if, upon the death of the primary beneficiary, the power of appointment conferred upon her has not been exercised in a valid manner or has been renounced or released by the primary beneficiary, the corpus of Trust will be held, administered and distributed by the trustee for the benefit of the deceased primary beneficiary's spouse and children.

Paragraph EIGHTH 11(h) provides that if any interest created in the trust or in any instrument exercising a power created in the trust, is challenged under the Rule against Perpetuities, the trustee must appoint the assets in a manner that will closely approximate the Decedent's distributive intent and that such exercise must be within a reasonable time after the interest is challenged but not later than the end of the applicable period of perpetuities computed from the date when the period of perpetuities begins to run on the challenged interest. The "lives in being" used for computing the period of perpetuities shall be those used in determining the validity of the challenged interest, plus issue of the Decedent who are living at the time the period of perpetuities starts to run on the challenged interest.

You represent that there have been no additions to Trust after September 25, 1985.

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Taxpayer has four children; Child 1, Child 2, Child 3, and Child 4, all of whom are living. Taxpayer proposes to exercise the power of appointment granted to her pursuant to Paragraph EIGHTH (10)(a) of Decedent's will in the following manner:

(a) The trust estate held for my benefit, including both principal and any accrued and undistributed income, shall be divided into as many equal shares as there are children of mine then living and children of mine then deceased leaving descendants then living. Trustee shall allocate one (1) such equal share to each living child and one (1) such equal share to each group composed of the living descendants of a deceased child. Each such share shall be distributed, or retained in trust, as hereafter provided.

(1) Each share allocated to a group composed of the living descendants of a deceased child shall be distributed to such descendants by right of representation, subject, however, to the provisions of subparagraph (3) and (4) following.

(2) Each share allocated to a living child shall be distributed free of trust.

(3) If any person entitled to outright distribution of a trust or a portion of a trust is under twenty-five (25), trustee shall hold and administer that portion of the Trust Estate for the beneficiary's benefit. Income from the portion shall be added to principal and trustee shall pay to or apply for the benefit of the beneficiary as much of the portion as trustee in trustee's discretion considers necessary for the beneficiary's maintenance and education. When the beneficiary becomes twenty-five (25), trustee shall distribute to him or her the entire portion of the Trust Estate.

(4) Provided, however, any trust created by the exercise of this power of appointment may not postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from [Date 1], the date of creation of the trust for the benefit of [Taxpayer] under the will of [Decedent], and extending beyond any life in being plus a period of 21 years plus, if necessary, a reasonable period of gestation (the perpetuities period). A "life in being" as used directly above shall mean a descendant of [Decedent], which descendant was living on [Date 1]. On the termination of any trust in accordance with this rule against perpetuities such portion, share or partial share then held in trust for any living person shall be distributed outright and free of trust to such person.

As set forth in Paragraph EIGHTH (10)(a) of Decedent's will, the exercise of the power of appointment by Taxpayer, as proposed, will be effective as of Taxpayer's

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death.

Taxpayer requests the following rulings:

1. Trust is not subject to the generation-skipping transfer tax imposed under § 2601 of the Internal Revenue Code.
2. The power of appointment given to Taxpayer pursuant to Paragraph EIGHTH (10)(a) of Decedent's will is not a general power of appointment as defined in §§ 2514(c) or 2041(b).
3. The exercise by Taxpayer, as proposed, of the power given to Taxpayer pursuant to Paragraph EIGHTH (10)(a) of Decedent's will will not affect the exempt status of Trust for generation-skipping transfer tax purposes, and will not result in a transfer of property that will subject Trust, or distributions thereunder, to the generation-skipping transfer tax imposed under § 2601.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made after October 22, 1986.

A generation-skipping transfer is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) 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 where the property passes to a skip person with respect to the transferor of the property. 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.

Section 1433(a) of the Tax Reform Act of 1986 (Act), provides that the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. Under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the GST tax does not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. However, this exemption does not apply to additions (actual or constructive) that are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(iv) provides that, if an addition is made after September 25, 1985, to a trust which was irrevocable on September 25, 1985, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the GST tax provisions. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to the GST tax and a portion subject to the GST tax.

In the present case, Trust was irrevocable on September 25, 1985. Trustee has

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represented that no additions, actual or constructive, have been made to the trust after that date. Accordingly, pursuant to § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), Trust is not subject to the GST tax and thus, any generation-skipping transfer under Trust is not subject to the GST tax imposed under § 2601.

A general power of appointment is defined in § 2041(b)(1), for federal estate tax purposes, as a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. The definition of a general power of appointment under § 2514(c), for federal gift tax purposes, is generally the same as that provided in § 2041(b)(1). Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, is deemed a transfer of property by the individual possessing the power.

Section 26.2601-1(b)(1)(v)(A) provides that, except as provided in § 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 for estate or gift tax purposes, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

Paragraph EIGHTH (10)(a) of Decedent's will gives Taxpayer the power to appoint the principal and any accrued but undistributed income to one or more of a group consisting of Taxpayer's spouse, issue, brothers, sisters, lineal descendants, or any educational or charitable institution, either outright or in trust, provided that the property could not be appointed, directly or indirectly, to Taxpayer, her creditors, her estate, or the creditors of her estate, or in any way discharge any legal obligation of herself or her estate.

Thus, the testamentary power held by Taxpayer to appoint the remainder of Trust to Taxpayer's spouse, Child 1, Child 2, Child 3, and Child 4, or, if any of the children of Taxpayer who predecease Taxpayer, to the living descendants of those children, or any educational or charitable institution is not a general power of appointment as defined in §§ 2041(b)(1) or 2514(c) because Taxpayer could not exercise the power in favor of herself, her estate, or the creditors of either.

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) is not treated as an addition to a trust if (1) the power was created in an irrevocable trust that is not subject to the GST tax because it was irrevocable on September 25, 1985, and (2) in the case of an exercise, the power was not exercised in such a way that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period beyond the rule against perpetuities measured from the creation of the trust. The rule against perpetuities is described in § 26.2601-1(b)(1)(v)(B)(2) as any life in being at the date of creation of the trust plus a period of 21 years plus, if

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necessary, a reasonable period of gestation. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

The proposed exercise by Taxpayer, which will be effective on Taxpayer's death, of the limited power of appointment in favor of her children who are living on the date of Taxpayer's death and the issue of any child of hers who may have died before that date will not postpone or suspend the vesting or ownership of any interest in Trust beyond the rule against perpetuities measured from the creation of Trust on Date 1. Thus, pursuant to § 26.2601-1(b)(1)(v)(B), the exercise of the power by Taxpayer will not be treated as an addition, constructive or otherwise, to Trust.

Based on the facts submitted and the representations made, the exercise by Taxpayer, as proposed, of the power given to Taxpayer pursuant to Paragraph EIGHTH (10)(a) of Decedent's will will not affect the exempt status of Trust for generation-skipping transfer tax purposes, and will not result in a transfer of property that will subject Trust, or distributions thereunder, to the generation-skipping transfer tax imposed under § 2601.

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

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 the 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. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

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
Assistant to the Branch Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes

cc: