

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200511013**

Release Date: 3/18/05

Index Number: 2601.03-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-167268-03

Date:
November 29, 2004

Legend

- Taxpayer =
- Trust A =
- Trust B =
- Trust C =
- Trust D =
- Grantor =
- Date 1 =
- Date 2 =
- Trust 1 =
- Beneficiary 1 =
- Beneficiary 2 =
- Date 3 =
- Date 4 =
- Court =
- Trust 2 =
- Date 5 =

Dear :

This letter responds to your letter, dated November 18, 2004, and prior correspondence requesting rulings regarding the generation-skipping transfer (GST) tax consequences of Taxpayer's proposed exercise of a special power of appointment over Trust A, Trust B, Trust C and Trust D.

Trust A and Trust B

Grantor executed his Last Will and Testament on Date 1. Grantor died on Date 2. Paragraph 4.01(b) of Grantor's will created Trust 1. Paragraph 3.03 provides that Trust 1 will terminate after the death of the last survivor of the beneficiaries in being on Date 2. Paragraph 4.09 provides that during Taxpayer's lifetime, the income from Trust 1 shall be paid, in shares and amounts as the trustee determines, to and among one or more of the following: Taxpayer, Grantor's issue living at the time of payment, or the spouse of any of Grantor's issue. Paragraph 4.10 provides that Taxpayer shall have the power to appoint by deed or will all or any part of the principal of Trust 1 to or for the benefit of any one or more of the following: Grantor's issue living at the time of the exercise of the power or the spouse of any of Grantor's issue.

The beneficiaries in being on Date 2 were: Taxpayer, Beneficiary 1, and Beneficiary 2. Date 2 is prior to September 25, 1985. Taxpayer was Grantor's spouse.

On Date 3, Taxpayer exercised her special power of appointment ("first Trust 1 exercise") over Trust 1. In the preamble of the first Trust 1 exercise, Taxpayer disclaimed, renounced, and waived all of her rights as a beneficiary of Trust 1 and directed the trustees of Trust 1 to immediately divide the Trust 1 estate into two parts of equal value. After the division, Trust A is held for the benefit of Beneficiary 1 and Trust B is held for the benefit of Beneficiary 2. Article I of Part One provides that during a named beneficiary's life, the income is payable to that beneficiary. After the beneficiary's death, income is payable to his or her descendants, per stirpes, for their lives. Paragraph 1.2.3 under Article II of Part One provides that Taxpayer reserves the right to exercise her power of appointment under Grantor's will at any time after Date 3; provided, however, no appointment shall be made in favor of Taxpayer, her estate, her creditors, or the creditors of her estate. Furthermore, no appointment may be made in such a manner that would relieve or discharge a legal obligation of support of Taxpayer. Paragraph 1.2.6 provides that unless earlier terminated, Trust A and Trust B shall be distributed to the persons then entitled as current income beneficiaries twenty-one years after the death of the survivor of Beneficiary 1 and Beneficiary 2, each of whom were living on Date 2.

On Date 4, Court reformed Trust A and Trust B by removing Article I of Part Two of Taxpayer's first Trust 1 exercise and replacing it. Article I of Part Two names the trustees of each trust and provides for the naming of successor trustees. The reformation named Beneficiary 1 as the family trustee of Trust A and Beneficiary 2 as the family trustee of Trust B. In addition, the reformation removed the requirement for a corporate trustee.

Taxpayer represents that no additions (actual or constructive) have been made to the trusts since Trust 1 was created on Date 2. Date 3 and Date 4 are after September 25, 1985. Taxpayer further represents that Trust A and Trust B have been treated as exempt from the generation-skipping transfer tax. Taxpayer now wishes to exercise her retained special power of appointment ("second Trust 1 exercise") over

Trust A and Trust B to give a current income beneficiary of a trust the power to appoint the trust's assets to Taxpayer's descendants and/or the spouses of Taxpayer's descendants. The power of appointment may be exercised either during the beneficiary's life or by will effective at the beneficiary's death. The power of appointment would not be exercisable in favor of the current income beneficiary, his estate, his creditors, or the creditors of his estate. Furthermore, the power of appointment could not be exercised in a manner that would relieve or discharge a legal obligation of support of the beneficiary possessing the power.

Trust C and Trust D

Grantor created Trust 2, a life insurance trust, on Date 5. Paragraph 1.03 provides that Trust 2 is irrevocable. Paragraph 2.01 of the Trust 2 Agreement provides that any trust created under the agreement shall terminate when all of the trust property has been fully distributed. Unless earlier terminated, the trust(s) shall terminate no later than twenty-one years after the death of the last survivor of the beneficiaries in being on Date 5.

Paragraph 3.01 provides that during Taxpayer's lifetime, the net income may be paid to, or applied for the benefit of, any one or more of the group consisting of Taxpayer, Grantor's children, the spouses of Grantor's children, or the issue of Grantor's deceased children in such amount or amounts as the corporate trustee in its uncontrolled discretion may determine. Any net income in any year that is not paid to, or applied for the benefit of, any one or more of the group shall be added to the principal at the end of the year. Paragraph 3.02 provides that Taxpayer shall have the power to appoint by deed or by will all or any part of the principal of the trust to or for the benefit of any one or more of a group consisting of Grantor's issue or the spouses of Grantor's issue.

The beneficiaries in being on Date 5 were: Taxpayer, Beneficiary 1, and Beneficiary 2. Date 5 is prior to September 25, 1985.

On Date 3, Taxpayer exercised her special power of appointment ("first Trust 2 exercise") over Trust 2. In the preamble of the first Trust 2 exercise, Taxpayer disclaimed, renounced, and waived all of her rights as a beneficiary of Trust 2 and directed the trustees of Trust 2 to immediately divide the Trust 2 estate into two parts of equal value. After the division, Trust C is held for the benefit of Beneficiary 1 and Trust D is held for the benefit of Beneficiary 2. Article I of Part One provides that during a named beneficiary's life, income is payable to that beneficiary. After the beneficiary's death, the income is payable to his or her descendants, per stirpes, for their lives. Paragraph 1.2.3 of Article II of Part One provides that Taxpayer reserves the right to exercise her power of appointment under Trust 2 at any time after Date 3; provided, however, no appointment shall be made in favor of Taxpayer, her estate, her creditors, or the creditors of her estate. Furthermore, no appointment may be made in such a manner that would relieve or discharge a legal obligation of support of Taxpayer.

Paragraph 1.2.6 provides that unless earlier terminated, Trust C and Trust D shall be distributed to the persons then entitled as current income beneficiaries twenty-one years after the death of the survivor of Beneficiary 1 and Beneficiary 2, each of whom were living on Date 5.

On Date 4, Court reformed Trust C and Trust D by removing Article I of Part Two of Taxpayer's first Trust 2 exercise and replacing it. Article I of Part Two names the trustees of each trust and provides for the naming of successor trustees. The reformation named Beneficiary 1 as the family trustee of Trust C and Beneficiary 2 as the family trustee of Trust D. In addition, the reformation removed the requirement for a corporate trustee.

Taxpayer represents that no additions (actual or constructive) have been made to the trusts since Trust 2 was created on Date 5. Date 3 and Date 4 are after September 25, 1985. Taxpayer further represents that Trust C and Trust D have been treated as exempt from the generation-skipping transfer tax.

Taxpayer now wishes to exercise her retained special power of appointment ("second Trust 2 exercise") over Trust C and Trust D to give a current income beneficiary of a trust the power to appoint the trust's assets to Taxpayer's descendants and/or the spouses of Taxpayer's descendants. The power of appointment may be exercised either during the beneficiary's life or by will effective at the beneficiary's death. The power of appointment would not be exercisable in favor of the current income beneficiary, his estate, his creditors, or the creditors of his estate. Furthermore, the power of appointment could not be exercised in a manner that would relieve or discharge a legal obligation of support of the beneficiary possessing the power.

Rulings Requested

Taxpayer has requested the following rulings: (1) Trust A and Trust B are exempt from the generation-skipping transfer tax because the trusts were irrevocable on September 25, 1985, and because no additions, either actual or constructive, have been made to the trusts after September 25, 1985; (2) Taxpayer's second Trust 1 exercise will not constitute a constructive addition to the trusts and therefore will not eliminate the trusts' status as exempt from the generation-skipping transfer tax; (3) The exercise by a current income beneficiary of the special power of appointment, created by the Taxpayer's second Trust 1 exercise will not constitute a constructive addition to the trusts and will not eliminate the trusts' status as exempt from the generation-skipping transfer tax; (4) Trust C and Trust D are exempt from the generation-skipping transfer tax because the trusts were irrevocable on September 25, 1985, and because no additions, either actual or constructive, have been made to the trusts after September 25, 1985; (5) Taxpayer's second Trust 2 exercise will not constitute a constructive addition to the trusts and therefore will not eliminate the trusts' status as exempt from the generation-skipping transfer tax; and (6) The exercise by a current income beneficiary of the special power of appointment, created by the Taxpayer's

second Trust 2 exercise will not constitute a constructive addition to the trusts and will not eliminate the trusts' status as exempt from the generation-skipping transfer tax.

The current applicable state rule against perpetuities generally provides that the absolute power of alienation shall not be suspended, by any limitation or condition whatever, for a longer period than during the continuance of the lives of persons in being at the creation of the limitation or condition plus twenty-one years. The state law further provides that the period during which the absolute right of alienation may be suspended by any instrument in execution of a power shall be computed from the time of the creation of the power and not from the date of the instrument. However, in the case of a general power presently exercisable, the period shall be computed from the date of the instrument.

Section 2041(a)(2) of the Internal Revenue Code 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 a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive. For purposes of § 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent of giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

Section 2041(b)(1) provides that a general power of appointment is a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. Under § 2041(b)(1)(A), 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 2601 imposes a tax on each generation-skipping transfer.

Section 2611(a) defines the term "generation-skipping transfer" to include a taxable distribution, taxable termination, and a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that such 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, is considered an irrevocable except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, Trust 1 and Trust 2 are considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

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 12, 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.

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 the 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 twenty-one years.

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Unless specifically noted, the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held

the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

Rulings 1 and 4

Trust 1 was irrevocable on Date 2, the date of Grantor's death. Trust 2 was irrevocable on Date 5. Taxpayer represents that there have been no constructive or actual additions to Trust 1 or Trust 2 since September 25, 1985. Taxpayer's powers of appointment over Trust 1 and Trust 2 were exercisable only in favor of Grantor's issue or the spouse of any of Grantor's issue. Taxpayer was Grantor's spouse. Thus, under § 2041(b) and § 20.2041-1(c)(1) and for purposes of § 26.2601-1(b)(1)(v)(B), Taxpayer's powers of appointment over Trust 1 and Trust 2 are not general powers of appointment. In addition, Taxpayer's Date 3 exercise of her powers of appointment over Trust 1 and Trust 2 did 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 the trust, extending beyond any life in being at the date of the creation of the trust plus a period of twenty-one years. In addition, the Date 4 reformations were administrative in nature and did not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trusts. Therefore, based on the facts submitted and the representations made and in accordance with § 26.2601-1(b)(1)(v)(B), Trust A, Trust B, Trust C, and Trust D are exempt from the generation-skipping transfer tax because the trusts were irrevocable on September 25, 1985, and because no additions, either actual or constructive, have been made to the trusts after September 25, 1985.

Rulings 2 and 5

The powers of appointment reserved by Taxpayer over Trust 1 and Trust 2 are not exercisable in favor of Taxpayer, her estate, her creditors, or the creditors of her estate. Thus, under § 2041(b) and § 20.2041-1(c)(1) and for purposes of § 26.2601-1(b)(1)(v)(B), Taxpayer's reserved powers of appointment over Trust 1 and Trust 2 are not general powers of appointment. Taxpayer's proposed second Trust 1 exercise and proposed second Trust 2 exercise 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 the trust, extending beyond any life in being at the date of the creation of the trust plus a period of twenty-one years. Therefore, based on the facts submitted and the representations made and in accordance with § 26.2601-1(b)(1)(v)(B), Taxpayer's second Trust 1 exercise and Taxpayer's second Trust 2 exercise will not constitute constructive additions to the trusts and therefore will not eliminate the trusts' status as exempt from the generation-skipping transfer tax.

Rulings 3 and 6

The powers of appointment created by Taxpayer in favor of Beneficiary 1 and Beneficiary 2 over Trust A, Trust B, Trust C, and Trust D would not be exercisable in favor of the named beneficiary, his estate, his creditors, or the creditors of his estate. Furthermore, applicable state law and the terms of the original trust instruments prohibit a beneficiary of one of the trusts from postponing or suspending the vesting, absolute ownership or power of alienation of an interest in the trusts for a period, measured from the date of creation of each trust, extending beyond twenty-one years after the death of the survivor of Beneficiary 1 and Beneficiary 2, the lives in being on the date of the creation of each of the original trusts. Therefore, based on the facts submitted and the representations made and in accordance with § 26.2601-1(b)(1)(v)(B) and Oklahoma law, the exercise by a current income beneficiary of the special power of appointment, created by the Taxpayer's second Trust 1 exercise will not constitute a constructive addition to the trusts and will not eliminate the trusts' status as exempt from the generation-skipping transfer tax.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's 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,

Melissa C. Liquerman
Chief, Branch 9
(Passthroughs & Special Industries)

Enclosure

Copy of this letter for § 6110 purposes