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LEGEND

- Trust =
- Decedent =
- Date 1 =
- State =
- Spouse =
- Year 6 =
- Statute =

Dear :

This is in response to your representative's letter of September 21, 2004, and previous correspondence submitted on your behalf, in which rulings are requested on the application of the estate, gift, and generation-skipping transfer (GST) tax to certain powers created under Trust.

FACTS

The facts, as represented, are as follows:

Decedent died testate on Date 1, a date prior to September 25, 1985. At his death, Decedent was a resident of State and was survived by Spouse and three children.

Article 6 of Decedent's Will created Trust. Under the terms of Trust, until the death of Spouse, the trustees may accumulate the net income of the trust or pay to or apply so much thereof to the use of such one or more of Spouse, Decedent's children, and the then living issue of Decedent's children, in such amounts and proportions as the trustees in their sole and absolute discretion deem advisable from time to time without regard to equality of distribution. There is no power to distribute the principal of Trust

during the lifetime of Spouse. At Spouse's death, Trust provides for distributions to Decedent's descendants.

In Article 7 of Decedent's Will, Decedent designated his father, his brother, and Spouse as original co-trustees of Trust. Spouse and sister of Spouse are the current trustees and have been serving as co-trustees since Year 6 of Trust.

Trust was irrevocable on September 25, 1985. It has been represented that there have been no actual or constructive additions to Trust for GST purposes since the death of Decedent.

In 1995, Statute was added to the State Code that provides, in part, that unless the terms of a trust refer specifically to this provision and provide to the contrary, a trustee shall not, on behalf of or for the benefit of a beneficiary who is also a trustee, make discretionary distributions of either principal or income for the benefit of the trustee, except to provide for the health, education, maintenance, or support of the trustee as described under §§ 2041 and 2514 of the Internal Revenue Code (Code). The Statute also provides that a trustee shall not, on behalf of or for the benefit of a beneficiary who is also a trustee, make discretionary distributions of either principal or income to satisfy any legal or support obligations of the trustee. This provision applies to all irrevocable trusts existing on July 7, 1995, unless all parties in interest elect affirmatively not to be subject to the application of this section.

It is represented that the parties in interest with respect to Trust have not elected affirmatively for Trust to be excluded from the application of Statute.

You have asked us to rule, as follows:

1. That, upon her death, no portion of trust income will be included in Spouse's gross estate under § 2041(b)(2).
2. That, during Spouse's lifetime, no distributions of trust income from Trust after the effective date of Statute will be subject to gift tax under § 2514(c)(1).
3. That the enactment of Statute will not cause Trust to lose status under § 1433 of the Tax Reform Act of 1986 as exempt from the application of the generation-skipping transfer tax under chapter 13 of the Code.

LAW AND ANALYSIS

Rulings 1 and 2

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)(A) provides that a general power of appointment is a power that is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; however, a power to consume, invade, or appropriate property for the benefit of the decedent that is limited to the health, education, support, or maintenance of the decedent is not deemed to be a general power of appointment.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, is considered a release of the power to the extent that the property that could have been appointed by exercise of the lapsed power during the calendar year 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 powers could be satisfied.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides 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. 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 donee 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 20.2041-1(b)(3) provides that if a power of appointment exists as to part of an entire group of assets or only over a limited interest in property, § 2041 applies only to such part or interest.

Section 2501 imposes a tax on the transfer of property by gift by an individual.

Section 2511 provides that the tax imposed by § 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.

Section 2514(c)(1) provides the term "general power of appointment" means a power that is exercisable in favor of the individual possessing the power (possessor), his

estate, his creditors, or the creditors of his estate. However, 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 2514(e) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of the power to the extent that the property that could have been appointed by exercise of the lapsed power during the calendar year exceeds the greater of \$5,000 or 5 percent of the aggregate value of the assets out of which the exercise of the lapsed powers could be satisfied.

Section 25.2514-1(b)(1) of the Gift Tax Regulations provides 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. 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 donee 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 25.2514-1(b)(3) provides that if a power of appointment exists as to part of an entire group of assets or only over a limited interest in property, § 2514 applies only to such part or interest.

While federal law controls what rights or interests shall be taxed after they are created, creation of legal rights and interests in property (such as the breadth and scope of a power of appointment over the corpus of a testamentary trust) is a matter of state law. *United States v. Pelzer*, 312 U.S. 399 (1941), 1941-1 C.B. 441; *Morgan v. Commissioner*, 309 U.S. 78 (1940), 1940-1 C.B. 229.

As referred to above, Statute provides that unless the terms of a trust refer specifically to the provision and provide to the contrary, a trustee shall not perform any of the following on behalf of or for the benefit of a beneficiary who is also a trustee: (1) make discretionary distributions of either principal or income for the benefit of the trustee, except to provide for the health, education, maintenance, or support of the trustee as described under §§ 2041 and 2514 of the Internal Revenue Code, as amended; (2) make discretionary allocations of receipts or expenses as between principal and income, unless the trustee has no power to enlarge or shift any beneficial interest except as an incidental consequence of the discharge of the fiduciary duties of the trustee; and (3) make discretionary distributions of either principal or income to satisfy any legal or support obligations of the trustee.

Statute provides, in part, that it applies to all irrevocable trusts existing on July 7, 1995, unless all parties in interest elect affirmatively not to be subject to the application of this section.

Rev. Proc. 94-44, 1994-2 C.B. 683, sets forth the Service's position regarding the transfer tax consequences of the enactment of Florida Statutes Annotated (F.S.A.) § 737.402(4)(a)(1). Under this statute, any fiduciary power conferred upon a trustee to make discretionary distributions of either principal or income to or for the trustee's own benefit cannot be exercised by the trustee, except to provide for that trustee's health, education, maintenance, or support, as described in §§ 2041 and 2514. The statute was effective with respect to trusts that were irrevocable on or after July 1, 1991. Pursuant to the revenue procedure, the Service will not treat the statute as causing the lapse of a general power of appointment for purposes of §§ 2041 and 2514, where the scope of a fiduciary power held by a beneficiary was restricted as a result of the statute.

In the present case, prior to the effective date of Statute, Spouse's unlimited power to distribute income to herself as a trustee-beneficiary constituted a general power of appointment over the income of Trust under §§ 2041(b)(1)(A) and 2514(c)(1). See § 20.2041-1(b)(1) and (3) and § 25.2514-1(b)(1) and (3). Consistent with the principles of Rev. Proc. § 94-44, the enactment of Statute will not be treated as causing a lapse of Spouse's general power of appointment over Trust income for transfer tax purposes. The statute will be treated as effective with respect to Trust on the effective date of Statute. Therefore, as of the effective date, Spouse, as trustee-beneficiary of Trust, will not have the power to appoint trust income for her own benefit except in satisfaction of any needs she may have for health, education, maintenance, and support. Since Spouse's power to distribute income to herself is limited to an ascertainable standard as described in §§ 2041(b)(1)(A) and 2514(c)(1), Spouse will not possess a general power of appointment over the trust income for transfer tax purposes by virtue of any fiduciary power to distribute income. Accordingly, we conclude that no portion of trust income will be included in Spouse's gross estate under § 2041(b)(2) upon her death and that distributions of trust income to the trust beneficiaries after the effective date of Statute will not be subject to gift tax under § 2514(c)(1).

Ruling 3

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST), which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under section 1433 of the Tax Reform Act of 1986 (the Act), GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the 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 that was irrevocable on September 25, 1985, except to the extent the transfer is made out of

corpus added to the trust by an actual or constructive addition after September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains exempt status for generation-skipping transfer tax purposes. 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) provides that a modification that is valid under applicable state law will not cause an exempt trust to be subject to the GST tax 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 for in the original trust. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST or the creation of a new GST.

In the present case, we conclude that the enactment of Statute will not be considered a modification that: (1) results in a shift of a beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification; or (2) extends the time for vesting of any beneficial interest in Trust beyond the period provided for in the original Trust.

Accordingly, we rule with respect to the third ruling request that the enactment of Statute will not cause Trust to lose status under § 1433 of the Tax Reform Act of 1986 as a trust exempt from the application of the GST tax under chapter 13 of the Code.

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.

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 requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

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

cc: