

INTERNAL REVENUE SERVICE  
UIL 2601.00-00  
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CC:DOM:P&SI:7--PLR-103367-99  
July 13, 1999

Re:

Legend:

Decedent:

SSN:

Son:

SSN:

Daughter:

SSN:

Grandchildren:

Son's Children:

Daughter's Children:

Trust:

EIN:

Trustees:

Corporate Trustee:

Court:

State:

date 1:

date 2:

date 3:

date 4:

date 5:

Dear \_\_\_\_\_ :

We received your letter, dated \_\_\_\_\_, submitted on behalf of Trustees, requesting a ruling concerning the proper application of the generation-skipping transfer (GST) tax under § 2601 et. seq. of the Internal Revenue Code to an exempt trust with a non-general power of appointment. This letter responds to that request.

The taxpayer represents that the facts are as follows: Decedent executed a Last Will and Testament on date 1. The Decedent's will created a trust for the benefit of Decedent's spouse. If Decedent's spouse predeceased Decedent, spouse's trust was to be divided into two equal trusts for Decedent's children and their lineal descendants. Decedent's spouse died on date 2. On date 3, the Court in State adjudicated Decedent mentally incompetent. Decedent died on date 4. Decedent was survived by Son, Daughter, and Grandchildren, all of whom are still living.

Under Article Eighth, paragraph I, subparagraph B(2) of Decedent's will, Decedent directs that the principal of the Residuary Trust, as it is then constituted, shall be divided into two (2) equal shares. Article Eight, paragraph I, subparagraph B(2)(b)(1) further provides that one of the equal shares (Trust) shall be held as one fund for and during the lifetime of Son. The Trustees are required to pay the net income from the share held for Son at such time or times and in such amounts and proportions as the Corporate Trustee, in its sole discretion, shall deem advisable to or for the benefit of Son and/or Son's children. The subparagraph also provides that the Decedent's Trustees will be under no duty to equalize disbursements of income and/or principal from this share of the Trust to or for the benefit of the beneficiaries thereof, for it is the Decedent's intent to specifically authorize by the terms of this subparagraph unequal distributions as made in the sole discretion of Decedent's corporate trustee.

Article Eighth, paragraph I, subparagraph B(2)(b)(2) provides that upon the death of Son, during the continuance of this trust for Son's benefit, Trustees shall pay and distribute the principal of this share of the Trust as Son shall appoint and direct by specific reference to this power of appointment in Son's Last Will and Testament, provided however, any appointment or direction to Son, to Son's estate, to Son's creditors or to the creditors of Son's estate shall in all respects be null and

void. In default of the valid exercise of this limited power of appointment herein given, or in the event Son is not living at the time for the creation of this separate trust, the principal of this share of the Residuary Trust, as it is then constituted, shall be divided into as many equal shares as there are children of Son living at the time for this division and children of Son then deceased with issue then surviving.

Article Eighth, paragraph II provides that notwithstanding anything to the contrary herein contained, upon the expiration of twenty-one years following the death of the survivor of all the beneficiaries herein named or described who are living at my death, any trust remaining hereunder shall terminate, and the principal shall be transferred and delivered to the persons then entitled to the income.

On date 5, Son exercised the power of appointment granted to Son in Decedent's Will in behalf of Son's spouse, children and grandchildren by specific reference to the power of appointment in Son's Last Will and Testament. Article 6(B) of Son's Will provides that the Trustees shall pay the net income from the Trust to or for the benefit of Son's wife during her life, in convenient installments not less frequently than quarterly, together with so much principal, if any, as the corporate trustee, in its sole discretion, deems advisable for her health, maintenance and support in her accustomed manner of living, after giving consideration to the prior utilization of other assets and sources of income readily available to her.

Article 6(C) of Son's Will provides that upon his wife's death or upon Son's death if Son's wife does not survive Son, the trustee shall divide the trust corpus of the Trust for the Family of Son into such number of equal shares as Son has children then living and deceased children with issue then living. The share of each such deceased child shall be distributed as provided in Article 6(C)(2) below. The share of each living child shall be held in a separate trust under the following provisions.

Article 6(C)(1) provides that the Trustees shall pay so much income of the trust to or for the benefit of Son's child and Son's child's issue, or any of them, in such proportions and at such times as the corporate trustee, acting alone and in its sole discretion, shall deem advisable; and so much principal as the corporate trustee shall deem advisable for their health, maintenance and support in their accustomed manner of living and complete education. Any undistributed income shall be added to principal and invested as such.

Article 6(C)(2) provides that upon the death of any of Son's children prior to the termination of his or her trust, or upon Son's wife's death should a child have survived Son but

predeceased Son's wife, the trustee shall distribute the remaining trust corpus to any one or more beneficiaries other than the child's estate, or the creditors of child's estate, in such proportions and subject to such trusts and conditions, as such child shall appoint by specific reference to this power in his or her will. Provided, however, that this power of appointment shall not be exercised in any manner which might postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period extending beyond the date of such child's death plus a period of twenty-one years, each of such children having been alive at the death of Decedent, who died on date 4. If such power is not exercised in full, the unappointed portion, or the portion for the living issue of a child of Son who has predeceased Son, shall be distributed to such child's then living issue, per stirpes, and if the child has no such living issue, to Son's then living issue, per stirpes; provided, however, any portion of such principal which would be distributable to any beneficiary for whom a trust is then held hereunder, shall be added to such trust, and subject, if applicable, to the Trust Continuation Provisions of this will.

Trustees request a ruling that Son's exercise of the testamentary power of appointment in favor of Son's spouse for life, then to Son's children for life, and then to Son's grandchildren, not extending beyond the period of perpetuities with respect to the death of Decedent, does not constitute a "constructive addition" to the Residuary Trust, and therefore does not affect the GST tax exempt status of the trust under GST tax regulation § 26.2601-1(b)(3).

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Section 2041(a) provides in part that the value of the gross estate shall include the value of all property--(2) 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. 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 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, in part, that the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors or his estate.

Section 20.2041-1(b)(3)(c) of the Estate Tax Regulations provides that a power of appointment is not a general power of appointment 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 creditor's of his estate.

Section 2601 imposes a tax on every generation-skipping transfer (within the meaning of subchapter B).

Section 26.2601-1(a)(1) of the Generation-Skipping Transfer Tax Regulations provides that except as otherwise provided in § 26.2601, the provisions of chapter 13 of the Internal Revenue Code of 1986 (Code) apply to any generation-skipping transfer (as defined in § 2611) made after October 22, 1986.

Section 26.2601-1(b)(1)(i) provides that the tax does not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii) provides that, except as provided in section 26.2601-1(b)(1)(ii)(B) (Property includible in the gross estate under § 2038) or (C) (Property includible in the gross estate under § 2042), any trust in existence on September 25, 1985, is considered an irrevocable trust.

Section 26.2601-1(b)(3)(i) provides that if an individual was under a mental disability to change the disposition of his or her property continuously from October 22, 1986, until the date of his or her death, the provisions of chapter 13 do not apply to any generation-skipping transfer --(A) Under a trust (as defined in § 2652(b)) to the extent that the trust consists of property, or the proceeds of property, the value of which was included in the gross estate of the individual (other than property transferred by or on behalf of the individual during the individual's life after October 22, 1986); or (B) Which is a direct skip (other than a direct skip from a trust) that occurs by reason of the death of an individual.

Section 26.2601-1(b)(3)(ii) provides that the term "mental disability" means mental incompetence to execute an instrument governing the disposition of the individual's property, whether or not there was an adjudication of incompetence and regardless of whether there has been an appointment of a guardian, fiduciary, or other person charged with the care of the individual or the care of the individual's property.

Section 26.2601-1(b)(3)(iii)(A) provides that if there has not been a court adjudication that the decedent was mentally incompetent on or before October 22, 1986, the executor must file, with Form 706, either--(1) A certification from a qualified physician stating that the decedent was--(i) mentally incompetent at all times on and after October 22, 1986; and (ii) did not regain competence to modify or revoke the terms of the trust or will prior to his or her death; or (2) Sufficient other evidence demonstrating that the decedent was mentally incompetent at all times on and after October 22, 1986, as well as a statement explaining why no certification is available from a physician; and (3) Any judgment or decree relating to the decedent's incompetency that was made after October 22, 1986. Section 26.2601-1(b)(3)(iii)(B) provides that such items will be considered relevant, but not determinative, in establishing the decedent's state of competency.

Section 26.2061-1(b)(3)(iv) provides that if the decedent has been adjudged mentally incompetent on or before October 22, 1986, a copy of the judgment or decree, and any modification thereof, must be filed with the Form 706.

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 26.2611-1 provides that a generation-skipping transfer is an event that is either a direct skip, a taxable distribution, or a taxable termination. The determination as to whether an event is a generation-skipping transfer is made by reference to the most recent transfer subject to the estate or gift tax.

Section 2612(a)(1) provides that the term "taxable termination" means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless--(A) immediately after the termination, a non-skip person has an interest in the property, or (B) at no time after the termination may a distribution (including distributions on termination) be made from the 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). Section 2612(c)(1) provides that

the term "direct skip" means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613(a) provides that the term "skip person" means-- (1) a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or (2) a trust--(A) if all interests in the trust are held by skip persons, or (B) if--(i) there is no person holding an interest in the trust, and (ii) at no time after such transfer may a distribution (including distributions on termination) be made from the trust to a non-skip person.

In this case, Trust is a generation-skipping trust because Trust provides for distributions to persons that are two or more generations below the Decedent's generation. The trustees represent, however, that the Trust is exempt from the GST tax under § 26.2601-1(b)(3), because the Decedent was under a mental disability at all times on and after October 22, 1986, through the date of her death. Whether Decedent was under a mental disability at all times on and after October 22, 1986, is an issue to be determined by the Director District with audit jurisdiction over Decedent's federal estate tax return. Accordingly, this letter does not address that issue.

Based on the information submitted and the representations made, we conclude that if the Decedent was mentally incompetent as of October 22, 1986, within the meaning of § 26.2601-1(b)(3), through Decedent's death on date 4, Son's exercise of the testamentary limited power of appointment in favor of Son's spouse for life, then to Son's children for life, and then to Son's grandchildren, not extending beyond the period of perpetuities stated in Decedent's Will does not constitute a "constructive addition" to the Trust. Therefore, the Son's exercise of the testamentary limited power of appointment does not affect the GST tax exempt status of the Trust under § 26.2601-1(b)(3). If no other actual or constructive additions are made to Trust, Trust will retain its tax exempt status.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions or any other provision of the Code.

This letter 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,

CHRISTINE E. ELLISON  
Christine E. Ellison

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Branch Chief,  
Branch 7  
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