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Person to Contact:

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Legend

Spouse =

a =

b =

Decedent =

Son =

c =

d =

A =

Grandson =

Granddaughter =

e =

f =

g =

h =

i =

Court =

j =

Dear Sir:

In a letter, dated , you requested several rulings concerning the generation-skipping transfer (GST) tax consequences of the exercise of a testamentary special power of appointment. This letter responds to your request.

The facts and representations submitted are summarized as follows: Spouse died testate on a. Spouse's last will and testament is dated b. After certain specific bequests, Article Third, Paragraph (A)(iii) of Spouse's will, directs the trustee to divide Spouse's residuary estate, after the deduction of specified expenses, into two parts: (1) Part A (the Marital Trust),and (2) Part B (the By-Pass Trust).

Article Third, Paragraph (E) of Spouse's will provides that the income of the By-Pass Trust is to be paid quarterly to Decedent during Decedent's lifetime. On Decedent's death, the principal of the By-Pass Trust, and all accumulations thereon, is to be paid to such person or persons as Decedent may by Decedent's will designate by name and description or class from among the following:

(1) Son,

(2) Son's spouse, and

(3) Any or all of the descendants of Son and the spouses of those descendants.

Article Third, Paragraph (E) of Spouse's will further provides that in the event that Decedent dies without exercising the testamentary special power of appointment, the principal of the By-Pass Trust, and all accumulations thereon, is to be paid over absolutely to Son, if he is then living. If Son is not then living, the principal of the By-Pass Trust, and all accumulations thereon, is to be divided equally among such of Spouse's issue, if any, as are then living, *per stirpes* and not *per capita*.

Decedent died testate on c. Decedent's will is dated d. In Paragraph Fourth of Decedent's last will and testament, Decedent exercised the testamentary special power of appointment granted to Decedent under Paragraph Third, Subparagraph (E) of Spouse's will.

Paragraph Fourth of Decedent's will directs that, if Son survives Decedent, Decedent's residuary estate, including any property over which Decedent had a special power of appointment under Spouse's will, is to be divided into two parts: (1) the Exempt Part, and (2) the Non-Exempt Part. The Exempt Part is to consist of an amount equal to the maximum federal GST tax exemption equivalent in Decedent's estate under § 2631 of the Internal Revenue Code, which is not otherwise allocated during Decedent's lifetime or at death. The Non-Exempt Part is to consist of the excess of Decedent's residuary estate over the Exempt Part.

The Exempt Part is to be held in trust for the benefit of Son. The trustees are to distribute all of the net income from the Exempt Part to Son, in quarter-annual or more frequent intervals as the trustees may determine, for the duration of Son's lifetime. In addition, the trustees are to pay over and distribute to Son, so much of the principal as the trustees deem necessary for his needs of health, maintenance, and support.

At any time during Son's lifetime and on Son's death, the trustees are to pay over, transfer, convey, assign and administer upon such estates, in trust or otherwise, in such amounts or share, any part or all of the property then held in trust, to, among, or on behalf of Decedent's grandchildren and their issue, and Son's spouse, A, as Son from time to time directs and appoints by instrument executed during his lifetime or under his last will and testament. The exercise of the special power of appointment, whether during Son's lifetime or by his will, is to refer specifically to the special power of appointment granted under the Exempt Part.

On Son's death, the remaining unappointed trust estate is to be paid over and distributed in accordance with the terms and conditions of Paragraph Fifth of Decedent's will.

The Non-Exempt Part is to pass to Son, if surviving, outright and free of trust. In the event Son is not surviving, then the property in the Non-Exempt Part is to pass to Son's issue, in equal shares *per stirpes*, subject to the provisions of Paragraph Eighth of Decedent's will.

Paragraph Fifth of Decedent's will provides that on Son's death, the remaining trust estate under Subparagraph (A), or in the event Son predeceases Decedent, Decedent's residuary estate, as the case may be, is to be divided into two equal shares: (1) one share to be held for Grandson, or his issue, collectively, if he is not surviving, and (2) one share to be held for Granddaughter, or her issue, collectively, if she is not surviving; provided, however, that if either grandchild is not then surviving, and if the deceased grandchild leaves no issue then surviving, then the deceased grandchild's share is to be held under the provisions of Paragraph Fifth for the benefit of the surviving grandchild, or his or her respective issue, collectively, if he or she is not surviving.

Paragraph Eighth of Decedent's will provides that if any legatee or distributee under the will has not attained the age of 21 years at the time specified for the outright distribution of his or her share, then and in such event, notwithstanding such direction, the distribution of the beneficiary's share is to be postponed and the beneficiary's parent or guardian is to hold the same in trust until the beneficiary attains the age of 21 years. Until that time, the parent or guardian is to apply so much of the net income, and if that is not sufficient, so much of the principal, as the parent or guardian deems to be necessary to meet the beneficiary's needs of health, maintenance, support, and education, and is to accumulate any income not so applied. The principal and accumulated income, if any, is nevertheless to vest in interest in the beneficiary and is to be distributed to the beneficiary upon his or her attaining the age of 21 years; or in the event of his or her death prior thereto, is to be distributed to his or her surviving issue, *per stirpes*, and if there be no issue, to his or her brothers or sisters, if any, in equal shares, otherwise to Decedent's surviving issue, *per stirpes*. In any event, the parent or guardian is to make the final distribution of principal and accumulated income no later than 21 years after the last to die of Spouse and Decedent's issue who are surviving at the time of Decedent's death.

Son, as a beneficiary and sole executor of the last will and testament of Decedent, petitioned Court for the clarification of certain language contained within Decedent's will and a certain trust established under Decedent's will. On j, Court ruled as follows:

1. The second sentence of Paragraph Fourth of Decedent's will (which provided for the funding for the Exempt Part and the Non-Exempt Part) was stricken in its entirety and in its place, the following sentence was inserted:

> The Exempt Part shall consist of: (a) all of the assets of the trust designated as "Part B" under the Last Will and Testament of Spouse over which I, Decedent, was granted a special power of appointment, which power I have exercised under the provisions of this Paragraph Fourth, plus, (b) an amount equal to the maximum federal generation skipping transfer tax exemption equivalent in my estate under § 2631 of the Internal Revenue Code, or such other section of like import, which is not otherwise allocated during my lifetime or at my death.

2. Subparagraph (A)(3) of Paragraph Fourth of Decedent's will (which granted Son a special power of appointment over the assets of the Exempt Part) was stricken in its entirety and in its place the following was inserted:

> At any time or times during the lifetime of Son and upon the death of Son, the trustees shall pay over, transfer, convey, assign and administer upon such estates, in trust or otherwise, in such amounts or shares, any part or all of the property then in trust, to, among, or on behalf of my grandchild,

> Grandson, and his issue, and my grandchild, Granddaughter and her issue, and Son's spouse, A, as Son shall from time to time direct and appoint by an instrument executed during the lifetime of Son, ... ; provided, the vesting, absolute ownership, or power of alienation of an interest in the appointed property passing in trust or otherwise shall not be postponed or suspended beyond 21 years after the last to die of Son, Grandson, and Granddaughter. ... .

3. The perpetuities savings clause in the last sentence of Paragraph Eighth of Decedent's will (which provided for the final distribution of principal and accumulated income no later then 21 years after the last to die of Spouse and Decedent's issue living at the time of Decedent's death) was stricken in its entirety and in its place the following was inserted:

> In any event, such parent or guardian shall make the final distribution of principal and accumulated income no later than 21 years after the last to die of Son, Grandson, and Granddaughter.

It is represented that the By-Pass Trust created under Spouse's will was irrevocable on September 25, 1985, and there have been no additions to it since that date. It is also represented that at the time of Decedent's death, Decedent had not allocated any of Decedent's available GST tax exemption.

You have requested the following rulings:

1. The By-Pass Trust created under Spouse's will is exempt from the GST tax because it became irrevocable on or before September 25, 1985, and no additions (actual or constructive) have been made to it since that date.

2. The exercise of Decedent's testamentary special power of appointment to appoint the assets of the By-Pass Trust to the Exempt Part will not be considered a constructive addition to the By-Pass Trust for purposes of the GST tax.

3. If the Exempt Part is funded with (i) all of the assets passing pursuant to Decedent's will (net of federal estate tax and other expenses) limited by the available GST tax exemption; and (ii) all of the assets of the By-Pass Trust (as a result of the exercise of Decedent's special power of appointment), the Exempt Part will have an inclusion ratio of zero for purposes of the GST tax.

Section 2601 imposes a tax on every generation-skipping transfer made by the "transferor" to a "skip-person."

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that the provisions of chapter 13 do 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 § 26.2601-1(b)(1)(ii)(B) or (C), any trust (as defined in § 2652(b)) in existence on September 25, 1985, is considered an irrevocable trust.

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)) is not treated as an addition to a 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, 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 plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of § 26.2601-1(b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership, or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership, or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

Section 2631 provides that for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of $1,000,000 that may be allocated by that individual (or his executor) to any property with respect to which the individual is the transferor. An allocation under § 2631(a), once made, is irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for the individual's estate (determined without regard to extensions), regardless of whether the return is required to be filed.

Section 2641(a) provides that for purposes of chapter 13, the term "applicable rate means, with respect to any generation-skipping transfer the product of–-

(1) the maximum federal estate tax rate, and

(2) the inclusion ratio with respect to the transfer.

Section 2642(a)(1) provides that for purposes of chapter 13, except as otherwise provided in § 2642, the inclusion ratio with respect to any property transferred in a generation-skipping transfer is the excess (if any) of 1 over—

(A) except as provided in subparagraph (B), the applicable fraction determined for the trust from which the transfer is made, or

(B) in the case of a direct skip, the applicable fraction determined for the skip.

Section 2642(a)(2) provides that for purposes of § 2642(a)(1), the applicable fraction is a fraction—

(A) the numerator of which is the amount of the GST exemption allocated to the trust (or in the case of a direct skip, allocated to the property transferred in the skip), and

(B) the denominator of which is—

(i) the value of the property transferred to the trust (or involved in the direct skip), reduced by

(ii) the sum of—

(I) any federal estate tax or state death tax actually recovered from the trust attributable to the property, and

(II) any charitable deduction allowed under § 2055 or 2522 with respect to the property.

Section 2652(a)(1) provides that except as provided in this subsection or § 2653(a), the term “transferor” means—

(A) in the case of any property subject to the tax imposed by chapter 11, the decedent, and

(B) in the case of any property subject to the tax imposed by chapter 12 the donor.

An individual shall be treated as transferring any property with respect to which the individual is the transferor.

Section 26.2652-1(a)(1) provides that except as otherwise provided in

§ 26.2652-1(a)(3), the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13. An individual is treated as transferring any property with respect to which the individual is the transferor. Thus, a person may be a transferor even though there is no transfer of property under local law at the time the federal estate or gift tax applies.

Section 26.2654-1(a)(2)(i) provides that if there is more than one transferor with respect to a trust, the portions of the trust attributable to the different transferors are treated as separate trusts for purposes of chapter 13. Treatment of a single trust as separate trusts under this paragraph (a)(2) does not permit treatment of those portions as separate trusts for purposes of filing of returns and payment of tax for purposes of computing any other tax imposed under the Internal Revenue Code. Also, additions to, and distributions from, such trusts are allocated pro rata among the separate trusts unless otherwise expressly provided in the governing instrument.

Section 26.2654-1(a)(2)(ii) provides that if an individual makes an addition to a trust of which the individual is not the sole transferor, the portion of the single trust attributable to each separate trust is determined by multiplying the fair market value of the single trust immediately after the contribution by a fraction. The numerator of the fraction is the value of the separate trust immediately after the contribution. The denominator of the fraction is the fair market value of all the property in the single trust immediately after the transfer.

Based on the information submitted and the representations made, we conclude as follows:

1. The By-Pass Trust created under Spouse's will is exempt from the GST tax because it became irrevocable on or before September 25, 1985, and no additions (actual or constructive) have been made to it since that date.

2. The exercise of Decedent's testamentary special power of appointment to appoint the assets of the By-Pass Trust to the Exempt Part will not postpone or suspend vesting, absolute ownership, or power of alienation of an interest in property for a period measured from the date of the creation of the By-Pass Trust, extending beyond any life in being at the date of the creation of the By-Pass Trust plus a period of 21 years. Therefore, we conclude that Decedent's exercise of the testamentary special power of appointment is not treated as an addition to the By-Pass Trust pursuant to § 26.2601-1(b)(1)(v)(B).

3. Spouse is the transferor for GST tax purposes of the portion of the Exempt Part attributable to the assets of the By-Pass Trust. Decedent is the transferor for GST tax purposes of the portion of the Exempt Part attributable to the assets from Decedent's estate. The portion of the Exempt Part for which Spouse is the transferor

and the portion of the Exempt Part for which Decedent is the transferor are treated as separate trusts for GST tax purposes pursuant to § 26.2654-1(a)(2).

The portion of Exempt Part consisting of the trust for which Spouse is the transferor is exempt from the GST tax. Therefore, provided distributions from the Exempt Part are allocated pro rata between the two separate trusts, distributions from and terminations with respect to the portion of the Exempt Part for which Spouse is the transferor will be exempt from the GST tax.

If the portion of the Exempt Part for which Decedent is the transferor is funded with all of the assets passing pursuant to Decedent's will (net of federal estate tax and other expenses) limited by the available GST tax exemption, the portion of the assets of the Exempt Part for which Decedent is the transferor will have an inclusion ratio of zero. Therefore, provided distributions from the Exempt part are allocated pro rata between the trust for which Decedent is the transferor and the trust for which Spouse is the transferor, distributions from and terminations with respect to the portion of the Exempt Part for which Decedent is the transferor will be exempt from the GST tax.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter under the cited provisions or any other provision of the Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely yours,

Christine E. Ellison

Christine E. Ellison
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Office of Assistant Chief Counsel
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