

Number: **200637025**  
Release Date: 9/15/2006  
**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Index Number: 671.00-00, 2501.00-00,  
2501.01-01

Third Party Communication: None  
Date of Communication: Not Applicable

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, ID No.

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Refer Reply To:  
CC:PSI:B01  
PLR-155267-05  
Date: June 5, 2005

Legend

A =

B =

C =

Trust =

State1 =

State2 =

Foundations =

Dear :

This responds to a letter dated October 28, 2005, submitted on behalf of A, A's father B, and A's brother C by their authorized representative, requesting rulings under §§ 671 and 2501 of the Internal Revenue Code.

FACTS

According to the information submitted, on D1, A, a resident of State1, executed Trust, which is governed by the laws of State2. A State2 corporate trustee is appointed as trustee.

Article 4.1 of Trust provides that during the lifetime of A, the trustee shall pay over or apply such sums of net income and principal, including all or none thereof, as (a) the Distribution Committee by unanimous agreement shall appoint, or (b) A and one member of the Distribution Committee by unanimous agreement shall appoint, to or for the benefit of one or more members of the "Class." The "Class" is defined in Article 3.3 as consisting of A, A's spouse (if and when A marries), A's father B, A's mother, any descendant's of A's father or mother, including A's descendants, A's brother C, any descendants of C, and any Qualified Charity (defined as an organization described in §§ 170(c), 2055(a) and 2522(a)). Any net income not so paid over or applied shall be accumulated and added to the principal of Trust at least annually and thereafter shall be held, administered and disposed of as a part of the Trust corpus.

Article 4.2 provides that upon the death of A, the residue of the Trust, after providing for payment of estate taxes, is to be distributed in accordance with A's exercise of a limited testamentary power to appoint the Trust property. A may exercise the power in any valid manner provided that: (a) the power may not be exercised in favor of A, A's estate, A's creditors or the creditors of A's estate; and (b) A must expressly refer to and exercise the power in a valid will or codicil in order for the appointment to be effective. A may, at any time and from time to time during A's life, by a written, acknowledged instrument delivered to the trustee, release the power of appointment with respect to any or all of the property subject to the power or may further limit the persons or entities in whose favor or the extent to which the power may be exercised.

Trust provides that if, or to the extent that, A does not effectively exercise A's power of appointment, the residue of Trust is to be distributed as follows: (a) if B and C survive A, then one half to each of them outright and free of trust, or 100% to the survivor; or (b) if neither B nor C survive A, then to A's descendants who survive A, per stirpes. If none of A's descendants are then living, then the residue is to be distributed to Foundations in a specified order, or if none of the Foundations are then in existence, to Qualified Charities to be selected by the trustee.

Article 8.1 provides that the Distribution Committee shall initially consist of B and C. During A's lifetime, there shall always be two members of the Distribution Committee, each of whom must be an adult member of the Class; provided that (1) neither A nor A's spouse may be a member of the Distribution Committee; and (2) if there are less than two competent adult individual members of the Class, a parent or guardian (other than A or A's spouse) of any member of the Class who is a minor or not a competent adult may serve as a member of the Distribution Committee. In the event that either B or C predeceases A, then A's oldest living descendant who is not a

member of the Distribution Committee shall become the successor member of the Distribution Committee. If no living descendant of A is able to serve, the surviving member of the Distribution Committee is to appoint a successor. Neither A nor any member of the Distribution Committee shall exercise the powers of appointment granted under Article 4 in a fiduciary capacity and none of them shall be deemed to be a fiduciary owing any fiduciary duties to themselves or any other person.

The following rulings have been requested:

1. So long as the Distribution Committee is serving, no portion of the items of income, deductions, and credits against tax of Trust shall be included in computing the taxable income, deductions, and credits of A under § 671.
2. The contribution of property to Trust by A will not be a completed gift subject to federal gift tax.
3. Any distribution of property from Trust to A by the Distribution Committee will not be a completed gift subject to federal gift tax.

#### Ruling 1

Section 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 672(a) provides, for purposes of subpart E, the term “adverse party” means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust.

Section 673 through 677 specify the circumstances under which the grantor is treated as the owner of a portion of a trust.

Section 673(a) provides that the grantor shall be treated as the owner of any portion of a trust in which the grantor has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the

income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(b)(3) provides that § 674(a) shall not apply to a power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Under § 675 and applicable regulations, the grantor is treated as the owner of any portion of a trust if, under the terms of the trust agreement or circumstances attendant to its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiary of the trust.

Section 676(a) provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of part I, subchapter J, chapter 1, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

Section 677(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Based solely on the facts and representations submitted, we conclude an examination of Trust reveals none of the circumstances that would cause A to be treated as the owner of any portion of Trust under §§ 673, 674, 676, or 677.

We further conclude that an examination of Trust reveals none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of A under § 675. Thus, the circumstances attendant on the operation of Trust will determine whether A will be treated as the owner of any portion of Trust under § 675. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office with responsibility for such examination.

### RULINGS 2 AND 3

Section 2501(a)(1) provides for the imposition of a gift tax on the transfer of property by gift. Section 2511(a) provides that the gift tax applies to a transfer by way of

gift 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 25.2511-2(b) of the Gift Tax Regulations provides that a gift is complete as to any property with respect to which the donor so parted with dominion and control as to leave the donor with no power to change the disposition of the property, whether for the donor's own benefit, or for the benefit of another. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

Section 25.2511-2(b) provides an example where the donor transfers property in trust to pay the income to the donor, or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among the donor's descendants. The regulation concludes that no portion of the transfer is a completed gift. However, if the donor had not retained a testamentary power of appointment, but had instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift.

Section 25.2511-2(f) provides that the relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by death of the donor, is regarded as the event which completes the gift and causes the gift tax to apply. See also, Estate of Sanford v. Commissioner, 308 U.S. 39 (1939).

Section 2514(b) provides that, in the case of a power of appointment created after October 21, 1942, the exercise or release of the general power of appointment shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that the term "general power of appointment" means a power exercisable in favor of the individual possessing the power, the individual's estate, the individual's creditors, or the creditors of the individual's estate.

Section 25.2514-1(c)(1) provides that a power of appointment is not a general power if by its terms it is exercisable only in favor of one or more designated persons or classes other than the possessor or his creditors, or the possessor's estate or the creditors of the estate.

Section 2514(c)(3)(B) provides that, in the case of a power of appointment created after October 21, 1942, which is exercisable by the possessor only in conjunction with another person, if the power is not exercisable by the possessor except in conjunction with a person having a substantial interest in the property subject to the power, which is adverse to the exercise of the power in favor of the possessor, then the

power is not a general power of appointment. For purposes of § 2514(c)(3)(B), a person who, after the death of the possessor, may be possessed of a power of appointment (with respect to the property subject to the possessor's power) which he may exercise in his own favor shall be deemed as having an interest in the property and such interest shall be deemed adverse to such exercise of the possessor's power.

Section 25.2514-3(b)(2) provides that a co-holder of a power of appointment has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a coholder of a power is considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. Thus, for example, if X, Y, and Z held a power jointly to appoint among a group of persons which includes themselves and if on the death of X the power will pass to Y and Z jointly, then Y and Z are considered to have interests adverse to the exercise of the power in favor of X. Similarly, if on Y's death the power will pass to Z, Z is considered to have an interest adverse to the exercise of the power in favor of Y.

Section 25.2514-1(b)(2) provides that the term "power of appointment" does not include the powers reserved by a donor to himself or herself. However, no provision of § 2514 or the applicable regulations is to be construed as limiting the application of any other Code section or provision of the regulations.

In this case, A has retained a limited testamentary power to appoint the Trust corpus and accumulated income to any persons (other than A's estate, etc.). In view of this retained power, A's transfer of property to Trust will not be a completed gift subject to federal gift tax. See § 25.2511-2(b).

In addition, B and C, as members of the Distribution Committee, have the power to distribute Trust income and corpus to themselves. However, B's power can only be exercised with the consent of C, or with the consent of A, and C's power can only be exercised with the consent of B, or with the consent of A. Further, on the death of either B or C, the deceased's power will devolve to the surviving Committee member and A jointly (and a new committee member will be appointed). Therefore, B and C will not have a general power of appointment by reason of the joint distribution power. See § 25.2514-3(b)(2). Accordingly, during the period the Distribution Committee consists of B and C, neither B nor C will be treated as making a taxable gift if Trust income or corpus is distributed to A under the terms of Trust.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of the facts described above under any other provision of the Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) 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 taxpayers' authorized representative.

Sincerely,

Audrey W. Ellis  
Senior Counsel, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter  
Copy for section 6110 purposes