Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-124679-04

Date:
September 17, 2004

X =

Y =

Z =

Trust =

State 1 =

State 2 =

Dear :

This letter responds to your letter dated April 27, 2004, submitted on behalf of X, Y, and Z as their authorized representative, requesting rulings under §§ 671 and 2501 of the Internal Revenue Code.

The information submitted states that X, a resident of State 1, proposes to execute Trust, which will be governed by the laws of State 2 and will have a State 2 corporate trustee. Y is a sibling of X, and Z is a parent of X.

Paragraph 2.1 of Trust provides that during the lifetime of X, any property that is directed to be held in accordance with the terms and conditions set forth in Article 2 shall be held by the Trustee, in trust, nevertheless, in a separate trust for the following uses and purposes: To manage, invest and reinvest the same, to collect the income thereof, and to pay over or apply the net income and principal thereof to such extent, if any, including the whole thereof, and in such amounts and proportions, including all to one to the exclusion of the others, and at such time or times as (a) the Distribution Committee by unanimous agreement shall appoint, or (b) X and one member of the Distribution Committee by unanimous agreement shall appoint, to or for the benefit of such one or more members of the class consisting of X, X's current spouse, X's descendants, Y, and Z, until the death of X. Any net income (which may be the whole of such income) not so paid over or applied shall be accumulated and added to the principal of the trust at least annually and thereafter shall be held, administered and disposed of as a part thereof.

Paragraph 2.2 provides that upon the death of X, the principal of the Trust under Paragraph 2.1 of Article 2, as it is then constituted, and any accumulated accrued and undistributed income, shall be transferred, conveyed and paid over to such person or persons (other than X, X's estate, X's creditors and the creditors of X's estate) to such extent, in such amount or proportions, and in such lawful interests or estates, whether absolute or in trust, as X may appoint by Last Will and Testament by specific reference to this power. X may, at any time and from time to time during X's life by a written, acknowledged instrument delivered to the Trustee, release such power of appointment with respect to any or all of the property subject to such power or may further limit the persons or entities in whose favor or the extent to which this power may be exercised.

If the power of appointment is for any reason not effectively exercised in whole or in part, by X, the principal of Trust, as it is then constituted, to the extent not effectively appointed by X upon X's death, (a) shall be transferred, conveyed and paid over in equal shares to such of Y and Z who are then living, or if neither is then living, (b) shall be divided into a sufficient number of equal shares so that there shall be set aside one such share for each child of X who is then living and one such share for the collective descendants who are then living of any child of X who is not then living. From each such share so set aside for the collective descendants who are then living of any child of X who is not then living there shall be set aside per stirpital parts for such descendants. Each child who is then living for whom a share is set aside and each descendant who is then living of a child of X who is not then living for whom a per stirpital part is set aside is herein referred to as a "primary beneficiary." The share or part of a share so set aside for a primary beneficiary shall be held in a separate trust in accordance with the terms and conditions set forth in Article Third. If none of Y, Z, and the descendants of X is then living, the principal of the trust, as it is then constituted, and any accumulated, accrued and undistributed income to the extent not effectively appointed by X, shall be disposed of in accordance with the terms and conditions set forth in Article Fourth.

Article Fourth provides that any property that is directed to be disposed of in accordance with the terms and conditions set forth in Article Fourth shall be transferred, conveyed, and paid over to Y, if Y is still living, or if Y is not then living, the descendants of Y who are living, per stirpes, or, if no descendant of Y is then living, to such one or more organizations described in and meeting the requirements of §§ 170(c), 2055(a), and 2522(a), as the Trustee, in exercise of sole and absolute discretion, shall select, in such amounts and proportions, including all to one to the exclusion of the others, as the Trustee, in the exercise of sole and absolute discretion, shall determine.

Paragraph 12.4 provides that the Distribution Committee shall initially consist of Y and Z. At all times, at least two persons who are beneficiaries under Trust (other than X, X's current spouse or any successor spouse of X), or who are parents or guardians of such beneficiaries if there are less than two adult beneficiaries, shall be members of the Distribution Committee. In the event that either Y or Z shall die before the death of X, X's then eldest living descendant shall become the successor member of the Distribution Committee. If any additional member of the Distribution Committee dies before the death of X, the then eldest living descendant of X who is not a member of the Distribution Committee shall become the successor member of the Distribution Committee. Any member of the Distribution Committee shall exercise the power of appointment granted under Article Second only in a non-fiduciary capacity and shall manifest any exercise of the power of appointment granted under Article Second by an acknowledged instrument in writing delivered to the Trustee.

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.

Sections 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 on 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 the Trust reveals none of the circumstances that would cause X to be treated as the owner of any portion of the 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 X under § 675. Thus, the circumstances attendant on the operation of Trust will determine whether the Taxpayer 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(c) of the Gift Tax Regulations provides that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title in himself or herself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

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.

Section 2514(b) provides that the exercise or release of a 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 -- such power shall not be deemed a general power of appointment. For purposes of section 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, in part, that a coholder 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 25.2514-3(c)(1) provides that the general principles set forth in section 25.2511-2 for determining whether a donor of property (or of a property right or interest) has divested himself or herself of all or any portion of an interest therein to the extent necessary to effect a completed gift are applicable in determining whether a partial release of a power of appointment constitutes a taxable gift. Thus, if a general power of appointment is partially released so that thereafter the donor may still appoint among a limited class of persons not including himself or herself, the partial release does not effect a completed gift. Under these circumstances, the possessor of the power has retained the right to designate the ultimate beneficiaries of the property over which he or she holds the power. Since it is only the termination of such control which completes the gift under section 25.2511-2, the partial release is not subject to gift tax under § 2514.

In Estate of Sanford v. Commissioner, 308 U.S. 39 (1939), the taxpayer created a trust for the benefit of named beneficiaries and reserved the power to revoke the trust in whole or in part, and to designate new beneficiaries other than himself. Six years later, in 1919, the taxpayer relinquished his power to revoke the trust. However, the taxpayer continued to retain his right to change the beneficiaries. In 1924, the taxpayer relinquished his right to change the beneficiaries. The Court held that a donor's gift is not complete, for purposes of the gift tax, when the donor has reserved the power to determine those others who would ultimately receive the property. Accordingly, the Court concluded that the taxpayer's gift was complete in 1924, when he relinquished his right to change the beneficiaries of the trust.

Under § 2514, only the exercise or release of a general power of appointment (rather than a limited power of appointment) is subject to gift tax. However, when a person transfers property and retains a limited power to appoint the property to others, the person's retention of the limited power of appointment is a retention of dominion and control over the transferred property, for purposes of the gift tax. Consequently, under those circumstances, the person's exercise or relinquishment of the limited power of appointment is subject to the gift tax under § 2511.

In this case, by reason of his limited power of appointment, X has retained the power to change the beneficiaries of Trust. X continues to possess dominion and control over the property transferred to the Trust. Accordingly, based on the facts submitted and representations made, we conclude that the contribution of property to the trust by X will not be a completed gift subject to the federal gift tax.

Moreover, the members of the Distribution Committee do not have a general power of appointment because their powers can only be exercised if both consent to a proposed distribution. Because the members of the Distribution Committee have a non-general power of appointment, any distribution of Trust principal or income to X does not trigger a taxable gift. Furthermore, X's initial transfer of property to Trust was incomplete because he retained a testamentary limited power of appointment. Thus, the return of that property to X does not trigger a taxable gift. However, when the Distribution Committee appoints Trust property to a beneficiary other than X, or if, during X's lifetime, X releases the testamentary power to appoint the Trust property, the gifts will be complete. Accordingly, based on the facts submitted and representations made, we conclude that any distribution of property from the Trust back to X by the Distribution Committee will not be a completed gift subject to the federal gift tax.

Except as specifically set forth above, no opinion is expressed 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 requesting it. Section 6110(k)(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 taxpayers' authorized representative.

Sincerely,

J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes