

# New PLR Addresses Special Trustee's Power to Limit or Eliminate Testamentary General Power of Appointment



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IRS Rules Appointment of Special Trustee and Special Trustee's Subsequent Exercise of Power to Limit or Eliminate Trust Beneficiary's Testamentary General Power of Appointment Will Not Constitute Exercise or Release for Purposes § 2514 or § 2041 of the Code

The IRS recently issued a [private letter ruling](#), which we anticipate will be available for public inspection on November 9, 2018, addressing key issues with respect to an independent special trustee's power under a trust instrument to limit or eliminate a testamentary power of appointment granted in favor of the primary trust beneficiary (the "Primary Beneficiary"). Perhaps the most significant impact of this private letter ruling is the IRS's acknowledgement that a testamentary general power of appointment is not considered to be exercisable during the lifetime of the powerholder.

The trust agreement at issue gave the Primary Beneficiary a testamentary power of appointment over certain trust property, and the language read as follows:

Any part, or all, of the then remaining principal of the Trust Estate, together with any accrued and undistributed income therefrom, shall be paid over, conveyed and distributed to [his or her] creditors or the creditors of [his or her] estate or such appointee or appointees among those of [the Primary Beneficiary's] lineal descendants who are living at the death of [the Primary Beneficiary] in such manner and in such proportions as [he or she] may appoint **in and by [his or her] Last Will and Testament**, but subject to the terms and conditions hereinafter provided . . . .

The trust agreement also granted certain powers to a non-beneficiary trustee of the trust, including the following powers:

- to create in a lineal descendant of the Grantor a testamentary general power of appointment within the meaning of IRC § 2041 [including the power the exercise of which requires the consent of the Trustee (other than any beneficiary)];
- to limit a general power of appointment of a lineal descendant of the Grantor, as to all or part of such principal at any time prior to the death of such lineal descendant by narrowing the class to whom the powerholder may appoint the property subject to such appointment, so as to convert such power into a special power of appointment; and
- to eliminate such power for all or any part of such principal as to which such power was previously created.

Because no non-beneficiary was serving as trustee of the trust, in connection with the request for a private letter ruling, it was necessary for the trust to be judicially modified to provide a method for appointing an independent special trustee who would have the authority to exercise the foregoing powers. The taxpayer had some concern that the IRS might raise an issue regarding the Primary Beneficiary's consent to the judicial modification, which put a non-beneficiary in the position to be able to exercise such powers. However, because (i) the testamentary power of appointment is not currently exercisable by the Primary Beneficiary, (ii) the trust modification did not change or transfer the interests of the Primary Beneficiary during the Primary Beneficiary's lifetime (i.e., the Primary Beneficiary retained the same interest in the trust both before and after the trust modification), and (iii) the trust modification did not confer any new rights to any beneficiaries, the IRS ruled that the independent special trustee's acceptance and appointment to the office of special trustee (pursuant to the state court order modifying the trust (the "Order")) did not constitute the exercise or release of a general power of appointment under § 2514 so as to constitute a gift by the Primary Beneficiary for federal gift tax purposes.

The [private letter ruling](#) is particularly interesting in light of the fact that certain trust assets that would otherwise be included in the Primary Beneficiary's gross estate (absent any action by the special trustee) may now be excluded from the Primary Beneficiary's gross estate if the special trustee exercises its power to limit or eliminate the Primary Beneficiary's testamentary power of appointment.

Property subject to a power of appointment created after October 21, 1942, is includable in the gross estate of the holder of the power under varying conditions depending on whether the power is (i) general in nature, (ii) possessed at death, or (iii) exercised or released.<sup>[1]</sup> The term "general power of appointment" as defined in § 2041(b)(1) means any power of appointment exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.<sup>[2]</sup> For purposes of determining whether the decedent possessed a power of appointment at death under § 2041, a distinction is drawn in Treas. Reg. § 20.2041-3(b) between: (1) powers that are subject to a precedent giving of notice or that are effective only after a stated period of time after they are exercised; and (2) powers that are exercisable only upon the occurrence of certain future events that did not in fact occur before the decedent's death. A power of appointment is considered to exist on the date of the decedent's death even though the exercise of the power is subject to a requirement of giving notice, or the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the decedent's death notice has been given or the power has been exercised.<sup>[3]</sup> However, a power does not exist on the date of the decedent's death, if, by its terms, it is exercisable only upon the occurrence of an event or a contingency during the decedent's lifetime that did not take place during his or her lifetime. A restriction on exercising a power based upon the power holder reaching a certain age, surviving another person, or having descendants are examples of these types of events, contingencies, or conditions precedent.<sup>[4]</sup>

A release occurs where a power holder voluntarily forfeits all or part of a power. A post-October 21, 1942 general power released by a decedent at the time of his or her death is subject to estate tax. Moreover, under § 2041(a)(2), a post-October 21, 1942 power released by a power holder during his or her lifetime is subject to estate tax upon his or her death if the release is of such a nature that, if it were a transfer of property owned by the decedent, the property would be includable in the decedent's estate under § 2035 to § 2038. This treatment of releases is consistent with the statutory approach that a post-October 21, 1942 general power is a taxable power if it is possessed by the decedent at the time of his or her death, whether exercised or not, or if it has been exercised in a manner that would fall within § 2035 to § 2038.<sup>[5]</sup> A release can have the same effect as a failure to exercise as far as takers in default of appointment are concerned. A failure to act or release may lead to the same result and, therefore, should be accorded consistent treatment. A release of a power of appointment need not be formal or express in character.

As set forth above, the original trust agreement in the present case granted the Primary Beneficiary a general power of appointment over certain trust property, exercisable in favor of the Primary Beneficiary's creditors or creditors of the Primary Beneficiary's estate, which would result in such trust

property being included in the Primary Beneficiary's gross estate in absence of any action on the part of the special trustee.

The trust agreement also specifically gave an independent trustee the authority to (1) limit a general power of appointment so as to convert such power into a special power of appointment and (2) to eliminate a general power of appointment. As a result, the taxpayer noted that the Primary Beneficiary's testamentary power of appointment in this case is subject to being withdrawn by an independent trustee without the Primary Beneficiary's consent before the power of appointment ever becomes exercisable. In support of this position, the taxpayer cited Arkansas law, which provides that an individual's Last Will and Testament is revocable at any time during his or her lifetime,<sup>[6]</sup> and a decedent's Last Will and Testament is not effectual until it has been admitted to probate.<sup>[7]</sup> As a result, the taxpayer concluded that it was not possible for the Primary Beneficiary to exercise the testamentary power of appointment at issue prior to the Primary Beneficiary's death. Furthermore, the taxpayer argued, an invalid attempt to exercise a power of appointment is not effective for purposes of § 2041.<sup>[8]</sup>

The IRS accepted the taxpayer's position that the power of appointment set forth in the trust agreement is conditioned upon the Primary Beneficiary dying before an independent trustee limits or eliminates the power of appointment granted to the Primary Beneficiary and that the event permitting the exercise of the testamentary power of appointment is not within the Primary Beneficiary's control because the special trustee appointed pursuant to the Order was not "related or subordinate," as contemplated by § 672(c), to the Primary Beneficiary.

The result of this [ruling](#) is that if the independent trustee were to exercise its discretionary power under the trust agreement to eliminate the Primary Beneficiary's testamentary power of appointment, then such power of appointment would not exist upon the Primary Beneficiary's death, and the trust assets would not be included in the Primary Beneficiary's gross estate. Furthermore, no lapse or release of such power of appointment occurs under § 2041(a)(2) upon the special trustee's exercise of its power to limit or eliminate the testamentary power of appointment as a result of the Primary Beneficiary's failure to act on the power of appointment because it never became exercisable.

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<sup>[1]</sup> Treas. Regs. § 20.2041-3(a)(1).

<sup>[2]</sup> Treas. Regs. § 20.2041-1(c)(1).

<sup>[3]</sup> I.R.C. § 2041(a)(2).

<sup>[4]</sup> Treas. Regs. § 20.2041-3(b).

<sup>[5]</sup> I.R.C. § 2041(a)(2).

<sup>[6]</sup> See, e.g., *Heirs of Goza v. Estate of Potts*, 2010 Ark. App. 149, 374 S.W.3d 132 (Ark. App. 2010).

<sup>[7]</sup> Ark. Code Ann. § 28-40-104(a).

<sup>[8]</sup> See *Estate of Minot v. Commissioner*, 45 T.C. 578 (1966).