No. 10-363

In the Supreme Court of the United States

ESTATE OF LOUISE BLYTH TIMKEN, DECEASED, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether 26 C.F.R. 26.2601-1(b)(1)(v)(A), which provides that certain generation-skipping transfers effected by the exercise, release, or lapse of general powers of appointment are taxable, constitutes a valid exercise of the Department of the Treasury's rulemaking authority.

2. Whether 26 C.F.R. 26.2601-1(b)(1)(v)(A) applies in the circumstances of this case.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is reported at 601 F.3d 431. The opinion of the district court (Pet. App. 19a-44a) is reported at 630 F. Supp. 2d 823.

JURISDICTION

The judgment of the court of appeals was entered on April 2, 2010. A petition for rehearing was denied on June 16, 2010 (Pet. App. 47a-48a). The petition for a writ of certiorari was filed on September 14, 2010. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. As part of its comprehensive overhaul of federal tax laws in 1986, Congress enacted statutory provisions that impose a generation-skipping transfer (GST) tax on transfers of property to persons (such as great-nieces and great-nephews) who are at least two generations below the transferor. Tax Reform Act of 1986 (Tax Reform Act), Pub. L. No. 99-514, § 1431, 100 Stat. 2717 (26 U.S.C. 2601 *et seq.*). Those provisions were designed "to ensure taxation of generation skipping transfers in a comparable manner to outright transfers from one generation to the next, and to remove the estate planning tool of escaping taxation by skipping a generation in an estate transfer." *Comerica Bank, N.A.* v. *United States*, 93 F.3d 225, 228 (6th Cir. 1996).

The GST tax applies to "every" generation-skipping transfer. 26 U.S.C. 2601. As is relevant here, however, Congress excepted "any generation-skipping transfer under a trust which was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985." Tax Reform Act § 1433(b)(2)(A), 100 Stat. 2731. The issue in this case is whether that statutory exception applies to generation-skipping transfers resulting from the lapse of a testamentary general power of appointment that occurred after September 25, 1985, where the general power of appointment was conferred by a trust that had become irrevocable before that date.

In 1995, the Department of the Treasury, acting pursuant to a specific grant of rulemaking authority, see 26 U.S.C. 2663, promulgated a final regulation addressing that issue. That regulation—26 C.F.R. 26.2601-1(b)(1)(v)(A) (1996)—excludes from the statutory exemption generation-skipping transfers resulting from a

post-September 25, 1985 release, exercise, or lapse of a power of appointment over all or part of a trust corpus to the extent that the release, exercise, or lapse is treated as a taxable transfer under the estate or gift tax. The regulation explains that the portion of the trust that is subject to the power of appointment that is released, exercised, or lapsed "is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse." *Ibid.* Therefore, if the appointment power is released, exercised, or lapsed after September 25, 1985, there has been a "constructive addition" to the corpus of the trust after the qualifying date specified in the grandfather exemption, and the exemption is inapplicable. See Tax Reform Act § 1433(b)(2)(A), 100 Stat. 2731.

The regulation contains an illustration of the tax consequences in a case where a husband, before the effective date of the GST tax, has established an irrevocable trust with a life estate in the income to his wife, who is also given a general power of appointment over half of the trust assets. If the wife dies after the effective date of the GST tax and fails to exercise her general power of appointment, "the lapse of S's [the wife's] power of appointment is treated as if $750,000 * * * had been distributed to S and then transferred back to the trust." 26 C.F.R. 26.2601-1(b)(1)(v)(D), Example 1 (1996). Thus, the wife is treated as having made a post-September 25, 1985, constructive addition to the trust, and the grandfather exemption is inapplicable. *Ibid*.

2. In 1936, Henry Timken created a trust that became irrevocable upon his death in 1968. The trust conferred a testamentary general power of appointment over the entire trust estate upon his wife, Louise Timken, who is the decedent in this case. Pet. App. 23a-24a.

The trust further provided that if the power of appointment lapsed, trust assets would be used to pay the estate-tax portion attributable to the inclusion of the trust in Mrs. Timken's estate, and the remaining trust assets would be divided and placed in separate trusts for Mr. Timken's nieces and nephews, and for the children of any deceased niece or nephew. *Id.* at 4a-5a.

Mrs. Timken died in 1998 without appointing new trust successors. Her general power of appointment therefore lapsed, and the remaining trust assets passed to Mr. Timken's nieces and nephews. Some nieces and nephews made qualified disclaimers of their shares, which were then divided equally among their respective children, who were Mr. Timken's great-nieces and great-nephews. Pet. App. 4a-5a.

In compliance with IRS instructions relating to the GST tax, petitioners reported and paid a GST tax of $4,077,253. They subsequently filed claims for a refund, which the IRS did not allow. Petitioners then commenced this refund suit, contending that the regulation was invalid and inapplicable. Pet. App. 28a-29a, 35a-44a. The district court delayed ruling on the parties' cross-motions for summary judgment until the Sixth Circuit had decided *Estate of Gerson* v. *Commissioner*, 507 F.3d 435 (2007), cert. denied, 553 U.S. 1076 (2008), which involved the validity of a more recent version of the regulation at issue here. Pet. App. 5a.[1]

In *Gerson*, the decedent had general appointment power conferred by an irrevocable trust. She exercised that power in her will, leaving the trust assets to her grandchildren, which was a generation-skipping trans-

[1] The regulation at issue in *Gerson* was 26 C.F.R. 26.2601-1(b)(1)(i) (1999).

fer. 507 F.3d at 437. The Sixth Circuit evaluated the validity of the regulation under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984). *Gerson*, 507 F.3d at 438.

Applying *Chevron*'s step one, the court in *Gerson* held that the grandfather exemption was ambiguous as applied to a generation-skipping transfer resulting from the exercise of a general power of appointment granted in a pre-GST-tax irrevocable trust, because it was unclear whether the transfer was made "under" the irrevocable trust, or pursuant to the decedent's general appointment power. 507 F.3d at 441; see Tax Reform Act § 1433(b)(2)(A), 100 Stat. 2731. Applying *Chevron*'s step two, the *Gerson* court concluded that the regulation, which stated that the grandfather exemption "does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment," 26 C.F.R. 26.2601-1(b)(1)(i), was a reasonable interpretation of the grandfather exemption because it "conforms the grandfather clause to other elements of the tax scheme." *Gerson,* 507 F.3d at 439-441. The *Gerson* court also explained that, under the grandfather exemption, there is no substantive difference between assets that are transferred pursuant to an exercise of general appointment power, and assets transferred pursuant to a lapse of that power. *Id.* at 440-441.

3. Relying on *Gerson*, the district court in this case ruled against petitioners and upheld the validity of 26 C.F.R. 26.2601-1(b)(1)(v)(A). Pet. App. 31a-41a. The court applied the *Chevron* framework and held that the regulation was "valid as a permissible construction of the effective date provision of the GST tax which does harmonize with the plain language of the statute." *Id.* at 41a.

The district court further held that the regulation applied to this case because both of the regulation's requirements—that part of the trust remain in the trust after the lapse of a general power of appointment, and that the lapse be treated as a taxable transfer under the estate or gift tax—were satisfied. Because the regulation treated the portion of the trust estate that remained in the trust by virtue of the lapse of Mrs. Timken's general power of appointment as a post-GST-tax constructive addition to the trust, the transfers at issue fell outside the grandfather exemption to the GST tax. Pet. App. 42a-44a.

4. The court of appeals affirmed. Pet. App. 1a-17a. Applying the *Chevron* framework, the court of appeals held that it was bound by *Gerson* to conclude that the grandfather exemption was ambiguous. *Id.* at 6a-10a. The court further held that the regulation was reasonable "[b]ecause the constructive additions provision reaches the same result as the 1999 regulatory amendment" considered in *Gerson*. *Id.* at 11a. The court added that, "[e]ven without *Gerson*, the constructive additions regulation is a reasonable interpretation of the statute because it construes the grandfather exemption to treat a general power of appointment like outright ownership, as that power is treated in other tax code provisions." *Id.* at 11a-12a n.1.

The court of appeals also held that the regulation is applicable to the generation-skipping transfers at issue in this case. Pet. App. 13a-16a. The court explained that "[t]he first requirement [of the regulation] is met because trust assets remained in the trust after the payment of Louise Blyth Timken's estate taxes attributable to the inclusion of trust property in her estate." *Id.* at 14a. The second requirement was met because, "as the

parties stipulated," Mrs. Timken's estate paid estate taxes because of the general power of appointment over the Trust property. *Ibid.*; see also Pet. 5. The court of appeals also relied on 26 C.F.R. 26.2601-1(b)(1)(v)(D), Example 1, to conclude that "[w]hen Louise Blyth Timken's general power of appointment lapsed, the portion of the trust over which she had a general power of appointment—the entire trust—is treated as if it had been distributed to her, then transferred back to the trust, so that she is considered to have added that portion of the trust assets to the trust after September 25, 1985." Pet. App. 15a. Thus, the trust assets that subsequently passed to Mr. Timken's great-nieces and great-nephews were subject to the GST tax. *Ibid.*

ARGUMENT

Petitioners contend that 26 C.F.R. 26.2601-1(b)(1)(v)(A) (1996) is invalid and that the regulation does not apply in the circumstances of this case. The court of appeals correctly rejected those arguments, and its decision does not conflict with any decision of this Court or of another court of appeals. In addition, because the regulation at issue involves the interpretation of a transitional rule that applies only to trusts that became irrevocable more than 25 years ago, this case presents an issue of diminishing importance. Further review is not warranted.

1. The court of appeals correctly held that 26 C.F.R. 26.2601-1(b)(1)(v)(A) (1996), which provides that certain generation-skipping transfers effected by the release, exercise, or lapse of general powers of appointment are taxable, is a valid exercise of the Treasury's rulemaking authority. Under the familiar framework of *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984), the first step

of the inquiry is "whether Congress has directly spoken to the precise question at issue." *Id.* at 842. If the legislative intent is clear, that is the end of the matter, "for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.* at 842-843.

As the court of appeals correctly concluded (Pet. App. 7a), the text of the relevant statutory provision—Section 1433(b)(2) of the Tax Reform Act—"was ambiguous as to whether it included exercises of a general power of appointment under an irrevocable trust." By its terms, Section 1433(b)(2) applies only to "[a] generation-skipping transfer under a trust which was irrevocable on September 25, 1985." 100 Stat. 2731. But a transfer effected by a general power of appointment that was conferred by a trust can easily be viewed as a transfer by the party exercising the power of appointment, rather than a transfer under the trust itself. See *Estate of Gerson* v. *Commissioner*, 507 F.3d 435, 441 (6th Cir. 2007), cert. denied, 128 S. Ct. 2502 (2008). That is especially clear in this case, where the generation-skipping transfers occurred when some of Mr. Timken's nieces and nephews disclaimed their interest in the trust, allowing the assets to skip to the next generation.

Moreover, as the Second Circuit explained in *E. Norman Peterson Marital Trust* v. *Commissioner*, 78 F.3d 795 (1996), the term "added" in the second clause of the grandfather exemption is also ambiguous. See Tax Reform Act § 1433(b)(2)(A), 100 Stat. 2731 (stating that grandfather exemption applies "only to the extent that [the] transfer is not made out of corpus added to the trust after September 25, 1985"). As the term is used in gift and tax law, assets may be "added" to a trust even though the corpus does not increase in size. The term

can also be used to describe constructive additions that occur when trust assets flow back through the trust as the result of an exercise, release, or lapse of a general appointment power, as the regulation contemplates. *Peterson*, 78 F.3d at 800-801.

Under *Chevron*, the second step of the inquiry is "whether the agency's [interpretation] is based on a permissible construction of the statute." 467 U.S. at 843. In this case, the Treasury's interpretation is not only a permissible one, but the one more closely in accord with the purpose of the transitional rule. As the Second Circuit explained, the exception to the GST tax on generation-skipping transfers was enacted "to protect those taxpayers who, on the basis of pre-existing rules, made arrangements from which they could not reasonably escape," not "to allow taxpayers * * * to continue benefitting from a tax advantage that Congress has eliminated." *Peterson*, 78 F.3d at 801. Petitioners' interpretation of Section 1433(b)(2) would disserve that intent by allowing taxpayers to avoid paying GST tax on voluntary generation-skipping transfers, such as those at issue here, that were made well after the effective date of the provisions imposing that tax.

The Treasury's interpretation is also consistent with the treatment of general powers of appointment under other provisions of the Internal Revenue Code. It is a well-established principle of federal tax law that possession of a general power of appointment is tantamount to ownership of the property subject to the power. Thus, when an individual exercises or releases a general power of appointment, that exercise or release is treated as a gift of the underlying property by that individual for purposes of the federal gift tax. 26 U.S.C. 2514(b); see 5 Boris I. Bittker & Lawrence Lokken, *Federal Taxa-*

tion of Income, Estates and Gifts ¶ 121.6.1, at 121-39 to 121-40 (2d ed. 1993) (Bittker & Lokken). And when an individual holds a general power of appointment at the time of his death, the underlying property is treated as if it were owned by the individual, and is thereby included in the individual's estate, for purposes of the federal estate tax. 26 U.S.C. 2041(a)(2); see Bittker & Lokken ¶ 128.1, at 128-3 to 128-4.

In applying the GST tax's transitional rule, it would be inconsistent with the treatment of general powers of appointment under those provisions to treat a transfer of property effected by a general power of appointment as if it were a transfer under the trust that conferred the power of appointment. See H.R. Rep. No. 426, 99th Cong., 1st Sess. 827 (1985) (explaining that the GST tax was "coordinat[ed]" with the gift and estate taxes); cf. *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 44 (1939) (stating that the gift and estate taxes "are *in pari materia* and must be construed together"). For purposes of gift and estate taxes, the conferral of a power of appointment (unless timely disclaimed) is itself in effect a transfer to the holder of the power. The lapse of that power results in two additional transfers—a transfer of the trust corpus from the decedent (who failed to exercise her general power) to the trust, and the subsequent transfer from the trust corpus to the designated trust beneficiaries. See 26 C.F.R. 26.2601-1(b)(1)(v)(D), Example 1 (1996); *Gerson*, 507 F.3d at 440-441. Because the post-mortem transfer of property that results from the lapse of a general power of appointment therefore is not a transfer of property under the trust that initially conferred the general power of appointment, it does not come within the exemption set forth in Section 1433(b)(2)(A) of the Tax Reform Act. The transfer is

also excluded from the exemption because, assuming the general appointment power lapsed after September 25, 1985, it is made out of corpus that was constructively added to the trust after the qualifying date set forth in the exemption. *Ibid.*

2. Petitioners do not contend that the Sixth Circuit's decision conflicts with the decision of any other court of appeals with respect to the specific question presented in this case—*i.e.*, whether 26 C.F.R. 26.2601-1(b)(1)(v)(A) (1996) constitutes a valid exercise of the Treasury's rulemaking authority. Instead, petitioners contend (Pet. 8-9) that a conflict exists on the question whether the grandfather exemption, Section 1433(b)(2)(A) of the Tax Reform Act, is ambiguous. Petitioners rely on *Simpson* v. *United States*, 183 F.3d 812 (8th Cir. 1999), and *Bachler* v. *United States*, 281 F.3d 1078 (9th Cir. 2002). Pet. 9. In both cases, the courts of appeals held, without regard to any Treasury regulation, that the Section 1433(b)(2)(A) exemption was applicable to generation-skipping transfers effected by the exercise of general powers of appointment created in trusts that became irrevocable on or before September 25, 1985.

In neither *Bachler* nor *Simpson*, however, did the court hold that the statute was "unambiguous" under the "demanding *Chevron* step one standard." *National Cable & Telecomms. Ass'n* v. *Brand X Internet Servs.*, 545 U.S. 967, 982 (2005). In *Simpson*, the Eighth Circuit held that a transfer effected by the exercise of a general power of appointment was a "transfer under a trust" because "[t]he transfer was made possible by the trust." 183 F.3d at 814. Although the court did state that "[t]he words of Section 1433(b)(2)(A) are clear, at least to us," and that there was not "substantial uncertainty as to the meaning" of the provision, the court also

attached weight to the fact that "there [was no] regulation, temporary or permanent, that applies to the particular sort of transfer made here—a transfer of the entire corpus of the trust remaining at the time of the exercise of the power [of appointment]." *Id.* at 816. The absence of such a regulation would have been irrelevant if, as petitioners contend, the Eighth Circuit had believed that Congress directly spoke to the precise question at issue when it enacted Section 1433(b)(2)(A). As the Sixth Circuit noted in *Gerson*, "[*S*]*impson* never held that the statute was so clear that it foreclosed regulation." 507 F.3d at 440 n.2.

Similarly in *Bachler*, the Ninth Circuit held that a transfer effected by the exercise of a general power of appointment was a "transfer under a trust," on the ground that "[t]he transfer could not have been effected if it had not been under the trust." 281 F.3d at 1080. At the same time, however, the court noted that it was "not express[ing] any opinion on the validity of [26 C.F.R.] 26.2601-1(b)(1)(i)"—the Treasury regulation at issue in *Gerson*—which had been promulgated while proceedings in the case were ongoing and was not made retroactively applicable to the time period at issue in that case. *Bachler*, 281 F.3d at 1080 n.1. There would have been no basis for the Ninth Circuit to reserve the question of the validity of a regulation if it had believed that Congress had unambiguously addressed the question at issue in Section 1433(b)(2)(A) itself. *Bachler* and *Simpson* therefore do not directly conflict with the Sixth Circuit's determinations here and in *Gerson* that Section 1433(b)(2)(A) is ambiguous with respect to generation-skipping transfers resulting from the exercise, release, or lapse of a general power of appointment.

This Court denied review in *Gerson*, where the same alleged conflict was asserted. See Petition for Writ of Certiorari, *Estate of Gerson* v. *Commissioner*, 2008 WL 450088 (No. 07-1064) at *10, *16-*17 (Feb. 17, 2008). Indeed, the claim of a circuit conflict is even weaker here than in *Gerson*. Unlike in *Bachler*, *Simpson*, and *Gerson*, all of which involved the *exercise* of a general appointment power under an irrevocable trust, the decedent in this case allowed her general appointment power to lapse. The courts in both *Bachler* and *Simpson* distinguished the Second Circuit's decision in *Peterson* on that basis, stating that when a decedent allows her general appointment power to lapse, generation-skipping transfers of the trust assets would fall outside the exemption because the trust property would be deemed "added to the corpus" after the grandfather exemption's effective date. *See Bachler*, 281 F.3d at 1080 (noting that when a general power of appointment lapses, property is "added to the corpus"); *Simpson*, 183 F.3d at 815-816 (same). Because that is precisely what happened in this case, the opinions in *Simpson* and *Bachler* indicate that the Eighth and Ninth Circuits would have reached the same outcome as the court below in the circumstances presented here.

3. Petitioners further contend (Pet. 23-26) that the Treasury regulation is inapplicable in the circumstances of this case. That fact-bound argument lacks merit and does not warrant this Court's review.

Under the regulation, a generation-skipping transfer resulting from a post-September 25, 1985, lapse of a power of appointment is excluded from the statutory exemption if (a) part of the trust assets remain in the trust after the lapse, and (b) the lapse is treated as a taxable transfer under the estate tax or gift tax. Both of

those regulatory requirements were satisfied here. By virtue of the lapse of Mrs. Timken's general power of appointment, "the assets flow[ed] back through the trust as a second transfer." *Gerson*, 507 F.3d at 441; see also 26 C.F.R. 26.2601(b)(1)(v)(D), Example 1 (1996). The trust property subject to the lapsed power was, in substance, transferred from Mrs. Timken's gross estate to the trust, where it "remain[ed] in the trust" until it subsequently was transferred to trusts established for the benefit of some of her husband's great-nieces and great-nephews. Thus, the first regulatory requirement was satisfied.

The second requirement was also satisfied. Both the estate tax (set forth in Chapter 11 of Subtitle B of the Internal Revenue Code) and the gift tax (set forth in Chapter 12 of the same subtitle) are transfer taxes. See, *e.g.*, 26 U.S.C. 2001(a). For purposes of both taxes, the release of a general power of appointment results in a taxable transfer. See 26 U.S.C. 2041(a)(2), 2514(b). The Second Circuit, relying on a temporary version of the same regulation at issue here, held that the lapse of the decedent's general power of appointment, which resulted in a transfer to her husband's grandchildren of the property subject to her power of appointment, effected a taxable generation-skipping transfer. *Peterson*, 78 F.3d at 799-801. *Peterson* is on all fours with this case, and petitioners have not even attempted to distinguish it. Moreover, as the court of appeals observed, petitioners "stipulated [that] Louise Blyth Timken's estate paid estate taxes '[b]ecause of the general power of appointment over the Trust property.'" Pet. App. 14a; see Pet. 5. Thus, the regulation applies to this case, as the courts below correctly held.

4. Finally, the questions presented in this case are of diminishing significance, because the regulation at issue involves the interpretation of a transitional rule that applies only to trusts that became irrevocable more than 25 years ago. Indeed, the underlying transitional rule has generated only a handful of cases since it was enacted in 1986 as part of the Tax Reform Act. We are aware of no other pending case involving the specific questions presented here. Because the questions presented are unlikely to recur frequently, further review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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