

Internal Revenue Service

Department of the Treasury

Number: **200311020**

Washington, DC 20224

Release Date: 3/14/2003

Index Numbers: 2041.00-00; 2036.01-00;
2514.02-00; 2511.00-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09-PLR-132722-02

Date:

December 9, 2002

LEGEND:

Trust =

Date 1 =

Taxpayer =

Spouse =

Date 2 =

Child 1 =

Child 2 =

Child 3 =

Child 4 =

Date 3 =

Court =

Drafting Attorney =

Date 4 =

Date 5 =

State =

PLR-132722-02

Dear _____ :

This is in response to your authorized representative's letter, dated March 6, 2001, and subsequent correspondence, requesting rulings regarding the proper treatment of the Trust under §§ 2041, 2036, 2514, and 2511 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: On Date 1, Taxpayer and Spouse established the Trust, a revocable trust, for the benefit of Taxpayer, Spouse, and their children. Spouse died on Date 2.

Article I, paragraph D of the Trust provides that the property comprising the original corpus of the trust estate is jointly owned property of the trustors (Taxpayer and Spouse), and is held by them as tenants by the entirety. Article I, paragraph D, part 1 of the Trust provides that during the joint lives of the trustors, any property transferred to the trust shall retain its original character and, in the event of revocation, the trustee shall distribute such property to the respective trustors based on the same property rights they had prior to the transfer to the trust.

Article III of the Trust provides that the trustee shall hold, manage, invest, and reinvest the trust estate and shall collect the income and upon demand of the trustors or the survivor of them, pay to the trustors or to the survivor of them all net income of the trust estate and pay to each trustor all separate net income from his or her respective share of the trust estate. The trustee shall further pay principal, up to the whole thereof, to the trustors or to the survivor of them upon written request. Upon the written request of the trustor who transferred separate estate property to the trust, the trustee shall pay so much of the principal of the separate estate established by such trustor, up to the whole thereof, as he or she shall request.

Article V of the Trust provides that upon the death of the trustor whose death shall occur first, the trustee shall divide the trust estate, including all property received as a result of the decedent's death, into two parts, each part to be administered as a separate trust to be known respectively as the "Decedent's Trust" and the "Survivor's Trust."

Article V, paragraph A of the Trust provides that the Decedent's Trust shall include an amount equal to the lesser of the equivalent estate tax exemption in effect during the year of the death of the decedent, or one-half of the trust estate. In determining the equivalent estate tax exemption, the trustee is to take into consideration any lifetime gifts made which may decrease the actual amount available to transfer to the Decedent's Trust. The trustors acknowledge that it is their intent that the amount to be distributed to the Decedent's Trust shall not exceed an amount which will provide for zero tax upon the death of the first of the trustors to die. Article V,

PLR-132722-02

paragraph B of the Trust provides that all of the rest and residue of the assets of the trust estate shall be allocated to the Survivor's Trust.

Article VI of the Trust contains provisions governing the Decedent's Trust. Article VI, paragraph A of the Trust provides that all of the net income shall be distributed in convenient installments, not less frequently than quarterly, to the survivor during his or her lifetime. Article VI, paragraph B of the Trust provides that the trustee shall also distribute principal to the survivor, which in the sole discretion of the trustee is necessary to provide proper support for the survivor. Article VI, paragraph C of the Trust provides that the survivor, during his or her lifetime, shall have the power to appoint the principal and undistributed income of the trust estate, or any part thereof, to himself or herself, or to any person or persons; however, the survivor may exercise said power of appointment during any calendar year only to the extent of \$5,000.00 or five percent of the aggregate value of the trust estate, whichever amount shall be greater. Any such power of appointment shall not be construed to be cumulative and if not exercised in any calendar year, such power shall be terminated as to that year. Article VI, paragraph D of the Trust provides that upon the death of the survivor, the Decedent's Trust shall terminate and shall become a part of the Survivor's Trust created under Article VII, and shall be administered in accordance with the provisions of Article VII.

Article VII of the Trust contains provisions governing the Survivor's Trust. Article VII, paragraph A of the Trust provides that all of the net income shall be distributed in convenient installments, not less frequently than quarterly, to the survivor during his or her lifetime.

Article VII, paragraph B of the Trust provides that during his or her lifetime, the survivor shall have a general power to appoint the principal and any undistributed income of the Survivor's Trust or any part thereof, to himself, or to herself, or to any person or persons. Upon the death of the survivor, he or she shall have the power to appoint the principal and any undistributed income of the Survivor's Trust or any part thereof to his or her estate or to any person or persons, or to the Decedent's Trust.

Article VII, paragraph C of the Trust provides that upon the death of the survivor, the Survivor's Trust shall terminate and shall be distributed in accordance with Article VIII. Article VII, paragraph D of the Trust provides that the Survivor's Trust shall be revocable.

Article VIII of the Trust provides that unless sooner terminated in the manner provided herein, both the Decedent's Trust and the Survivor's Trust shall cease and terminate on the death of the survivor of the trustors. On such termination, the trustee is directed to distribute the trust as follows. Article VIII, paragraph A, part 1 of the Trust provides for distributions of personal property.

PLR-132722-02

Article VIII, paragraph A, part 2 of the Trust provides that the entire remaining trust estate, including principal and accrued or undistributed income, shall be distributed to the trustors' four children, Child 1, Child 2, Child 3, and Child 4, in equal shares, share and share alike, provided, however, that the share devised to Child 2 is to be held in trust by Child 1 and Child 4, or the survivor of them, for the benefit of Child 2. Article VIII, paragraph A, part 2, subpart (a) of the Trust provides that the share of a living child who has attained the age of twenty-one (21) years shall be distributed to him or her as soon as practicable. Article VIII, paragraph A, part 2, subpart (b) of the Trust provides that in the event that any of trustors' children shall not have attained the age of twenty-one (21) years at the time of distribution, then the trustee shall retain the distributable share of such child, and administer and distribute the trust according to the provisions of that article.

Taxpayer represents that a subsequent review of the Trust by Taxpayer's new estate planning attorney revealed three ambiguities in the Trust that may result in a construction contrary to the Taxpayer and Spouse's intent. The first ambiguity involves Article VI, paragraph D of the Trust and Article VII, paragraph B of the Trust. Article VI, paragraph D of the Trust provides that upon the death of the survivor, the Decedent's Trust shall terminate and shall become a part of the Survivor's Trust created under Article VII, and shall be administered in accordance with the provisions of Article VII. Article VII, paragraph B of the Trust provides, in part, that upon the death of the survivor, he or she shall have the power to appoint the principal and any undistributed income of the Survivor's Trust or any part thereof to his or her estate or to any person or persons, or to the Decedent's Trust. Taxpayer represents that these two provisions, taken together, may be construed to give Taxpayer (the survivor) a general power of appointment over the assets of the Decedent's Trust. Taxpayer further represents that this result is contrary to Taxpayer and Spouse's intent. Taxpayer states that she and Spouse intended to shelter the assets of the Decedent's Trust at the death of the first trustor by use of the deceased trustor's unified credit and distribute the assets of the Decedent's Trust on the death of the surviving trustor in the same manner as the remaining assets of the Survivor's Trust.

The second ambiguity involves several provisions of the Trust relating to the nature of jointly owned property contributed to the Trust. Specifically, Taxpayer contends that it is unclear how Article I, paragraph D, part 1 of the Trust is meant to apply on the death of a trustor. Taxpayer asserts that this provision, which purports to preserve the tenancy by the entireties character of the Trust property, could be construed as an attempt to preserve the surviving trustor's right of survivorship in assets in the Decedent's Trust, contrary to the provisions of Article V.

The third ambiguity arises from the fact that the Trust does not expressly state that the Decedent's Trust is to be funded with assets from the decedent's share of the trust estate. While some provisions of the Trust mention separate shares of the trust estate to be attributable to each trustor, other provisions fail to suggest the existence of

PLR-132722-02

separate trust shares. Taxpayer asserts that if the Decedent's Trust was funded with assets from the survivor's share of the trust estate, then such assets would be includible in Taxpayer's gross estate under § 2036. Taxpayer represents that this result would be inconsistent with the trustors' intent.

In order to eliminate the ambiguities contained in the Trust and to accurately reflect the intent of the trustors, on Date 3, Taxpayer, as trustee of the Trust, filed a petition with the Court seeking authorization to reform the Trust. Taxpayer, Child 1, Child 2, Child 3, and Child 4, the named beneficiaries of the Trust, indicated their written consent to the reformation sought by the petition. Drafting Attorney, the attorney who drafted the Trust, provided a sworn affidavit that the ambiguous provisions of the Trust, as described above, were the result of a scrivener's error and are contrary to the intent of Taxpayer and Spouse.

On Date 4, the Court issued an order authorizing the reformation of the Trust. The Court found, in part, that: (i) there were ambiguities present on the face of the Trust instrument; (ii) that because of circumstances not known to or anticipated by the trustors, compliance with the terms of the Trust would defeat or substantially impair the accomplishment of a material purpose of the Trust; and (iii) that the reformation is consistent with the Court's belief of the trustors' intent.

On Date 5, Taxpayer executed the reformation of the Trust. The reformation provides that it shall be effective retroactively as of Date 1. As a result of the reformation, the following changes were made to the Trust. Article I, paragraph D of the Trust was reformed in its entirety. Article I, paragraph D of the Trust, as reformed, provides that the trustors shall each have an equal one-half ($\frac{1}{2}$) beneficial interest in the trust estate. All property transferred to the trust estate, whether by the trustors or otherwise, shall be held in such separate shares as tenants in common property. Prior to the death of either trustor, each trustor's one-half ($\frac{1}{2}$) beneficial interest in the trust estate may be further characterized as an undivided one-half ($\frac{1}{2}$) tenant in common interest in the property comprising the trust estate. Certain property transferred to the trust estate may be jointly owned by the trustors and held as joint tenants with the right of survivorship or held as tenants by the entirety. Trustors acknowledge and agree that upon their transfer of such property to the trust estate, it shall lose its character as joint tenancy with the right of survivorship property or tenancy by the entirety property and be thereafter held as tenants in common property, with each trustor's individual one-half ($\frac{1}{2}$) interest to be held as such trustor's separate share, in accordance with the terms of this trust. Each trustor acknowledges and understands the nature of each trustor's separate share of the trust estate as tenancy in common property.

Article V, paragraph A was reformed in its entirety. Article V, paragraph A, as reformed, provides that the trustee shall set aside as the Decedent's Trust all assets of the decedent's separate share of the trust estate that cannot qualify for the federal estate tax marital deduction, plus the largest pecuniary amount (if any) of the remaining

PLR-132722-02

assets of the decedent's separate share of the trust estate that can be added to the Decedent's Trust without incurring or increasing the state and federal estate tax liability of the decedent's estate. This amount will be calculated by taking into account the decedent's applicable exclusion amount and all other tax credits, deductions and other preferences allowed to the decedent's estate. In determining that amount, the trustee shall consider all other transfers of assets included in the decedent's gross estate for federal estate tax purposes and all the decedent's adjusted taxable gifts. The Decedent's Trust shall be held, administered and distributed in accordance with the provisions of Article VI.

Article V, paragraph B was reformed in its entirety. Article V, paragraph B, as reformed, provides that all assets of the decedent's separate share of the trust estate that are not set aside as the Decedent's Trust, plus all assets of the survivor's separate share of the trust estate, shall be set aside by the trustee as the Survivor's Trust. The Survivor's Trust shall be held, administered and distributed in accordance with the provisions of Article VII.

Article VI, paragraph D of the Trust was reformed in its entirety. Article VI, paragraph D, as reformed, provides that upon the death of the survivor, the Decedent's Trust shall terminate and shall be distributed in accordance with the provisions in Article VIII.

Taxpayer has requested the following rulings: (1) Article VI, paragraph D of the Trust, as reformed, does not provide Taxpayer with a general power of appointment over the assets of the Decedent's Trust, and upon the death of Taxpayer, the assets of the Decedent's Trust will not be includible in Taxpayer's gross estate under § 2041 (with the exception of 5% of the principal of the Decedent's Trust, due to the existence of the "5 and 5" power); (2) The assets of the Decedent's Trust will not be includible in Taxpayer's estate under § 2036; (3) The reformation of the Trust does not constitute the release of a general power of appointment by Taxpayer resulting in a gift under § 2514; and (4) The reformation of the Trust does not result in Taxpayer being deemed to have made a gift of her remainder interest in the Decedent's Trust to her children upon Spouse's death.

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2031(a) provides, generally, that the value of the gross estate of the decedent shall be determined by including to the extent provided for in §§ 2031 through 2046, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

PLR-132722-02

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2036(a) provides, generally, that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death: (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2041(a)(2) provides that to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive. For purposes of § 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

Section 2041(b)(1) provides that for purposes of § 2041(a), the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts: (A) \$5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

Section 2501(a)(1) provides, generally, that a tax is imposed for each calendar year on the transfer of property by gift by any individual, resident or nonresident. Section 2511(a) provides that the gift tax shall apply 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.

PLR-132722-02

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

Section 2514(c) provides that for purposes of § 2514, the term “general power of appointment” means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court’s characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving “proper regard” to the state trial court’s determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

Generally, if, due to a mistake in drafting, the instrument does not contain the terms of the trust that the settlor and the trustee intended, the settlor or other interested party may maintain a suit in equity to have the instrument reformed so that it will contain the terms that were actually agreed upon. George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* § 991 (rev. 2d ed. 1983).

Based on the facts submitted and the representations made, we conclude that the Court order modifying the Trust based on scrivener’s error is consistent with applicable state law, as it would be applied by the highest court of State. Accordingly, we conclude as follows: (1) The Taxpayer does not have a general power of appointment over the assets of the Decedent’s Trust, and upon the death of Taxpayer, the assets of the Decedent’s Trust will not be includible in Taxpayer’s gross estate under § 2041 (with the exception of 5 percent of the principal of the Decedent’s Trust due to the existence of the “5 and 5” power); (2) The assets of the Decedent’s Trust will not be includible in Taxpayer’s estate under § 2036; (3) The reformation of the Trust does not constitute the release of a general power of appointment by Taxpayer resulting in a gift under § 2514; and (4) The reformation of the Trust does not result in Taxpayer being deemed to have made a gift of her remainder interest in the Decedent’s Trust to her children upon Spouse’s death.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

PLR-132722-02

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions 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.

Pursuant to the power of attorney on file, we are sending a copy of this letter to your authorized representative.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Branch Chief, Branch 9
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes