

Internal Revenue Service

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Department of the Treasury

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Person to Contact:

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Refer Reply To:
CC:PSI:4 - PLR-118700-01
Date: August 03, 2001

Re:

Legend

Taxpayer =

Decedent =

Trust Agreement =

Date 1 =

Court =

Date 2 =

Dear :

This is in response to a letter dated February 28, 2001, and subsequent correspondence submitted on behalf of the taxpayers, in which rulings were requested concerning the federal gift and estate tax consequences under §§ 2041 and 2514 of the Internal Revenue Code of a court order modifying a trust agreement.

Facts

The facts submitted and representations made are as follows:

Taxpayer and his spouse, Decedent, executed Trust Agreement, a joint revocable trust, and named themselves as cotrustees.

Article II, paragraph 2.4, of Trust Agreement provides that, during their joint lives, either spouse may amend or revoke Trust Agreement to the extent it pertains to the assets of that spouse. After the death of the first spouse to die, the surviving spouse may amend and revoke the Survivor's Trust; and the Decedent's Trust will be irrevocable.

Under Article V, at the death of the first spouse to die, the trust estate is to be divided into the Survivor's Trust and the Decedent's Trust. Under Article V, paragraph 5.2, the surviving spouse's separate property and share of the community property will

be allocated to the Survivor's Trust. Under Article V, paragraph 5.3, the balance of the trust assets will be allocated to the Decedent's Trust.

Under Article V, paragraph 5.2, during the surviving spouse's life, the Trustee will pay to the spouse all of the net income of the Survivor's Trust, any amounts of principal the Trustee deems necessary for the surviving spouse's health, welfare, and maintenance, considering the spouse's income from other sources, and any amounts of principal the spouse demands. At the death of the surviving spouse, the remaining assets of the Survivor's Trust will be distributed as appointed under the surviving spouse's will, or, in default of such appointment, will be added to the Decedent's Trust.

Under Article V, paragraph 5.3, during the surviving spouse's life, all of the net income of the Decedent's Trust and principal requested by the spouse in any calendar year equal to the greater of \$5,000 or 5 percent of the value of the trust assets at the end of the calendar year will be distributed to the surviving spouse.

Further, Article V, paragraph 5.3.1.3 provides:

In addition, Trustee shall, from time to time, pay to or for the benefit of the surviving Trustor such sums from the principal of the Decedent's Trust as Trustee may deem, in its sole and exclusive discretion, to be necessary for the health, welfare and maintenance of the surviving Trustor.

Trustee is directed that, prior to making any distributions for the health, welfare and maintenance of the surviving Trustor from the principal of the Decedent's Trust, Trustee shall not first ascertain all other assets available to the surviving Trustor, which other assets would be available to provide for his or her health, welfare and maintenance.

Trustee is directed that distributions of principal under the terms of this paragraph shall be made liberally.

Article V, paragraph 5.3.1.4 provides that in making investments of the principal of the Decedent's Trust, the Trustee must consider "the needs of the income beneficiary to be paramount and shall so invest the principal accordingly."

At the death of the surviving spouse, the Decedent's Trust will terminate and, under the terms of Article VI, be distributed to specified family members.

Decedent died on Date 1. Taxpayer is currently the sole trustee of the Survivor's and the Decedent's Trusts.

After Decedent's death, Taxpayer spoke with a bank about the possibility of its becoming trustee. During those discussions, a representative of the bank stated that

as trustee and beneficiary of the Decedent's Trust, Taxpayer has a general power of appointment over the trust due to the use of the word "welfare" in Article V, paragraph 5.3.1.3.

Taxpayer intended that his and Decedent's estate taxes would be minimized by their each using their unified credits against federal estate tax as provided under § 2010. In a September 8, 1986 letter to the Taxpayer and Decedent, the scrivener of Trust Agreement stated:

Under the Decedent's Trust, the survivor receives all of the income every year, has the right to take out \$5,000 or 5% per year, and can have the principal invaded for their needs. They do not, however, own this share. . .

The survivor's share is different. The survivor's share consists of that person's half of the community property. They can do anything with it they want.

As trustee of the Decedent's Trust, Taxpayer petitioned Court for reformation of Trust Agreement. On Date 2, Court issued an order modifying Article V, paragraph 5.3.1.3. In the order, Court states that notice was proper and that the interests of any unascertained potential beneficiaries of the trust are adequately represented. The Court further states that Article V, paragraph 5.3.1.3, contains a scrivener's error due to which Taxpayer is deemed to have a general power of appointment. The Court Order further states that Taxpayer has never exercised this general power of appointment under Article V, paragraph 5.3.1.3.

Court ordered that Trust Agreement is modified retroactively as of its date of execution by deleting the language of Article V, paragraph 5.3.1.3 in its entirety and substituting the following language:

Principal Invasion. In addition, Trustee shall, from time to time, pay to or for the benefit of the surviving Trustor such sums from the principal of the Decedent's Trust as Trustee may deem to be necessary for the health, education, support and maintenance of the surviving Trustor.

Trustee is directed that, prior to making any distributions for the health, education, support, and maintenance of the surviving Trustor from the principal of the Decedent's Trust, Trustee shall not first ascertain all other assets available to the surviving Trustor, which other assets would be available to provide for his or her health, education, support and maintenance.

Taxpayer has exercised his "5 and 5 power" over the Decedent's Trust but has not withdrawn any principal under Article V, paragraph 5.3.1.3.

The following rulings have been requested:

1. Taxpayer's power to invade the principal of the trust under Article V, paragraph 5.3.1.3, as modified under the Court Order, so that it is only exercisable as necessary for the Taxpayer's health, education, support, and maintenance, is limited by an ascertainable standard and is not considered a general power of appointment for federal estate and gift tax purposes under §§ 2041 and 2514.

2. Modification of Trust Agreement under the Court Order does not cause Taxpayer to be deemed to have released a general power of appointment resulting in a gift pursuant to § 2514.

Law and Analysis

Under § 2041(a)(2), the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has, at the time of death, a general power of appointment created after October 21, 1942.

Section 2041(b)(1) defines "general power of appointment" as a power which is exercisable in favor of the decedent, his estate, his creditors, or creditors of his estate. However, under § 2042(b)(1)(A), a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is not a general power of appointment.

Under § 20.2041-1(c)(2), a power is limited by an ascertainable standard if the extent of the holder's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). The words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

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

Under § 2514(b), the exercise or release of a general power of appointment created after October 21, 1942, is deemed the transfer of property by the individual possessing such power.

Under § 2514(c), "general power of appointment" is defined as a power which is exercisable in favor of the individual possessing the power ("the possessor"), his estate, his creditors, or creditors of his estate. However, under § 2514(c)(1), a power to consume, invade, or appropriate property for the benefit of the possessor which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor is not a general power of appointment.

Under § 25.2514-1(c)(2), a power is limited by an ascertainable standard if the extent of the possessor's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). The words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by an ascertainable standard. In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

Powers of appointment limited by an ascertainable standard are defined in the same way under §§ 2041 and 2514. Powers of appointment have the same meaning for purposes of both the gift and estate tax. See, Rev. Rul. 76-547, 1976-2 C.B. 302.

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. Bogert & Bogert, The Law of Trusts and Trustees, § 991 (revised 2d ed. 1983).

Based on an analysis of the facts submitted and the representations made, we conclude that the Court Order modifying the instrument based on scrivener's error is consistent with applicable state law, as it would be applied by the highest court of the state. Accordingly, we rule as follows:

1. Taxpayer's power to invade the principal of the trust under Article V, paragraph 5.3.1.3, as modified under the Court Order, so that it is only exercisable as necessary for the Taxpayer's health, education, support, and maintenance, is limited by an ascertainable standard and is not considered a general power of appointment for federal estate and gift tax purposes under §§ 2041 and 2514.

2. Modification of Trust Agreement under the Court Order does not cause Taxpayer to be deemed to have released a general power of appointment resulting in a gift pursuant to § 2514.

Except as specifically ruled herein, we express 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 taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
Associate Chief Counsel
(Passthroughs and Special Industries)
By Lorraine E. Gardner
Acting Senior Technician Reviewer
Branch 4

Enclosure

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