

## Internal Revenue Service

Department of the Treasury

Index No.: 2041.00-00

Washington, DC 20224

Number: **200028008**  
Release Date: 7/14/2000

**Person to Contact:**

**Telephone Number:**

Refer Reply To:  
CC:DOM:P&SI:7 / PLR-116532-99  
Date:

April 10, 2000

### Legend:

Trust:

Grantor:

A:

B:

Bank:

State:

Date 1:

Dear Sir:

This is in response to a letter dated October 9, 1999, submitted by the trustees of Trust requesting a ruling that addresses the estate and gift tax consequences of the proposed change in trustees of Trust. Specifically, the trustees seek a ruling that the proposed resignation of Bank as trustee followed by the proposed appointment of B as trustee and the resulting transfer of the discretionary powers from Bank to B to distribute or refrain from distributing the principal of Trust: (1) will not cause the property in Trust to be includible either in A's gross estate at A's death or, if B predeceases A, in B's gross estate at B's death; (2) will not constitute a gift by A or B; and (3) will not have any effect on the income tax treatment of Trust, its co-trustees or its beneficiaries.

On Date 1 Grantor, a resident of State, created Trust, which became irrevocable at the death of Grantor later in the same year. Currently, A and Bank are the trustees of Trust.

The dispositive provisions of Trust are summarized as follows:

Article Second (C)(1) of Trust provides that, during the lifetime of A (Grantor's spouse), the trustees are to pay all of the net income from Trust, in quarterly or more

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frequent installments, to or on behalf of A.

Article Second (C)(2) of Trust provides that in the event that, in the judgment of the trustee other than A, the distributions of income, pursuant to Article Second (C)(1), from Trust to A when added to A's other income are inadequate for A's proper care, support and maintenance, or in the event of any accident, illness, or other emergency occurring with respect to A during the continuance of Trust, the trustee is authorized within its discretion to distribute funds from the principal of Trust to or on behalf of A in such amounts as the trustee deems adequate for A's support or for meeting such accident, illness or other emergency.

Article Second (C)(3)(a) of Trust provides that, upon the death of A, the trustee is to pay the entire net income of Trust to or on behalf of B (the only child of Decedent and A), in quarterly or more frequent installments, for the lifetime of B.

Article Second (C)(3)(b) of Trust provides that, upon the death of A, if, in the opinion of the trustee, the distributions of income from Trust, together with receipts from other sources available to B and known to the trustee, is insufficient to suitably support and maintain B, B's spouse, and B's children, then the trustee is authorized to distribute to or for the benefit of B, B's spouse, and B's children, such portions of the principal of Trust as the trustee, in its sole discretion, may deem appropriate to make up such deficiencies.

Article Second (C)(3)(c) of Trust provides that, at any time after the death of A, B is to have the power to terminate Trust by written notice to the trustee, and after a reasonable time from the receipt of such notice by the trustee all of the remaining property of Trust is to be distributed to B, free of trust, and Trust is to be terminated.

Article Second (C)(3)(d) of Trust provides that, after the death of the last survivor of Grantor, A, and B, all property remaining in Trust is to be distributed to B's issue by right of representation. It further provides for the division and distribution scheme for Trust if there be no issue of B after the death of the last survivor of Grantor, A, and B.

The relevant provisions concerning the trustees of Trust are as follows:

Article Twelfth of Trust provides that any trustee may resign. If there is no successor trustee named to succeed the resigning trustee, the successor trustee may be appointed by all the beneficiaries entitled to receive income of Trust, or their legal representatives.

Article Fifteenth of Trust provides that, while A is acting as a co-trustee, A is not to act on matters involving discretionary distributions to A as a beneficiary and on these matters the corporate co-trustee (Bank) alone is to exercise the discretion granted to the trustees.

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The trustees represent that the proposed substitution of B for Bank as trustee of Trust is motivated solely by A's desire to save the trust service fees paid to Bank. The trustees further represent that although neither A nor B has the power under the terms of Trust to discharge Bank as trustee, Bank is willing to resign voluntarily. In addition, the trustees represent that B owes no support obligation to A.

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

Section 2041(a)(2) provides that 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 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; except that –

(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 shall not be deemed a general power of appointment.

....

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides in part that 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, except (i) joint powers, to the extent provided in §§ 20.2041-2 and 20.2041-3, and (ii) certain powers limited by an ascertainable standard, to the extent provided in § 20.2041-1(c)(2).

Section 20.2041-1(c)(2) provides that a power to consume, invade, or appropriate income or corpus, or both, 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, by reason of § 2041(b)(1)(A), not a general power of appointment. A power is limited by such a standard if the extent of the holder's duty to exercise and

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not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, 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. Examples of powers which are limited by the requisite standard are powers exercisable for the holder’s “support,” “support in reasonable comfort,” “maintenance in health and reasonable comfort,” “support in his accustomed manner of living,” “education, including college and professional education,” “health,” and “medical, dental, hospital and nursing expenses and expenses of invalidism.” 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) provides that a tax, computed as provided in § 2502, is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides in part that, subject to the limitations contained in this chapter, 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.

Section 25.2511-1(g)(2) provides that, if a trustee has a beneficial interest in trust property, a transfer of the property by the trustee is not a taxable transfer if it is made pursuant to a fiduciary power the exercise or nonexercise of which is limited by a reasonably fixed or ascertainable standard which is set forth in the trust instrument. A clearly measurable standard under which the holder of a power is legally accountable is such a standard for this purpose. For instance, a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; to enable him to maintain his accustomed standard of living; or to meet an emergency, would be such a standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not such a standard. The entire context of a provision of a trust instrument granting a power must be considered in determining whether the power is limited by a reasonably definite standard. For example, if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or nonexercise of a power, the power is not limited by a reasonably definite standard. However, the fact that the governing instrument is phrased in discretionary terms is not in itself an indication that no such standard exists.

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 in part that, for purposes of this section, the term

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“general power of appointment” means a power which is exercisable in favor of the individual possessing the power (hereafter in this subsection referred to as the “possessor”), his estate, his creditors, or the creditors of his estate.

While legal rights and interests in property (such as the creation and the breadth of a power to appropriate or consume the principal of a trust) is a matter of state law, it is the Federal law that designates what rights or interests so created shall be taxed. See Morgan v. Commissioner, 309 U.S. 78, 80 (1940). Thus, whether the trustee’s power to consume, invade, or appropriate the principal of Trust for the benefit of A or to refrain from exercising such power is limited by an ascertainable standard relating to health, education, support, or maintenance is a matter of State law.

A review of State law reveals no statutory or case law authority directly on point as to whether the invasionary power granted to the trustee is limited by an ascertainable standard. Thus, under Commissioner v. Bosch, 387 U.S. 456 (1967), we must forecast what the law of State is likely to be. Under Bosch, state law as announced by the highest court of the state is to be followed, but if there is no decision by the highest court, we must apply what we find to be the state law after giving “proper regard” to relevant rulings of other courts. Id., at 465.

In the present situation, the trustee is authorized to distribute the principal of Trust if, within the judgment of the trustee, the distributions of income from Trust to A when added to A’s other income are inadequate for A’s “proper care, support and maintenance, or in the event of any accident, illness, or other emergency occurring with respect to A” during the continuance of Trust.

The first standard, “proper care, support and maintenance,” is an ascertainable standard relating to the health, education, support, or maintenance within the meaning of the Estate Tax Regulations.

In Budd v. Commissioner, 49 T.C. 468, 470 (1968), acq., 1973-2 C.B. 1, the trust instrument provided for distribution in the event of “sickness, accident, misfortune or other emergency.” The Tax Court held that these conditions or circumstances under which the grantor, as trustee, could invade corpus of the trust for an income beneficiary reflected external standards to which a court of equity would give effect. Id., at 475. In Budd, use of the word “other” before the word “emergency” limited the meaning of the “emergency” to the type of emergencies itemized before the word “other.” Similarly, in the present case, distributions for emergencies are limited by the trust language which provided for distributions of the principal in the event of “accident” or “illness.” Consequently, we believe that the highest court of State would find that the trustee’s power to invade the principal of Trust on behalf of A under Article Second (C)(2) of Trust is limited by ascertainable standards relating to health, education, support, or maintenance.

Based on the information submitted and the representations made, we conclude

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that the proposed resignation of Bank as trustee followed by the proposed appointment of B as trustee and the resulting transfer of the discretionary powers from Bank to B to distribute or refrain from distributing the principal of Trust: (1) will not cause the property in Trust to be includible either in A's gross estate at A's death or, if B predeceases A, in B's gross estate at B's death; and (2) will not constitute a gift by A or B.

The ruling request includes a question that the proposed change in trustees of Trust will not have any effect on the income tax treatment of Trust, its co-trustees or its beneficiaries. This portion of the request does not identify any specific income tax issues that warrant a ruling. Furthermore, the trustees have cited no Code provisions and provided no analysis as to any specific income tax issue that might have arisen as a result of the proposed change in trustees of Trust.

Under § 7.01 of Rev. Proc. 2000-1, I.R.B. 21, the Service may decline to issue a letter ruling when appropriate in the interest of sound tax administration. We decline to rule on whether the proposed change in trustees of Trust will have any effect on the income tax treatment of Trust, its co-trustees or its beneficiaries. We have determined that ruling on the aforementioned issue in the context of this request would not be in the interest of sound tax administration.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

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

This letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,  
James C. Gibbons  
Assistant to the Chief, Branch 7  
Office of the Assistant Chief Counsel  
(Passthroughs and Special Industries)