

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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CC:DOM:P&SI:4 - PLR-116111-99
Date: March 7, 2000

Re:
Legend:

Taxpayer =
Decedent =
Trust Agreement=
Date 1 =
Date 2 =
Court =

Dear :

This is in response to a letter dated August 26, 1999, and subsequent correspondence, in which rulings were requested concerning the federal gift and estate tax consequences of a Court order construing and reforming Trust.

Facts

The facts submitted and representations made are as follows:

Taxpayer's spouse, Decedent, executed Trust Agreement, a revocable trust agreement. Under Decedent's will, Decedent's separately-held property passed to the trustee under Trust Agreement.

Under subparagraph (a) of Section 6 of Trust Agreement, a residuary marital trust is to be established at Decedent's death.

Under subparagraph (c) of Section 6, the marital trust is to consist of two shares, one for which Decedent's executor elects treatment as qualified terminable interest property (QTIP), the "qualified share," and the remaining share for which the QTIP election is not made, the "nonqualified share."

Under subparagraph (d)(i) of Section 6, the qualified share is to be funded with that amount necessary to reduce Decedent's federal estate tax to zero, after taking into account the credit

for state death taxes and "after giving effect to the unified credit available to the grantor's estate"

Under subparagraphs (a) and (b) of Section 7, during the surviving spouse's life, all of the net income of the marital trust is paid to her at least annually as well as any amount of principal the trustee deems appropriate for her support and health.

Subparagraph (c) of Section 7 provides as follows:

Upon the death of the grantor's spouse, the trustee shall distribute all undistributed principal of the marital trust to such person or persons, including the estate of the grantor's spouse or any other entity or entities, upon such conditions, in such proportions and estates, and at such time or times, as the grantor's spouse shall appoint by will, specifically referring to this power of appointment.

Under subparagraph (d) of Section 7, any part of the marital trust that is not appointed by the surviving spouse passes to Decedent's lineal descendants.

Decedent was the initial trustee under the Trust Agreement, and his surviving spouse and children were named as successor trustees. Section 15 prohibits the surviving spouse from acting as sole trustee and from participating in any way in distributions under subparagraphs (a) and (b) of Section 7. Two of Decedent's sons have been the only persons serving as co-trustees since Decedent's death.

Decedent died on Date 1, survived by his three sons and Taxpayer. The attorney advising the co-trustees about funding the marital trust determined that an ambiguity existed between subparagraphs (c) and (d) of Section 6 and subparagraph (c) of Section 7. He contacted the attorney who drafted the final restatement of the Trust Agreement. That attorney conceded that, as scrivener, he had inadvertently failed to use the language in subparagraph (c) of Section 7 which would have given proper effect to Decedent's intent.

On Date 2, at the request of the co-trustees, a hearing was held by the Court to reform subparagraph (c) of Section 7. It was represented to the Court that subparagraph (c) of Section 7 contained a scrivener's error in that under the subparagraph, as drafted, the surviving spouse possessed a general power of appointment over the entire marital trust corpus, but it was Decedent's intent that the surviving spouse have a

general power of appointment only over the qualified share of the marital trust. The attorney who drafted the final restatement of the Trust Agreement testified under oath that this error was due to his inadvertent omission of the words "qualified share" from the subparagraph and that this omission thwarted Decedent's intent to exclude the assets of the nonqualified share from the surviving spouse's gross estate for federal estate tax purposes.

On Date 2, following the hearing, the Court issued its order enjoining the surviving spouse from exercising the power of appointment as to the nonqualified share of the marital trust and reforming subparagraph (c) of Section 7 as follows:

Upon the death of the grantor's spouse, the trustee shall distribute all undistributed principal of the "qualified share" of the marital trust to such person or persons, including the estate of the grantor's spouse or any other entity or entities, upon such conditions, in such proportions and estates, and at such time or times, as the grantor's spouse shall appoint by will, specifically referring to this power of appointment.

Under state law, the reformation was retroactive to the date of execution.

You have requested the following rulings:

1. Taxpayer's power of appointment over the entire marital trust under subparagraph (c) of Section 7 of the Trust Agreement, as reformed by the Court order, will not be considered a general power of appointment for federal estate and gift tax purposes under §§ 2041 and 2514 of the Internal Revenue Code as to the nonqualified share.

2. The reformation of the Trust Agreement by the Court will not constitute the release of a general power of appointment resulting in a gift under § 2514.

Law and Analysis

Section 2041(a)(2) of the Internal Revenue Code 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 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 that 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.

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.

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

Under § 2514(c), a "general power of appointment" is defined as a power which is exercisable in favor of the individual possessing the power, 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.

Section 25.2514-1(c) contains rules similar to § 20.2041-1(c)(2), defining a general power of appointment for purposes of § 2514. Thus, the rules governing when a power of appointment is limited by an ascertainable standard under § 2041 also apply under § 2514. In addition, the term "power of appointment" has 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.

Based on an analysis of the facts submitted and the representations made, we conclude that the Court order reforming the Trust Agreement 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 of appointment over the entire marital trust under subparagraph (c) of Section 7 of the Trust Agreement, as reformed by the Court order, will not be considered a general power of appointment for federal estate and gift tax purposes under §§ 2041 and 2514 of the Internal Revenue Code as to the nonqualified share.

2. The reformation of the Trust Agreement by the Court will not constitute the release of a general power of appointment resulting in a gift under § 2514.

We note that, because all of the income of the qualified share of the marital trust is payable to Decedent's surviving spouse for life and because the surviving spouse has a testamentary general power of appointment over the corpus of the qualified share, Decedent's estate was entitled to a marital deduction for the date of death value of the qualified share. Further, at Taxpayer's death, the value of the qualified share will be includible in Taxpayer's gross estate under § 2041, and Taxpayer will be the transferor of this value for generation-skipping transfer tax purposes.

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 taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
Assistant Chief Counsel
(Passthroughs and Special Industries)
By Katherine A. Mellody
Senior Technician Reviewer, Branch 4

Enclosure: Copy for section 6110 purposes