

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

Telephone Number:

In Re:

Refer Reply To:
CC:PSI:B04
PLR-163804-03
Date:
August 17, 2004

LEGEND:

- Grantor =
- Spouse =
- Trust =
- Court =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- Son =
- Daughter 1 =
- Daughter 2 =
- State =
- Cite 1 =

- Cite 2 =

Dear :

This is in response to a letter dated October 28, 2003 and other correspondence requesting a ruling concerning the federal gift and estate tax consequences of the Court Order construing and modifying Article IX of Trust.

You have requested the following rulings:

1. The power of appointment granted to Spouse under Article IX of Trust, as reformed pursuant to Court's Order dated Date 4, does not constitute a general power of appointment under section 2041(b) of the Internal Revenue Code and thus Trust B will not be included in Spouse's gross estate for federal estate tax purposes upon her death under section 2041(a)(2).

2. The reformation of Article IX pursuant to Court's Order dated Date 4, did not result in the release of a general power of appointment under section 2514(b) so as to constitute a gift for federal gift tax purposes.

The facts and representations submitted are summarized as follows:

On Date 1, Grantor, a resident of State, executed his will and Trust, a revocable inter vivos trust. Article IV of the will provides that the residue of Grantor's estate is to be distributed to the Trustees of Trust to be held, administered, and distributed as an integral part of that trust.

In Article III of Trust, Grantor is designated as Trustee. Spouse is designated as the Successor Trustee, to serve in the event of the inability or unwillingness of the Trustee to serve.

Article VIII, provides, in relevant part, that upon the death of Grantor, if Grantor is survived by Spouse, the Trustee is to divide the Trust estate into two separate shares, Share A and Trust B. Share A is to be funded with assets "having a value equal to the maximum marital deduction as finally determined in Grantor's federal estate tax proceedings, less the aggregate amount of marital deductions allowed, if any, for property passing to [Spouse] otherwise than pursuant to the provisions of [Article VIII]." However, the amount passing to Share A is to be reduced by "the amount, if any, needed to increase the Grantor's taxable estate (for federal estate tax purposes) to the largest amount that, after allowing for the unified credit against the federal estate tax, and the state death tax credit . . . will result in the smallest (if any) federal estate tax being imposed on the Grantor's estate." Share A is to be distributed to an inter vivos trust created by Spouse, or if the trust is not established, outright to Spouse free of trust.

Trust B is to be funded with the balance of the Trust estate after the assets have been selected for Share A. If Spouse does not survive Grantor, Trust B is to be funded with the entire Trust Estate.

Article IX, provides that the Trustee is to pay or apply the net income from Trust B to the use of Spouse, for her life, at quarterly or more frequent intervals. In addition, the Trustee is to pay to Spouse such amounts of corpus, as from time to time, Trustee deems advisable to provide for Spouse's "medical care, education, support, and maintenance in reasonable comfort" taking into consideration to the extent the Trustee deems advisable, any other income or resources of Spouse known to the Trustee. Further, Spouse has a noncumulative right to withdraw annually from the principal of Trust B, the greater of \$5,000 or 5% of the total value of the principal of Trust B on the last day of the fiscal year.

Finally, Article IX provides for the disposition of the Trust B corpus on Spouse's death, as follows:

Upon the death of the Grantor's Wife, the corpus remaining in Trust B shall be distributed by the Trustee free of the Trust, to or for the benefit of one or more persons or corporations, in such manner and in such proportions, whether outright, in Trust or otherwise, as the Grantor's Wife by her Last Will and Testament may direct and appoint.

Any part of the Trust property not effectively appointed is to be distributed equally to Son, Daughter 1, and Daughter 2.

Grantor died on Date 2. Spouse, as Trustee of Trust, petitioned the Court to reform Article IX to insert language that would limit the potential appointees of Spouse's power of appointment to persons other than Spouse's estate, her creditors, or the creditors of her estate. It was represented to the Court that the failure of the instrument to contain this limiting language was a scrivener's error that contravened Grantor's intent to eliminate any federal estate tax due on Grantor's death and minimize the federal estate tax liability due on Spouse's death. It was further represented that Grantor did not intend for the assets of Trust B to be included in the gross estate of Spouse.

On Date 4, the Court issued a Court Order that modified the provision of Article IX, quoted above, to provide as follow:

Upon the death of the Grantor's Wife, the corpus remaining in Trust B shall be distributed by the Trustee free of Trust, to or for the benefit of one or more persons or corporations, excluding Grantor's wife, Grantor's wife's estate, the creditors of Grantor's wife, or the creditors of Grantor's wife's estate, in such manner and in such proportions, whether outright, in Trust or otherwise, as the Grantor's Wife by her Last Will and Testament may direct and appoint.

LAW AND ANALYSIS

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 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 sections 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 section 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 section 20.2041-1(c)(2) of the Estate Tax Regulations, 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 section 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 section 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 section 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 section 20.2041-1(c)(2), defining a general power of appointment for purposes of section 2514. Thus, the rules governing when a power of appointment is limited by an ascertainable standard under section 2041 also apply under section 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.

Under applicable State law, a trust with testamentary aspects may be reformed after the death of the settlor for a unilateral drafting mistake so long as the reformation

is not contrary to the interest of the settlor. Cite 1; Cite 2. Based on an analysis of 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 conclude that the power of appointment granted to Spouse under Article IX of Trust, as reformed pursuant to Court's Order dated Date 4, does not constitute a general power of appointment under section 2041(b) of the Internal Revenue Code. Therefore, Trust B will not be included in Spouse's gross estate for federal estate tax purposes upon her death under section 2041(a)(2), except to the extent that, at the time of Spouse's death, spouse is entitled to withdraw funds from Trust B pursuant to her noncumulative right to withdraw annually from the principal of Trust B, the greater of \$5,000 or 5% of the total value of the principal of Trust B. See section 20.2041-3(d)(3). We also conclude that the reformation of Article IX pursuant to Court's Order dated Date 4, did not result in the release of a general power of appointment under section 2514(b) so as to constitute a gift for federal gift tax purposes.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are 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.

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

Sincerely,

George L. Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for section 6110 purposes