

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

July 27, 2000

Legend:

Decedent =
Spouse =
Date 1 =
Intervivos Trust =

Corporate Trustee =

Date 2 =
Child A =
Child B =
\$x =
\$y =

Dear :

This is in response to the letter dated February 25, 1999, and subsequent correspondence submitted by your authorized representative requesting rulings on the application of the federal gift tax and estate tax to the transaction described below.

Decedent executed the Intervivos Trust, a revocable trust, on Date 1. Corporate Trustee was designated as trustee. Spouse was designated to become a co-trustee at Decedent's death. Decedent died on Date 2. The Intervivos Trust was funded and became irrevocable at Decedent's death. Decedent was survived by Spouse and two children, Child A and Child B.

Under Item Sixth of the Intervivos Trust, as executed by Decedent, if Spouse survives Decedent, the Trust property is to be divided at Decedent's death between Trust A and Trust B. Under Item Sixth, Paragraph A, Trust A is to be funded with the least amount of principal needed to reduce Decedent's

federal estate tax to the lowest possible figure. In calculating that amount so that the largest possible amount of the principal can pass free of federal estate tax to Trust B, (i) all other property which qualifies for the marital deduction and (ii) all other deductions and credits are to be utilized first to the greatest extent to reduce the tax. Under Item Sixth, Paragraph B, Trust B is to be equal in amount to the balance of Decedent's residuary estate after deducting the amount allocated to Trust A.

Under Item Seventh, Paragraph B, commencing as of Decedent's death and for Spouse's life or until her earlier remarriage, the net income of Trust A is to be paid to Spouse at least quarter-annually.

Under Item Seventh, Paragraph C, until Spouse's death or remarriage, the trustee is to pay to her so much of the Trust A principal that Corporate Trustee in its discretion deems necessary for any medical or health need or emergency and/or for the support and maintenance of Spouse so that she can live as she was accustomed. Until Spouse's death or remarriage, she can request up to 5 percent of the principal of Trust A annually, which is to be non-cumulative; however, there is to be no invasion of the principal of Trust A until the entire principal and interest of Trust B are exhausted. Any decision relating to the invasion of the principal of Trust A is to be made solely by Corporate Trustee.

Under Item Eighth, upon Spouse's remarriage the principal of Trust A is to be divided as follows: Under Item Eighth, Paragraph A, 50% of Trust A is to be held for Spouse's benefit until her death. The terms and conditions of Item Seventh are to apply to this one-half of Trust A. Under Item Eighth, Paragraph B, the other one-half of Trust A is to be held in a trust reserving the principal for Child A and Child B or their natural heirs. One-half of the annual income from this one-half of Trust A is to be paid to Spouse annually for her life. The other one-half of the income is to be paid to Child A and Child B equally. Spouse is not to have any right to the principal of this part of Trust A after her remarriage.

Under Item Ninth, Paragraph B, for Spouse's life, the income of Trust B is to be paid to her at least quarter-annually. Under Item Ninth, Paragraph C, the trustee is to pay to Spouse so much of the principal that Corporate Trustee in its sole discretion deems necessary for Spouse's health, education, welfare, and support. Upon written request, Spouse may receive part or all of the corpus of Trust B during her life.

Under Item Tenth, on Spouse's death, the trusts are to terminate and the assets are to be divided equally between Child A and Child B.

Based on the Intervivos Trust formula for funding Trust A and Trust B, Trust A would be considered a “marital deduction trust” holding that portion of Intervivos Trust property to which the unified credit allowed under § 2010 of the Internal Revenue Code would not apply. Trust B would be considered a “credit shelter trust” holding that portion of Intervivos Trust property that could pass free from estate tax because of the unified credit.

However, the governing provisions of Trust A and Trust B are at cross purposes with the funding purposes of these trusts. The governing provisions of Trust B, the purported credit shelter trust, provide Spouse with an income interest for life and a lifetime general power of appointment. Thus, Trust B would qualify for the marital deduction in Decedent’s estate under § 2056(b)(5) but would be includible in Spouse’s gross estate under § 2041, effectively eliminating the benefit of the unified credit to Decedent’s estate.

The property included in Decedent’s gross estate had a total value of \$x. Most of this property passed outright to Spouse and qualified for the marital deduction under § 2056(a). The remaining property, after payment of debts and expenses, had a value of \$y, which was less than Decedent’s available unified credit amount. Thus, there was no reason to fund Trust A.

Property with a value of \$y passed to the Intervivos Trust and the Intervivos Trust was administered under the governing provisions of Trust B. Spouse exercised her general power of appointment and withdrew \$30,000 from the trust; she also continued to receive all of the trust income after she remarried.

Spouse’s attorney, who was not involved with drafting the Intervivos Trust or administering Decedent’s estate, recognized the problem raised by the funding and governing provisions of Trust A and Trust B. Spouse and Corporate Trustee petitioned the local court for an interpretation of the Intervivos Trust, alleging that the funding provisions did not reflect Decedent’s intention. The person who drafted the Intervivos Trust submitted an affidavit to the court in which he described Decedent’s intentions with respect to Trust A and Trust B and affirmed that the transposition of the funding and governing provisions was inadvertent scrivener’s error; i.e., that each reference in Item Sixth, Paragraph A to “Trust A” should have been a reference to “Trust B,” and each reference in Item Sixth, Paragraph A, to “Trust B” should have been a reference to “Trust A.”

The court issued an order that corrected the funding provision nunc pro tunc so that in the formula for funding, each reference to Trust A in Paragraph A

of Item Sixth is a reference to Trust B, and each reference in Paragraph A of Item Sixth to Trust B is a reference to Trust A. The court further ordered that Spouse return the income paid to her from the Intervivos Trust after her remarriage and the principal withdrawn by her.

We have been asked to rule that:

1. Spouse will not be considered to have a general power of appointment under § 2041 or § 2514 over the trust property.
2. Neither the filing of the petition with the court nor the granting of the relief has gift tax consequences to Spouse.
3. No gift is made by Spouse by reason of her reimbursing the withdrawn funds and excess income that she received.

Section 2501 provides that the gift tax is imposed for each calendar year on the transfer of property by gift during the calendar year by any individual.

Section 2041(a) 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 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, the property would be includible in the decedent's gross estate under §§ 2035 to 2038 inclusive.

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

Under § 2514(b), the exercise or release of a general power of appointment is a transfer of property by the individual possessing the power.

Section 2514(c) defines a "general power of appointment" as a power exercisable in favor of the individual possessing the power, the individual's estate, the individual's creditors, or the creditors of the individual's 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 the court, 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, the doctrine of probable intent is a leading principle governing construction of wills and trusts. Under that doctrine, in ascertaining the subjective intent of the testator, courts will give primary emphasis to the testator's dominant plan and purpose as they appear from the entirety of the instrument when read and considered in the light of the surrounding facts and circumstances. In the Matter of the Estate of Branigan, 129 N.J. 324, 609 A.2d 431 (Sup. Ct. NJ, 1992). See also Rev. Rul. 77-194, 1977-1 C.B. 283.

In this case, after considering the facts submitted and the representations made, we conclude that the court order modifying the Intervivos Trust is consistent with applicable state law, as it would be applied by the highest court of the state. Pursuant to the order, the funding and governing provisions for a marital deduction trust apply to Trust B which, in this case, would not be funded. The funding and governing provisions applicable to a credit shelter trust apply to Trust A which would be funded.

Accordingly, Spouse will not be considered to have held or released a general power of appointment under § 2041 or § 2514 over the Intervivos Trust property; the filing of the petition with the local court and the granting of relief did not result in gift tax consequences to Spouse; and no gift is made by Spouse by reason of her reimbursing the withdrawn funds and excess income that she received.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

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(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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

Enclosure
copy for section 6110 purposes