

**Internal Revenue Service**

**Department of the Treasury**

Number: **200404004**  
Release Date: 1/23/2004  
Index No.: 2036.07-00; 2041.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4 / PLR-142964-02

Date:

OCTOBER 08, 2003

Re:

Legend

Decedent -  
Spouse -  
Trust 1 -  
Trust 2 -  
Decedent's Trust -

Survivor's Trust -

Date 1 -  
Date 2 -  
Date 3 -  
Date 4 -  
State X -  
County 1 -  
County 2 -  
X acres -  
Y acres -  
Z acres -  
State Statute 1 -  
State Statute 2 -  
Citation A -

Dear :

This is in response to your April 28, 2003, letter and prior submissions, requesting rulings on behalf of the personal representative of the above captioned estate regarding the application of federal estate, gift, and generation-skipping transfer tax to the proposed reformation of a trust.

The facts and representations submitted are summarized as follows:

On Date 1, Decedent and Spouse, residents of State X, created Trust 1. Decedent and

PLR -142964-02

Spouse were both the co-trustees and primary beneficiaries of Trust 1. Decedent died on Date 2, survived by Spouse.

Several provisions of the trust document are confusing and contradictory. In addition, as discussed below, several pages of the trust document could not be located. The instrument was drafted by a corporation that has been ordered, by court order, to cease doing business in State X.

Article One (C) of Trust 1 provides that Decedent and Spouse may add property to the trust during their joint lives and during the survivor's life. Article One (D) provides that Decedent or Spouse, or the survivor, can at any time transfer trust property into a separate "irrevocable" trust (Trust 2), discussed below.

Article Two (A) of Trust 1 provides that, during their joint lives, either Decedent or Spouse have the right to alter, amend, or revoke Trust 1 in whole or in part, except "as it affects any irrevocable trust created herein."

Article Three of Trust 1 contains the dispositive provisions covering both Trust 1 and Trust 2 during the joint lives of the trustors. Under Article Three(A), the trustees are directed to pay to Decedent and Spouse as much of the Trust 1 and Trust 2 net income, as Decedent and Spouse request. Under Article Three(C), the trustees are to distribute to Decedent and Spouse so much of the principal of Trust 1 as they request.

Article Two (B) provides that from and after the death of the first trustor to die, any assets of the decedent's separate trust estate and those assets of the decedent's share of the joint trust estate shall be distributed to the surviving trustor and shall merge with the survivor's share of the joint trust estate and any assets of the surviving trustor's separate trust estate and shall form the Survivor's Trust, described below. The Survivor's Trust may be revoked or amended at any time, in whole or in part, except to the extent such revocation would affect any irrevocable trust created under Trust 1.

Article Four (A) of Trust 1 provides that, upon the death of the first trustor to die, the trust estate will be divided into 3 separate trusts; Decedent's Trust, Survivor's Trust, and Insurance Trust. Article Four (C) provides that the Decedent's Trust is to include an amount equal to the lesser of the equivalent estate tax exemption in effect during the year of death of the first trustor to die, or one-half of the Trust 1 estate, and shall be funded only with separate or jointly-held property transferred by first trustor to die to Trust 1, including assets held in the irrevocable trusts created under Trust 1. Article Four (C) states that the intent is to transfer to the Decedent's Trust "an amount which will provide for a zero (0) tax upon the death of the first to die Trustor." Article Four (D) provides that the rest and residue of the trust estate (other than the insurance policies which will be allocated to the Insurance Trust) is to be allocated to the Survivor's Trust, including any remaining assets held in any irrevocable trust (Trust 2) that were transferred to the irrevocable trust by the surviving trustor.

Article Five (B) of Trust 1 provides that all the net income of the Survivor's Trust is to be distributed at least quarterly to the surviving trustor. Further, the trust instrument grants the surviving trustor an inter vivos and a testamentary general power to appoint principal and undistributed income (except for the part of the Survivor's Trust that is attributable to Trust 2),

PLR -142964-02

to anyone, including the surviving trustor and his or her estate. Upon the death of the surviving trustor, the trust will terminate and any unappointed corpus will be distributed in accordance with Article Five (F).

Article Five (C) of Trust 1 provides that the net income of the Decedent's Trust is to be distributed to the surviving trustor during his or her life. The surviving trustor has no right to invade the corpus for any reason, nor does the surviving trustor have any power to appoint the principal or undistributed income to himself or herself or to any person.

Article Five (C)(4) provides that upon the death of the surviving trustor, the Decedent's Trust is to terminate and the corpus is to be distributed in accordance with Article Five (F). You have represented, however, that pages 19-22 of Trust 1 that contain Article Five (E)(3), (F), (G), (H) and (I), are missing and could not be located by Spouse, or reconstructed.

As noted above, under Article One (D) the Decedent or Spouse, or the survivor, can at any time transfer trust property into a separate "irrevocable" trust (Trust 2). Under Article Three (A), the trustees shall pay to Decedent and Spouse, during their joint lives, as much income of Trust 2 as Decedent and Spouse request, unless otherwise limited under other trust provisions. Article One (D) designates Decedent and Spouse as the co-trustees of Trust 2 with all the powers of co-trustees as described in Trust 1. Under Article Two (D)(2), the Decedent and Spouse reserve the power to distribute, during their joint lives, or during the life of the survivor, all or part of the Trust 2 corpus to certain charitable institutions defined in Article Five (A) as "any and all not for profit organizations and entities, whether religious or humanitarian in nature." Article One (D) further states that "any amendment(s) following the date of such transfer of any asset(s) to this irrevocable trust, including those which change the designation of Beneficiaries or manner or timing of the distribution of such assets, shall not apply to any asset transferred prior thereto, except with regard to the exercise of [Decedent and Spouse's] power to gift any of these assets to any charity as provided in Article Two."

Article Five(E)(2) provides that the surviving trustor shall have no power of appointment over the assets of Trust 2, except as provided in Article Two (D), but the co-trustees shall pay to the trustors or the surviving trustor, if one of the trustors has died, all of the income from Trust 2 principal for the remainder of his/her/their life.

Upon the death of the last to die of Decedent and Spouse, the assets of Trust 2 will be distributed in accordance with the terms of Article Five. As stated above, the pages of Trust 1 that apparently contain these dispositive provisions (Article Five (E)(3) through (I)), are missing and cannot be located or reconstructed.

It is represented that the assets transferred to Trust 1 consisted of various parcels of real property owned by Decedent and Spouse as joint tenants located in County 1, approximately X acres of ranch land owned by Decedent and Spouse as joint tenants located in County 2, and Y acres of ranch land owned by Spouse located in County 2. The assets transferred to Trust 2 consisted of Z acres of real property owned by Decedent and Spouse as joint tenants located in County 2.

As discussed above, the trust document contains ambiguous and contradictory provisions. In particular, Article Two (B) appears to direct that the entire trust estate pass to the Survivor's Trust with respect to which Spouse possesses a general power of appointment. On the other hand, Article Four provides that the trust estate is to be divided into three trusts,

PLR -142964-02

including the Decedent's Trust, with respect to which Spouse does not have a general power of appointment. In addition, pages 19-22 of the trust document, that likely contained the provisions for disposition of Trust 1 and Trust 2 on the death of the surviving trustor, are missing. Accordingly, after Decedent's death, Spouse, as personal representative of Decedent's estate and surviving trustor, obtained a court order dated Date 3 as modified by order dated Date 4. The court orders modified Article Two (B) of Trust 1, and adopted new Articles Five (E)(3) and (F) in lieu of the missing Articles Five (E)(3) through (I), which, in addition to Article Five (J), were revoked by the court order.

Under Article Two (B), as modified by the court order, the assets of the first trustor to die's separate trust estate and the assets of his or her share of the joint trust estate (*with the exception of the assets forming the Decedent's Trust and Trust 2*) will be merged with the survivor's share of the joint trust estate and any assets of the survivor's separate trust estate and the resulting trust will constitute the Survivor's Trust, which, in accordance with the terms of Trust 1, may be revoked or amended at any time by the surviving trustor.

New Article Five (E)(3) and Article Five (F) provide for the disposition on the death of the survivor of Decedent and Spouse of the remaining corpus of the Decedent's Trust, Trust 2, and the Survivor's Trust (to the extent not appointed by Spouse) in the same manner as provided under the State X intestacy statute.

You have requested the following rulings:

1. One-half of the value of Trust 1 on the date of Decedent's death, is includible in Decedent's gross estate for estate tax purposes under §§ 2036 and 2038 of the Internal Revenue Code.
2. One-half of the value of Trust 2 on the date of Decedent's death, is includible in Decedent's gross estate for estate tax purposes under §§ 2036 and 2038.
3. Prior to the modification Spouse did not possess a general power of appointment as defined in § 2041 over either the Decedent's Trust or Trust 2 and the modification of Trust 1 as described above, did not constitute a release of a general power of appointment by Spouse.
4. The Internal Revenue Service will recognize the Court's modification of the Trust Agreement that adopt new Article Five (E)(3) and (F).

#### LAW AND ANALYSIS

Section 2001 imposes a tax on the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of the decedent's death.

Section 2035(a) provides that if the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, within three years of the decedent's death, and the value of the property (or an interest therein) would have

PLR -142964-02

been included in the gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been included in the gross estate.

Section 2036 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death, (1) the possession or enjoyment of, or right to income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income from the property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Rev. Rul. 69-577, 1969-2 C.B. 173, considers a situation where property held as either a joint tenancy or tenancy by the entirety is transferred by the co-tenants to a trust pursuant to which the transferors retain the right to receive trust income for life. The ruling concludes that since, under state law, each co-tenant possesses an undivided one-half interest in the property, each makes a transfer of a one-half interest in the property to the trust. Consequently, only one-half the value of the property is subject to inclusion in each co-tenant's gross estate under section 2036(a)(1). United States v. Heasty, 370 F. 2d 525 (10<sup>th</sup> Cir. 1966).

Section 2041(a)(2) provides for the inclusion in the gross estate of any property over which the decedent possesses, at the time of his death, a general power of appointment created after October 21, 1942. Section 2041(b)(1) provides that the term "general power of appointment" means 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, except that a power to consume property for the benefit of the decedent that is limited by an ascertainable standard relating to health, education, support, or maintenance of the decedent is not deemed a general power of appointment.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, is a transfer of property by the person possessing the power.

Section 20.2041-1(b)(2) of the Estate Tax Regulations provides that the term power of appointment does not include powers reserved by the decedent to himself within the concepts of §§ 2036 to 2038.

PLR -142964-02

Likewise, § 25.2514-1(b)(2) of the Gift Tax Regulations provides that, for gift tax purposes, the term “power of appointment” does not include powers reserved by the donor to himself.

#### Rulings 1 and 2

Under Articles Two (A) and Article Three of Trust 1, Decedent and Spouse retained the right to alter, amend, or revoke Trust 1 in whole or in part, except as this power applies to Trust 2. Further, Decedent and Spouse could require the trustee to distribute, without limitation, principal and income upon his or her request. Decedent retained these rights until his death on Date 2. Thus, with respect to Trust 1, Decedent retained rights described in §§ 2036(a)(1) and (2), and § 2038(a)(1). Further, as described above, the assets transferred to Trust 1 consisted of various parcels of real property owned by Decedent and Spouse as joint tenants located in County 1, approximately X acres of ranch land owned by Decedent and Spouse as joint tenants located in County 2, and Y acres of ranch land owned by Spouse located in County 2. In accordance with Rev. Rul. 69-577, only that portion of the value of Trust 1 on the date of Decedent’s death attributable to Decedent’s one-half interest in the County 1 real property, and Decedent’s one-half interest in the County 2 real property held by Decedent and Spouse as joint tenants prior to the transfer to Trust 1, is includible in Decedent’s gross estate under §§ 2036 and 2038.

Similarly, under Article Five (E)(2) of Trust 1, Decedent (and Spouse) retained the right to receive the income from Trust 2 during their joint lives and during the life of the survivor. In addition, the Decedent (and Spouse) retained the power to distribute the trust property, at his discretion, to charitable organizations as defined in Article Five (A). Thus, with respect to Trust 2, Decedent retained rights described in §§ 2036(a)(1) and (2), and § 2038(a)(1). Further, as noted above, the assets transferred to Trust 2 consisted of Z acres of real property located in County 2, that was owned by Decedent and Spouse as joint tenants. In accordance with Rev. Rul. 69-577, one-half of the value of Trust 2 on the date of Decedent’s death attributable to the Decedent’s one-half interest as a joint tenant in the County 2 property transferred to Trust 2 is includible in Decedent’s gross estate under §§ 2036 and 2038.

#### Rulings 3 and 4

In addressing the reformation of the terms of a trust, the law of State X provides:

On petition by a trustee or beneficiary, the court may reform the terms of the trust to conform to the trustor’s intention if the failure to conform was due to a mistake of fact or law and the testator’s intent can be established. The terms of the trust may be construed or modified, in a manner that does not violate the trustor’s probable intention, to achieve the trustor’s tax objectives.

State Statute 1.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Supreme Court held that where the issue involved is the determination of property interests for federal estate tax purposes, and the determination is based on state law, the highest court of the state is the best authority on its own law. The Service, however, is not bound by a lower court decision. If there is a decision by a lower court, then the federal authority must apply what it finds to be state law

PLR -142964-02

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.

In Citation A, the Supreme Court of State X upheld the general rule of law that, in case of uncertainty arising upon the face of a will, as to the application of any of its provisions, the testator’s intention is to be ascertained from the words of the will, taking into view the circumstances under which it was made, exclusive of his oral declarations. .

In reference to the modification of Article Two (B) of Trust 1, as originally drafted, the Article indicates that the entire Trust 1 corpus is to pass to the Survivor’s Trust, over which Spouse is granted a general power of appointment. However, this provision is in direct conflict with Article Four (A) which expressly provides that, upon the death of the first trustor to die, the trust estate is to be divided into 3 separate trusts, one of which is the Decedent’s Trust. Article Four (C) specifies that the Decedent’s Trust is to be funded with an amount equal to the lesser of the equivalent estate tax exemption in effect during the year of death, or one-half of the Trust 1 estate, and is to be funded only with separate or jointly-held property transferred by the decedent to the trust. Further, the language of Article Four (C) indicates trustors’ express intent to create a “credit shelter” trust that will make full use of the available unified credit of the first trustor to die. It is only the balance of the trust estate that is to pass to the Survivor’s Trust (after funding the Insurance Trust). Further, Articles Five (C) and (E)(2) specifically prohibit the beneficiaries of the Decedent’s Trust from holding a general power of appointment.

Accordingly, we conclude that the court order construing and reforming Article Two (B) to direct that only those assets that are not used to fund Decedent’s Trust or held in Trust 2 are to merge into the Survivor’s Trust is consistent with the intent of the trustors, properly resolves the ambiguity presented in this portion of the trust instrument, and is consistent with state law. Therefore, the reformation of Article Two (B) of Trust 1 will not be considered a release or transfer of any retained interest or power that would subject the assets of the Survivor Trust or Trust 2 to inclusion in Spouse’s gross estate under §§ 2041.

Further, the court order reformed Trust 1 by inserting new Article Five (E)(3) and (F) to provide dispositive provisions that were contained in the missing pages of Trust 1. The contents of these missing pages could not be ascertained by reference to other sections of Trust 1, or any of the trusts created therein. Because these pages were missing, the trust contained no direction regarding the disposition of the trust estate on the death of the surviving trustor. The trust, as reformed pursuant to the Date 4 court order, provides for the same distributive scheme that would apply if Spouse dies intestate. See State Statute 2. The application of this dispositive scheme to the trust estate on Spouse’s death, under the facts presented, is consistent with applicable state law. Accordingly, the reformation of Trust 1 on Date 4, adopting new Article Five (E)(3) and (F), did not result in a transfer of an interest in property that is subject to federal estate, gift, or generation-skipping transfer tax.

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.

Except as expressly provided herein, we express or imply no opinion on the Federal tax

PLR -142964-02

consequences of any aspect of any transaction or item discussed or referenced in this letter under any other provisions of the Code.

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

Sincerely,

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

Enclosures

Copy for section 6110 purposes  
Copy of this letter

cc:

cc:

cc: