

Internal Revenue Service

Number: **201132017**
Release Date: 8/12/2011
Index Number: 2041.00-00, 2501.00-00,
2514.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
Telephone Number: , ID No.

Refer Reply To:
CC:PSI:B04
PLR-147173-10
Date:
May 10, 2011

Re:

Legend

- Trust =

- Decedent =
- Surviving Spouse =
- Child 1 =
- Child 2 =
- Child 3 =
- Attorney 1 =
- Attorney 2 =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- State =
- Court =

- State Statute 1 =
- State Statute 2 =
- State Statute 3 =
- Citation 1 =

- Citation 2 =

- Citation 3 =

- Citation 4 =

Citation 5 =

Citation 6 =

Dear :

This letter responds to your authorized representative's letter of November 8, 2010, requesting rulings on federal gift and estate tax consequences of a judicial modification of a trust.

The facts submitted are as follows. Decedent and Surviving Spouse (Trustors) created an inter vivos revocable trust (Trust) on Date 1. Trustors were the original trustees of Trust. Upon the death of the first Trustor, the surviving Trustor became the sole trustee. Trust is governed by the laws of State.

Article III, Section 3.02 of Trust provides that upon the death of the first Trustor to die, the trust assets shall be divided among the Marital Trust, the By-Pass Trust, and the Survivor's Trust.

Article IV, Distributions on Death of Surviving Spouse, of Trust provides as follows:

Section 4.01 of Trust provides that on the death of the Surviving Spouse, unless the Trustee determines that other provisions have been made for payment, the Trustee shall pay from the trust estate the Surviving Spouse's debts, expenses, and death taxes due by reason of the Surviving Spouse's death and shall charge them against property in the *By-Pass Trust*, except that the Non-Qualified Marital Trust (if any) shall bear any estate, gift, generation-skipping or other transfer taxes imposed on such trust. (Emphasis added.)

To the extent that other assets are available, the Trustee shall not use any insurance proceeds, qualified retirement plan distributions, or other assets otherwise excludable from federal estate tax to pay debts, expenses, death taxes, or any other obligations enforceable against the Surviving Trustor's estate.

Section 4.02 provides that upon the death of the Surviving Spouse, the Trustee shall distribute and/or retain the balance then remaining in the Survivor's Trust, including both principal and any accrued but undistributed income, as the Surviving Spouse may appoint by the Surviving Spouse's Will or Codicil thereto specifically referring to and exercising this general power of appointment, to such one or more persons and entities, including the Surviving Spouse's estate, the Surviving Spouse's creditors, or the

creditors of the Surviving Spouse's estate. In exercising the foregoing general power of appointment, the Surviving Spouse may appoint outright or in trust, in present or future interest, or in any combination of these, and the Surviving Spouse may create new powers of appointment (including general powers), restrictions and conditions in or for the benefit of any of the objects of the Surviving Spouse's general power.

To whatever extent the then remaining balance of the Survivor's Trust has not been effectively appointed by the Surviving Spouse pursuant to the above general power of appointment and not consumed for the payment of debts, expenses, and taxes, the Trustee shall distribute the Survivor's Trust, including any additions made to the trust by reason of such death, such as from the Surviving Spouse's Will or life insurance policies on the Surviving Spouse's life, as set forth in Section 4.04 hereinbelow.

Decedent died on Date 2, survived by Surviving Spouse, Child 1, Child 2, and Child 3. Surviving Spouse was appointed executor of Decedent's estate. Surviving Spouse is the trustee of the Survivor's Trust, the By-Pass Trust, and the Marital Trust.

Prior to Decedent's death, Decedent and Surviving Spouse engaged Attorney 1 to provide them with estate planning advice. Attorney 1 drafted Trust for Decedent and Surviving Spouse. After Decedent's death, Attorney 2 was consulted. Upon review of the trust provisions, Attorney 2 confirmed that the language in Article IV, Section 4.01 contained an error. Article IV, Section 4.01 provides that "[o]n the death of the Surviving Spouse, . . . , the Trustee shall pay from the trust estate the Surviving Spouse's debts, expenses, and death taxes due by reason of the Surviving Spouse's death and shall charge them against property in the *By-Pass Trust* . . ." (Emphasis added.) Surviving Spouse contends that the language in Article IV, Section 4.01 of Trust, should refer to the Survivor's Trust, not the By-Pass Trust. As drafted, the reference to the By-Pass Trust may provide Surviving Spouse with a testamentary general power of appointment under § 2041(b)(1).

In affidavits, Surviving Spouse and Attorney 1 represent that it was the Decedent's and Surviving Spouse's intent as Trustors of Trust to minimize estate taxes, including maximizing the use of the unified credit. Accordingly, the By-Pass Trust should have been drafted to ensure that the assets in the By-Pass trust will not be included in the gross estate of the Surviving Spouse and the Surviving Spouse will not have any property or other rights to the trust property that would cause the assets to be included in the Surviving Spouse's gross estate upon Surviving Spouse's death.

In order to correct the error in the Trust and to accurately reflect the intent of the Trustors, on Date 3, Surviving Spouse, as the Trustee of Trust, filed a petition with Court seeking authorization to modify Trust *nunc pro tunc*. Surviving Spouse, as the

surviving Trustee, has stated that it is, and was at all times, Surviving Spouse's intent and desire that the assets of the By-Pass Trust be administered so as to avoid taxation at Surviving Spouse's death. To support the assertion that the reference to the By-Pass Trust was a scrivener's error, Surviving Spouse provided the following arguments. First, Section 3.01 pertains to the payment of the expenses of the first spouse to die and directs the trustee to pay the debts, expenses, and death taxes of the first spouse to die and charge the payment of such items against the By-Pass Trust. Section 4.01, on the other hand, pertains to expenses of the surviving spouse but contains the same language contained in section 3.01. Surviving Spouse asserts, and Attorney 1 confirms, that the language in Section 4.01 was copied from Section 3.01 but improperly edited and, therefore, the reference to the By-Pass Trust, rather than the Survivor's Trust, remained.

Second, the language in the second paragraph of Section 4.01 contradicts the language in the first paragraph in Section 4.01. The second paragraph directs the Trustee not to use "any insurance proceeds, qualified retirement plan distributions, or other assets otherwise excludable from federal estate tax to pay debts, expenses, death taxes, or any other obligations enforceable against the Surviving Trustor's estate." The phrase "other assets otherwise excludable" would necessarily include assets in the By-Pass Trust. This language contradicts the directive to the trustee to pay these items from the By-Pass Trust.

Finally, the language of Section 4.02 provides that "[t]o whatever extent the then remaining balance of the Survivor's Trust has not been effectively appointed by the Surviving Spouse pursuant to the above general power of appointment and not consumed for the payment of debts, expenses, and taxes, the Trustee shall distribute the Survivor's Trust, including any distributions made to the trust by reason of such death, such as from the Surviving Spouse's Will or life insurance policies on the Surviving Spouse's life, as set forth in Section 4.04 hereinbelow." This language suggests that the Survivor's Trust should bear the debts, expenses and taxes incurred due to the death of the Surviving Spouse.

On Date 4, the Court issued an Order granting the petition for modification. The Court approved the modifications as an equitable reformation of Trust under common law and State Statute 1.

You have requested the following rulings:

1. The By-Pass Trust, as modified, does not provide Surviving Spouse with a testamentary general power of appointment under § 2041 of the Internal Revenue Code over the assets of Trust.

2. The modification of Article IV, Section 4.01, of Trust pursuant to the Court's Order is not an exercise or release of a general power of appointment under § 2514(b) that constitutes a gift for federal gift tax purposes.

3. Surviving Spouse is not deemed to have made a gift, under § 2501, of an interest in Trust as a result of the Court Order modifying Section 4.01 of Trust.

Ruling 1

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2031(a) provides, generally, that the value of the gross estate of the decedent shall be determined by including to the extent provided for in §§ 2031 through 2046, 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 includes 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.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power.

Section 20.2041-1(c) of the Estate Tax Regulations provides, in part, that a power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the estate is included within the meaning of a power of appointment exercisable in favor of the decedent's estate, his creditors, or the creditors of his estate.

State Statute 1 provides, in part, that when through fraud or mutual mistake of the parties, or a mistake of one party, a written contract does not truly express the intention of the parties, it may be revised on the application of the party aggrieved.

State Statute 2 provides, in part, that if all beneficiaries of an irrevocable trust consent, they may compel modification upon petition to the court.

State Statute 3 provides, in part, that a court may modify the dispositive provisions of a trust if, owing to circumstances not known to the settler or not anticipated by the settler, the continuation of the trust under its terms would defeat or substantially impair the accomplishment of the purposes of the trust.

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 State law a trust has standing to seek reformation under State Statute 1. See Citation 1, *citing* Citation 3 at p. 1180. In addition, a probate court has equitable power to modify a trust if the provisions of the trust are ambiguous or if adherence to the terms of the trust would defeat the primary purpose of the trust. See Citation 2; Citation 3. The "equitable power of a trial court to modify or reform a trust extends to situations where the trust instrument contains some expression of the trustor's intention, but a drafting error renders that expression ambiguous." Citation 3 at 82-83, *citing* Citation 4. A mistake by the scrivener or draftsman in reducing the intent of the parties to writing is ground for reformation. See Citation 5. *Nunc pro tunc* amendments are permitted primarily so that errors in the record may be corrected; the power to amend *nunc pro tunc* is a limited one, and may be used only where necessary to correct a clear mistake and prevent injustice. See Citation 6.

In this case, the documentation submitted by Surviving Spouse strongly indicates that Decedent and Surviving Spouse did not intend to have any control over the assets held in the By-Pass Trust, and that the provision in Section 4.01 of Trust to charge Surviving Spouse's debts, expenses and death taxes from the By-Pass Trust was the result of a scrivener's error. In reforming the By-Pass Trust, Court found that the modification of Trust was an equitable reformation of Trust under common law and State Statute 1.

Consequently, we conclude that the Court's Order on Date 4, modifying the trust instrument *nunc pro tunc* based on a scrivener's error is consistent with applicable State law that would be applied by the highest court of that state. Section 4.01 of Trust, as modified pursuant to the Court's Order, does not provide Surviving Spouse with a general power of appointment under § 2041(b) over the assets of the By-Pass Trust. Therefore, based on the facts submitted and the representations made, we conclude that the value of the assets in the By-Pass Trust will not be included in Surviving Spouse's gross estate under § 2041(a)(2) upon his death.

Rulings 2 & 3

Section 2501(a) imposes a gift tax for each calendar year on the transfer of property by gift during the year by an individual.

Section 2511 provides that the gift tax 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 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift.

For gift tax purposes, § 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.

For gift tax purposes, § 2514(c) provides that the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate. Section 2514(e) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the person possessing the power is considered a release of the power.

Section 25.2514-1(c) of the Gift Tax Regulations provides, in part, that a power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the possessor or his estate is included within the meaning of a power of appointment exercisable in favor of the possessor, his estate, his creditors, or the creditors of his estate.

As discussed in the first ruling, Trust, as modified, does not provide Surviving Spouse with a testamentary general power of appointment. Accordingly, based on the facts submitted and the representations made, we conclude that the modification of Article IV, Section 4.01 of Trust will not constitute the exercise or release of a general power of appointment by Surviving Spouse, within the meaning of § 2514(b). Further, we conclude that the modification of Article IV, Section 4.01 of Trust pursuant to the

Court's order will not be treated as a deemed transfer of an interest in Trust by Surviving Spouse for gift tax purposes under § 2501.

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

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 specifically ruled herein, we express or imply 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 requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

By: _____
Lorraine E. Gardner, Senior Counsel
Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

Copy for section 6110 purposes

cc: