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Department of the Treasury
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Person To Contact:
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Telephone Number:

Refer Reply To:
CC:PSI:04
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Date:
March 18, 2014

RE:

Legend

Decedent =
Spouse =
Trust =
Date 1 =
Date 2 =
Daughter =
Son =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Date 3 =
Date 4 =
Law Firm =
Accountant =
Year =

Dear :

This letter responds to your authorized representative's letter of September 27, 2013, and other submissions, requesting rulings concerning the includibility of Family Trust in Decedent's gross estate under §§ 2036, 2038, and 2041 of the Internal Revenue Code.

The facts and representations submitted are as follows.

Decedent and Spouse created Trust, a joint revocable trust, on Date 1, restated in its entirety on Date 2. Spouse predeceased Decedent on Date 3. Decedent died on Date 4.

Article Four Section 1 of Trust provides that during Decedent's and Spouse's joint lifetime, the trustee shall pay to or apply for the benefits of a trustor, all or such part of the income and principal of such trustor's separate share of the trust estate as such trustor may direct. Under Article Four Section 3, when both Decedent and Spouse are alive, each holds a power to revoke his or her separate share. After the first spouse dies, the surviving trustor may amend any trust share over which the surviving trustor has a general non-lapsing power of appointment over principal, with the exception of retirement benefits.

Article Two Section 3 provides, in part, that unless clearly otherwise provided, as to property that is transferred to the trustee while Decedent and Spouse are both living, Decedent and Spouse shall hold the trust estate as tenants in common, each owning a separate share consisting of an undivided one-half beneficial interest.

Decedent and Spouse entered into Property Agreement, dated Date 1, stating in part, as to all joint tenancy property transferred or to be transferred into the name of Trust, Decedent and Spouse agree that all trust property shall be characterized as tenants in common rather than joint tenancy.

Under Article Seven Section 1, upon the first of Decedent and Spouse to die, the trustee shall allocate and distribute the remaining trust estate into two separate shares to be identified as the Survivor's Share and the Family Share. The Survivor's Share shall consist of the surviving trustor's separate share. The Family Share is to consist of all assets of the deceased trustor's separate share not distributed to the Survivor's Share. Each of Survivor's Share and Family Share is to be administered as Survivor's Trust and Family Trust, respectively.

Article Eight contains provisions governing the Survivor's Trust. Article Eight provides that trustee shall pay to or apply for the benefit of the surviving trustor, in monthly or other convenient installments but not less often than annually, so much of the net income of the Survivor's Trust as the surviving trustor directs. Any net income not distributed will be accumulated and added to principal. Trustee shall also pay to or apply for the benefit of the surviving trustor so much of the principal of the Survivor's Trust as the trustee deems proper for the surviving trustor's comfort, welfare and happiness. Trustee shall pay to the surviving trustor as much of the principal of the Survivor's Trust as the surviving trustor may from time to time demand in a signed writing delivered to the trustee. Upon the death of the surviving trustor, the trustee shall distribute all of the trust property, including the trust principal and accrued and undistributed income, to any person or entity, and upon any trust, terms and conditions, or to or in favor of the estate of the surviving trustor, as the surviving trustor may direct by his or her last will or living trust agreement. No exercise of this general power of appointment shall be effective unless it refers to this trust agreement and expressly indicates an intention to exercise this general power of appointment.

Article Nine contains provisions governing the Family Trust. Article Nine provides that trustee shall pay to or apply for the benefit of the surviving trustor, in monthly or other convenient installments but not less often than annually, so much of the net income of the Family Trust as the trustee in its discretion deems proper for the surviving trustor's health, education, maintenance and support. Any net income not distributed will be accumulated and added to principal. The Decedent and Spouse recommended that the trustee first exhaust the principal from the Survivor's Trust before making discretionary payments of principal to the surviving trustor from the Family Trust. Trustee shall also pay to or apply for the benefit of the surviving trustor so much of the principal of the Family Trust as the trustee in its discretion deems proper for the surviving trustor's health, education, maintenance and support. Notwithstanding any other provision in Trust, each calendar year the surviving trustor shall have the power to withdraw principal from the Family Trust in an amount not to exceed the greater of five thousand dollars or five percent of the assets of the Family Trust, valued as of the end of the preceding calendar year. This power is noncumulative and to the extent it is not exercised by the end of January of each calendar year, it shall lapse. This power shall exist each year until the death of the surviving trustor.

Upon the death of the surviving trustor, Survivor's Trust and Family Trust shall terminate and the trustee shall hold and administer the trust assets in further trust as provided.

Article Eleven contains provisions governing the Survivor's Trust and Family Trust after both Spouse and Decedent have died. Article Eleven Section 1 provides that upon the death of the surviving trustor, the trustee shall divide the trust property into separate shares for Daughter, Son, and Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, (collectively, Grandchildren) in specified amounts. The trustee of Son's share is to distribute to Son all the net income and principal free of trust. As to Daughter's share, the trustee in the trustee's discretion shall apply to or for the benefit of Daughter so much of the income and principal as the trustee deems advisable for Daughter's health, education, maintenance and support. Any net income not distributed will be accumulated and added to principal. Upon Daughter's death, the trustee shall distribute the balance of the trust share to daughter's then living descendants *per stirpes*. Each Grandchild's share is to be administered as follows: The trustee in the trustee's discretion shall apply to or for the benefit of such beneficiary so much of the income and principal as the trustee deems advisable for the beneficiary's health and education. Any net income not distributed will be accumulated and added to principal. When such beneficiary reaches the age of 30 years, the trustee shall distribute all of the accumulated net income and principal of such trust share to such beneficiary, free of trust. If a beneficiary dies before complete distribution of the trust's share, then the trustee shall distribute the balance of the trust share to the beneficiary's then living descendants *per stirpes*. Daughter, Son, and the Grandchildren survived Decedent.

Article Thirteen Section 6 provides that the trustee is not required to make a physical segregation or division of the various trust shares created under Trust except as segregation or division may be required by reason of the termination and distribution of any of the trusts or trust shares or as required elsewhere in the trust agreement. However, the trustee is required to keep separate accounts and records for different undivided interests.

Spouse died on Date 3, survived by Decedent, Daughter, Son, and Grandchildren. Decedent became the sole trustee and beneficiary of Survivor's Trust and Family Trust. Under the terms of Survivor's Trust, Decedent was eligible to withdraw income and principal as desired and possessed a testamentary general power of appointment over the Survivor's Trust. Under the terms of Family Trust, Decedent was eligible to receive distributions of income and principal limited to an ascertainable standard of health, education, maintenance and support. Decedent also held a lapsing right to annually withdraw the greater of five thousand dollars or five percent (5 or 5 Power) of the Family Trust's principal. Family Trust became irrevocable upon Spouse's death. Survivor's Trust remained a revocable trust.

It is represented that under Trust the Survivor's Trust should have been funded with Decedent's fifty percent beneficial interest as a tenant in common of property held in Trust and the Family Trust should have been funded with Spouse's fifty percent beneficial interest as a tenant in common of property held in Trust.

After Spouse's death, Law Firm incorrectly advised Decedent, as trustee of the Survivor's Trust and Family Trust, and Accountant that "the 'survivor's trust' will not be funded from the family trust; 100% of the trust assets remain as the family trust and are not split." Accordingly, Decedent, as trustee, failed to segregate the assets of the Survivor's Trust and Family Trust, and, instead, administered them as a combined trust. During Decedent's lifetime, Decedent, as trustee, adhered to a "buy and hold" investment strategy for the Survivor's Trust and Family Trust, purchasing securities, reinvesting all dividends, and retaining holdings indefinitely. In Year, prior to Decedent's death, Decedent retained new estate planning counsel who determined Decedent had been improperly advised regarding the funding and administration of Trust and its subtrusts, Survivor's Trust and Family Trust. Corrective measures were immediately taken during Decedent's life and continued after his death to properly allocate assets to the Survivor's Trust and Family Trust. Through a forensic review of the historical financial records, Decedent was able to ascertain and track the assets which should have been allocated to the Family Trust at Spouse's death.

It is represented that Decedent, as trustee, distributed certain items of income and principal from Survivor's Trust and Family Trust as provided under the terms of each trust. All distributions of income were properly reported on Decedent's individual federal and state income tax returns. Trustee also filed amended state and federal fiduciary income tax returns (Forms 1041) for Family Trust as well as original Forms 1041 for Survivor's Trust. It is further represented that distributions of principal made to Decedent were from sufficient funds allocated to Survivor's Trust and no principal distributions were made from Family Trust.

The executors of Decedent's estate request a ruling that the value of the assets of Family Trust are not includible in the gross estate of Decedent, with the exception of the value of the 5 or 5 Power held by Decedent at his death, under §§ 2036, 2038, and 2041.

LAW AND ANALYSIS

Section 2036(a) of the Internal Revenue Code provides that the value of the gross estate shall include the value of any property of which the decedent has made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) in which the decedent has retained for his life the possession or enjoyment of, or the right to the income from the property, or the right 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 his 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 on the date of the decedent's death.

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 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 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) provides that 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; except that 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 shall not be deemed a general power of appointment.

In Rev. Rul. 78-74, 1978-1 C.B. 287, the decedent was the income beneficiary of a trust created by his father. The trust terminated upon the death of the decedent and all assets became payable to the decedent's issue. Prior to his death, the decedent transferred stock to the trust. The Service concluded that since the value of the stock could be readily ascertained, the portion of the trust includible in the decedent's gross estate as a retained interest equals the value of the stock at the time of the decedent's death. In the revenue ruling, the Service compared the facts in the ruling to the facts in two cases, *Estate of Kinney v. Commissioner*, 39 T.C. 728 (1963), *acq*., 1964-2 C.B. 6, and *Estate of Bell v. Commissioner*, 66 T.C. 729 (1976), *acq*., 1977-2 C.B. 1.

In *Estate of Kinney v. Commissioner*, the decedent transferred shares of stock to a trust of which the decedent was the trustee and income beneficiary. At the time of the decedent's death these shares were still part of the trust corpus. The Tax Court held that the portion of the trust includible in the decedent's estate under § 2036 was the value of the stock contributed by the decedent and still retained in the trust. In *Estate of Bell v. Commissioner*, the decedent's husband and decedent transferred property to a trust to benefit their daughter. The court held that decedent's trustee powers over the trust gave her unbridled discretion to distribute the trust corpus for purposes of § 2038. In determining the value of the portion of the trust includible in the decedent's gross estate, the court considered two principles: 1) Where property transferred by several grantors to a trust is commingled with other property and cannot be identified, a proportionate formula may be appropriate; 2) If specific property transferred by a decedent is capable of identification, however, the value of such specified property should be included in the gross estate. The court in *Bell* also opined that, conversely, where someone other than the decedent has transferred specific assets to a trust which can be identified or traced, it is only reasonable that their value should be excluded in making the required allocations. In *Bell*, the parties stipulated to the securities transferred to the trust other than by the decedent.

The facts in the present case are similar to those in *Kinney* and *Bell*. The assets of Survivor's Trust and Family Trust were not segregated after Spouse's death, but rather were administered as a combined trust. As to the Survivor's Trust, Decedent served as the trustee and was also the unlimited income and principal beneficiary. Decedent could amend the Survivor's Trust during his lifetime and also held a non-lapsing general power of appointment over the assets in the Survivor's Trust. As to the Family Trust, Decedent served as the trustee and was also the income and principal beneficiary, as limited by an ascertainable standard. Decedent also held a 5 or 5 Power over the assets in the Family Trust. Before Decedent's death, the Decedent, as trustee, took corrective measures to properly allocate assets to the Survivor's Trust and Family Trust. Consequently, through a forensic review of the historical financial records, Decedent was able to ascertain and track the assets which should have been allocated to the Family Trust at Spouse's death.

Accordingly, based on the facts submitted and representations made, we conclude that the value of the assets of Family Trust are not includible in the gross estate of Decedent, with the exception of the value of the 5 or 5 Power held by Decedent at his death, under §§ 2036, 2038, and 2041.

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.

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.

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

Sincerely,

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

Enclosures (2)