

Internal Revenue Service

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Person To Contact:
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Date:
May 17, 2016

Legend

Settlors =
Trust =
Taxpayer =
Date 1 =
Court =
Date 2 =
Date 3 =
Statute =

Dear :

This responds to the letter dated November 13, 2015, submitted on behalf of taxpayer, in which rulings are requested concerning the federal gift and estate tax consequences under §§ 2041 and 2514 of the Internal Revenue Code of a court order modifying a trust agreement.

On Date 1, Settlers, husband and wife, executed an irrevocable trust (Trust) for the primary benefit of their son, Taxpayer. Under the terms of Trust, the trustees may, in their discretion, pay to or apply for the benefit of Taxpayer such amounts of income and principal as the trustees deem necessary or desirable for the “support, maintenance, health, education or other needs” of Taxpayer. Additionally, the trustees may terminate Trust at any time the trustees determine that the continued administration of Trust is uneconomical or impractical in view of the small value or extent of trust assets. If this discretion is exercised, the remaining trust corpus is to be distributed to Taxpayer or remainder beneficiaries then entitled to discretionary distributions.

Section 3 paragraph (b), of Trust provides that upon the beneficiary’s death, the Trustees shall pay the entire remaining balance of this Trust to and among the

beneficiary's surviving spouse and surviving issue in such amounts and proportions and upon such terms, conditions and trusts as the beneficiary, by a provision in his Last Will and Testament expressly referring to this power of appointment, shall validly direct and appoint.

Section 3 paragraph (c) of Trust provides in the event or to the extent that the beneficiary fails to validly exercise the foregoing general testamentary power of appointment, the trustees shall thereafter hold and administer this Trust for the benefit of the beneficiary's surviving children.

Under Section 7 of Trust, Taxpayer has the power, upon reaching age 40, to remove and replace the trustees of Trust. Taxpayer has not reached age 40.

On Date 2, pursuant to Statute, Settlers petitioned Court for reformation of Trust because of scrivener's errors. In support of the petition, Settlers represented that Section 3 paragraph (c) of Trust contains a reference to the Taxpayer's "general" testamentary power of appointment granted in Section 3 paragraph (b) of Trust. Settlers further represented that such reference is incorrect because the power granted to Taxpayer in Section 3 paragraph (b) of Trust is not a general power of appointment as defined in § 2041(b)(1) of the Code, as it is not exercisable in favor of the Taxpayer, his estate, his creditors or the creditors of his estate. Settlers contended that the terms of Trust as originally drafted are contrary to the intent of the Settlers to create a trust for Taxpayer and his issue without transfer tax upon Taxpayer's death.

On Date 3, Court ordered that only an "independent trustee" (who is not Taxpayer or a person who is a "related or subordinate party" defined in § 672(c)) may exercise discretion to make distributions to Taxpayer or terminate Trust. Court further ordered that the word "general" in Section 3 paragraph (c) be deleted, and that the reformation be effective as of Date 1.

The following rulings have been requested:

1. As a result of the judicial reformation, Taxpayer never possessed and will not possess a general power of appointment with respect to Trust which would cause the assets to be includible in Taxpayer's gross estate under § 2041 for federal tax purposes; and
2. As a result of the judicial reformation, Taxpayer will not be treated as having released a general power of appointment for federal gift and estate tax purposes under § 2514(b) or § 2041(a)(2)

Law and Analysis

Under § 2041(a)(2) 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.

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 § 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 § 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.

Section 2501(a)(1) imposes a tax, for each calendar year, on the transfer of property by gift by any individual, resident or nonresident. Section 2511 provides that the tax imposed by § 2501 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.

Under § 2514(b) the exercise or release of a general power of appointment created after October 21, 1942, is deemed the transfer of property by the individual possessing such power. Under § 2514(c) the term “general power of appointment” is defined as a power which is exercisable in favor of the individual possessing the power (“the possessor”), his estate, his creditors, or creditors of his estate. However, under § 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.

Under § 25.2514-1(c)(2) of the Gift Tax Regulations, a power is limited by an ascertainable standard if the extent of the possessor'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 an ascertainable 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. Powers of appointment limited by an ascertainable standard are defined in the same way under §§ 2041 and 2514. Powers of appointment have 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.

Generally, if, due to a mistake in drafting, the instrument does not contain the terms of the trust that the settlor and the trustee intended, the settlor or other interested party may maintain a suit in equity to have the instrument reformed so that it will contain the terms that were actually agreed upon. Bogert & Bogert, The Law of Trusts and Trustees, § 991 (revised 2d ed. 1983). Based on an analysis of the 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 rule as follows:

1. As a result of the judicial reformation, Taxpayer never possessed and will not possess a general power of appointment with respect to the Trust which would cause the assets to be includible in Taxpayer's gross estate under § 2041 for federal tax purposes; and
2. As a result of the judicial reformation, Taxpayer will not be treated as having released a general power of appointment for federal gift and estate tax purposes under § 2514(b) or § 2041(a)(2)

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 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.

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,

Leslie Finlow

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure (2)
Copy for § 6610 purposes
Copy of this letter

cc :