

This responds to your authorized representative's letter dated April 30, 2009, and subsequent correspondence, requesting rulings on the federal gift and estate tax consequences of a judicial modification of Trust.

The facts and representations submitted are as follows. Decedent and Spouse (Trustors) established Trust, a revocable trust, on Date 1, and amended the trust on Date 2. Trust is governed by the laws of State.

Pursuant to the terms of Trust, upon the death of the first Trustor to die, the Trust's assets are to be divided among the By-Pass Trust, the Marital Trust, and the Survivor's Trust.

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

Section 4.01 Surviving Spouse's Expenses. 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 Distribution of Survivor's Trust. 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 3, survived by Spouse, Child A, Child B, Child C, and Child D. Spouse was appointed executor of Decedent's estate. Spouse is the trustee of the Survivor's Trust. Child A is the trustee of the By-Pass Trust and the Marital Trust.

Prior to Decedent's death, Decedent and Spouse engaged Attorney to advise them as to their estate planning matters. Attorney drafted both the original Trust and restatement and amendment of Trust for Decedent and Spouse. Upon subsequent review of the trust provisions, Attorney discovered 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.) In addition, Spouse contends that the language in Article IV, Section 4.01, should refer to the Survivor's Trust, not the By-Pass Trust. Moreover, as drafted, the reference to the By-Pass Trust may provide Spouse with a testamentary general power of appointment under § 2041(b)(1).

In affidavits, Spouse and Attorney represent that it was the Decedent's and 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 an amount equal to the remaining credit shelter amount in the estate of the first spouse to die passed to the beneficiaries without tax and without subsequent inclusion in the surviving spouse's gross estate.

In order to correct the error in the Trust and to accurately reflect the intent of the Trustors, on Date 4, Spouse, as the co-Trustor of Trust, filed a petition with Court seeking authorization to modify Trust *nunc pro tunc*. Spouse, as the surviving Trustor, has stated that it is, and was at all times, Spouse's intent and desire that the assets of the By-Pass Trust be administered so as to avoid taxation at Spouse's death. To support the assertion that the reference to the By-Pass Trust was a scrivener's error, 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.

Spouse asserts, and Attorney 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 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." 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 5, the Court issued an Order granting the petition for modification. The Court determined that the proposed modification of Trust will not defeat a material purpose of the trust, but rather will serve to carry out the intent of the Trustors in establishing the Trust by allowing the assets in the By-Pass Trust to avoid taxation at Spouse's death.

You have requested the following rulings:

1. The By-Pass Trust, as modified, does not provide Spouse with a testamentary general power of appointment under § 2041 over the assets of Trust.
2. 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.
3. 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.

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.

In Commissioner v. Estate of Bosch, 387 U.S. 456, 87 S. Ct. 1776, 18 L. Ed. 2d 886 (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 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 1; Citation 2. 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 2 at pp. 82-83, citing Citation 3. A mistake by the scrivener or draftsman in reducing the intent of the parties to writing is ground for reformation. See Citation 4. *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 5.

In this case, the documentation submitted by Spouse strongly indicates that Decedent and 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 to charge 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, the Court found that the proposed modification of Trust will not defeat a material purpose of Trust, but rather will serve to carry out the intent of the Trustors in establishing the Trust by allowing the assets in the By-Pass Trust to avoid taxation at Spouse’s death.

Consequently, we conclude that the Court’s Order on Date 5, 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 the Trust, as modified pursuant to the Court’s Order, does not provide Spouse with a general power of appointment under § 2041(b). Therefore, we conclude that the value of the assets in the By-Pass Trust will not be included in Spouse’s gross estate under § 2041(a)(2) upon her 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 Spouse with a testamentary general power of appointment. Accordingly, the modification of Trust will not constitute the exercise or release of a general power of appointment by Spouse, within the meaning of § 2514(b). Further, the modification of Trust will not be treated as a deemed transfer of an interest in Trust by 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.

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.

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.

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 4
(Passthroughs & Special Industries)

Enclosures (2)
Copy for section 6110 purposes
Copy of this letter

cc: