

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

November 08, 2004

Third Party Communication: None
Date of Communication: Not Applicable

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Index (UIL) No.: 2056.07-03, 2056.07-05
CASE-MIS No.: TAM-133472-04/CC:PSI:B04

District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Years Involved:
Date of Conference:

LEGEND:

Decedent	-
Spouse	-
Trust A	-
Trustee	-
State X	-
Date 1	-
Date 2	-
Cite 1	-
Cite 2	-
Cite 3	-
Cite 4	-

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ISSUES:

Whether property passing to Trust A, a testamentary trust, qualifies for the estate tax marital deduction under either § 2056(b)(5) or § 2056(b)(7) of the Internal Revenue Code.

CONCLUSION:

The terms of Trust A do not satisfy the requirements of either §§ 2056(b)(5) or 2056(b)(7). Accordingly, the property passing to Trust A does not qualify for the estate tax marital deduction.

FACTS:

Decedent, a resident of State X, died testate on Date 1, survived by his spouse (Spouse) and their children. Spouse and Trustee, an independent corporation, are the co-executors of Decedent's estate. Under Articles SECOND and THIRD of Decedent's will, executed prior to 1981, Decedent bequeathed and devised all his interest in his personal residence and all personal property to Spouse. Article FOURTH directs that all the rest and residue of Decedent's property, real and personal, shall pass in trust to Trust A, for the primary benefit of Spouse. Trustee, a bank, is designated as the trustee of Trust A.

Article SEVENTH contains the dispositive provisions of Trust A. Article SEVENTH(a) states:

During the lifetime of my wife, [Spouse], the Trustee shall, subject to the limitations and provisions hereinafter set forth, distribute the net income of the Trust created hereby to my wife in such amounts and at such times as my wife, in her sole discretion but in consultation with the Trustee, shall desire for her maintenance, education, health or support commensurate with her station in life. In this connection, if at any time, or from time to time in the opinion of my wife, the income of said Trust is insufficient to provide for her maintenance, education, health or support commensurate with her needs, the Trustee, taking into consideration of all the sources of income or other capital available to it, is authorized and directed to distribute to my wife portions of the principal of this trust in such amounts as shall be desired by my wife, in her sole discretion but in consultation with the Trustee, for her maintenance, education, health and support. Any income not distributed shall be added to the principal.

Article SEVENTH(c) provides that Trust A will terminate upon the death of Spouse, at which time all the principal and accrued net income of Trust A shall pass to Trust B, to be held for the benefit of Decedent's children and their descendants, as set forth in Article SEVENTH(b). Under the terms of Trust B, the Trustee shall distribute the

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net income of the Trust to Decedent's living children, or the issue of any predeceased children, in such amounts and at such times as the Trustee, in consultation with a specified child of Decedent, shall in its sole discretion deem necessary for their maintenance, education, welfare or support commensurate with their stations in life. The trust is to terminate when Decedent's youngest child obtains age 25, at which time the corpus is to be distributed to Decedent's then living children, or their descendants, per stirpes.

Decedent's will contains no reference to the estate tax marital deduction and no specific statement providing that it is Decedent's intent that Trust A qualify for the estate tax marital deduction. The Decedent's estate has submitted file copies of two letters to Decedent from the attorney who drafted the will. The letters are dated approximately six months apart and transmit drafts of the will to the Decedent. In both letters, the attorney states that under the terms of the draft, Spouse has the right to obtain all income and principal from the trust by making the request to the trustee. In addition, Decedent's estate has submitted a letter dated two months prior to the date the will was executed, from the attorney who drafted the will to a trust officer at Trustee. The letter transmits a draft of the will and states that the Decedent has "maintained his decision that he wants his wife to have complete discretion with respect to the disposition of the trust assets . . ."

Decedent's estate filed a United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) on Date 2. On Schedule M of the return, the executor made the election under § 2056(b)(7) to treat the property passing to Trust A as qualified terminable interest property. A marital deduction was claimed for the value of the assets passing to Trust A.

LAW AND ANALYSIS:

Section 2001(a) of the Internal Revenue Code imposes a tax on the transfer of 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 death.

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. However, a power to consume property for the benefit of the decedent that is limited by an ascertainable

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standard relating to health, education, support, or maintenance of the decedent is not deemed a general power of appointment. See § 20.2041-1(c)(2) of the Estate Tax Regulations.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate shall, except as limited by § 2056(b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to the surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

In general, under § 2056(b)(1) a marital deduction is not allowable for an interest in property passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest passing to the surviving spouse will terminate or fail and after the termination of the spouse's interest, the property or interest in property passes to persons other than the surviving spouse (or the estate of the spouse).

Section 2056(b)(5) provides an exception to the terminable interest rule contained in § 2056(b)(1). Generally, under § 2056(b)(5), a marital deduction will be allowed if the surviving spouse is entitled for life to all the income from the property, payable annually or at more frequent intervals, and the spouse is granted a power to appoint the property, exercisable by will or during life, to the spouse or the spouse's estate, and no person has any power to appoint the property to any person other than the spouse. The spouse's power to appoint to the spouse or the spouse's estate must be exercisable by the spouse "alone and in all events."

Section 2056(b)(7) provides another exception to the terminable interest rule contained in § 2056(b)(1) for "qualified terminable interest property." Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, for purposes of § 2056(a), such property shall be treated as passing to the surviving spouse, and for purposes of § 2056(b)(1)(A), no part of the property shall be treated as passing to any person other than the surviving spouse.

Section 2056(b)(7)(B)(i) defines the term "qualified terminable interest property" as property: (I) which passes from the decedent; (II) in which the surviving spouse has a qualifying income interest for life; and (III) to which an election under § 2056(b)(7) applies.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if the surviving spouse is entitled to all the income from the property payable annually or at more frequent intervals, and no person has a power to appoint any part of the property to any person other than the surviving spouse.

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Section 20.2056(b)-5(a) of the Estate Tax Regulations provides rules for determining whether the spouse has received the right to income and power of appointment with respect to property required for qualification under § 2056(b)(5). This section provides that a property interest passing to the spouse will qualify under § 2056(b)(5), if the following conditions are satisfied:

- (1) The surviving spouse must be entitled for life to all of the income from the entire interest or a specific portion of the entire interest;
- (2) The income payable to the surviving spouse must be payable annually or at more frequent intervals;
- (3) The surviving spouse must have the power to appoint the entire interest or the specific portion to either the spouse or the spouse's estate;
- (4) The power in the surviving spouse must be exercisable by the spouse alone and (whether exercisable by will or during life) must be exercisable in all events; and
- (5) The entire interest or the specific portion must not be subject to a power in any other person to appoint any part to any person other than the surviving spouse.

Section 20.2056(b)-5(e) states that, in determining whether or not the conditions set forth in § 20.2056(b)-5(a)(1) are satisfied by the instrument of transfer, regard is to be had to the applicable provisions of the law of the jurisdiction under which the interest passes and, if the transfer is in trust, the applicable provisions of the law governing the administration of the trust.

Section 20.2056(b)-5(f)(1) provides that a surviving spouse is entitled to "all the income" from the property for purposes of §20.2056(b)-5(a)(1) if the spouse is granted the equivalent "beneficial enjoyment" of the trust estate as one who is "unqualifiedly designated as the life beneficiary." Section 20.2056(b)-5(f)(6) provides that if a trust may be terminated during the life of the spouse under the spouse's exercise of a power of appointment, or by the distribution of corpus to the spouse, then the interest will be treated as satisfying the requirement of § 20.2056(b)-5(a)(1) that the spouse be entitled to all the income, if the spouse has the right, exercisable in all events, to have the corpus distributed to the spouse at any time during life.

Section 20.2056(b)-5(f)(7) provides that the spouse will not be treated as entitled to all trust income, to the extent that the income is required to be accumulated in whole or in part or may be accumulated in the discretion of any person other than the surviving spouse; to the extent that the consent of any person other than the surviving spouse is required as a condition precedent to distribution of the income; or to the extent that any person other than the surviving spouse has the power to alter the terms of the trust so as to deprive the spouse of the right to the income. Under § 20.2056(b)-5(f)(8), the term "payable annually or at more frequent intervals" requires that, under the terms of the trust, the income referred to must be currently (at least annually; see § 20.2056(b)-5(e))

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distributable to the spouse or that the spouse must have such command over the income that it is virtually his or hers.

Section 2056(b)-5(g)(1), et. seq., addresses the requirement under § 2056(b)(5) and § 20.2056(b)-5(a)(3)-(5) that the spouse possess a power of appointment exercisable in the spouse's favor "alone and in all events." Section 2056(b)-5(g)(1) provides that this requirement will be satisfied if the spouse has a power to appoint that is fully exercisable in the spouse's own favor at any time following the decedent's death (as, for example, an unlimited power to invade). Section 20.2056(b)-5(g)(3) provides that a power is not considered to be a power exercisable by a surviving spouse alone and in all events if the exercise of the power in the surviving spouse to appoint the property to the spouse requires the joinder or consent of any other person.

Regarding the requirements for qualification as qualified terminable interest property under § 2056(b)(7), § 20.2056(b)-7(d)(2) provides that the principles of § 20.2056(b)-5(f), relating to whether the spouse is entitled for life to all the trust income for purposes of § 2056(b)(5), also apply in determining whether the surviving spouse is entitled for life to all of the income from the property for purposes of § 2056(b)(7). Section 20.2056(b)-7(g) states that the provisions of local law are taken into account in determining whether the conditions of § 2056(b)(7)(B)(ii)(I) are satisfied.

As noted, under §§20.2056(b)-5(e) and 20.2056(b)-7(g) the determination of the nature of the interest that passes to the surviving spouse is made under the law of the jurisdiction under which the interest passes. See also, Estate of Bowling v. Commissioner, 93 T.C. 286, 293 (1989). Under applicable State X law, the cardinal rule for construing a will requires that the testator's intent be ascertained by looking to the provisions of the instrument as a whole and the circumstances surrounding its execution. Cite 1. In looking at the surrounding circumstances, statements of subjective intent are ordinarily not admissible because "when a transaction has been voluntarily embodied in single document, no other expression of intent or will on the same subject can be given jural effect." Cite 2. State X law presumes that a testator would not make useless expressions in his or her will. Cite 3. If the language of the instrument is unambiguous and expresses the intention of the maker, it is unnecessary to construe the instrument because such instrument speaks for itself. In such a situation, a trustee's powers are conferred by the instrument and neither the trustee nor the courts can add to or take away from such powers, but must permit it to stand as written and give it only such construction as the settler or testator intended. Cite 4.

Spouse's right to income under §§ 2056(b)(5) and 2056(b)(7) and Spouse's power of appointment under § 2056(b)(5)

The standards contained in § 20.2056(b)-5(f) are applicable for both §§ 2056(b)(5) and 2056(b)(7) in determining whether the spouse received the requisite income interest in the property. In the instant case, under the terms of Trust A,

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Spouse's income interest falls far short of the requisite unqualified right to receive all of the income from the trust payable annually, described under §§ 20.2056(b)-5(a)(1) and (2) and § 20.2056(b)-5(f). The trustee is directed to distribute trust income to Spouse "subject to the limitations and provisions hereinafter set forth." Under the terms of Trust A, income distributions are limited to those amounts Spouse desires for "maintenance, education, health or support," to be determined "in consultation with the trustee." Thus, under the terms of the instrument, spouse is not entitled to all trust income, but only so much of the income as desired for certain specified purposes. These specified purposes are those that, under § 2041(b)(1) and the applicable regulations, are treated as limiting the circumstances under which a power can be exercised, such that the power is not considered a general power of appointment. See §20.2041-1(c)(2). Further, the amount of income to be distributed to Spouse for her maintenance, etc. is to be determined "in consultation with the Trustee." Thus, any income distribution to be made is subject to the Trustee's approval, if not consent. See §20.2056(b)-5(f)(7). Further, the trust instrument provides that any income not distributed is to be added to corpus, thus evidencing the understanding that not all trust income would necessarily be distributed to Spouse.

Although Spouse can also request a corpus distribution, her power is significantly limited and does not meet the requirements of § 20.2056(b)-5(f)(6). As is the case with income distributions, such corpus distributions are to be made in consultation with the trustee and are to be made only if trust income is not sufficient to provide for Spouse's maintenance, etc. commensurate with her needs. Further, in authorizing a corpus distribution, the trustee is directed to take into consideration all the sources of income or other capital available to the trustee. Thus, the power is not exercisable in all events and can not be exercised to draw down the entire corpus, as required under § 20.2056(b)-5(f)(6).

Thus, under the terms of Trust A, Spouse is not entitled to all trust income payable annually or more frequently, as required under §§ 20.2056(b)-5(a)(1) and (2). Estate of Nicholson v. Commissioner, 94 T.C. 666 (1990); Estate of Davis v. Commissioner, T.C. Memo 2003-55. Accordingly, Spouse does not possess the right to receive all trust income, as required for qualification under either § 2056(b)(5) or § 2056(b)(7).

Further, for similar reasons, Spouse does not possess the power of appointment over trust corpus described in §§ 20.2056(b)-5(a)(3)–(5) and § 2056(b)-5(g)(1), et. seq. required in order to qualify under § 2056(b)(5). Generally, in order to qualify under § 2056(b)(5), the surviving spouse must receive an unlimited power to appoint to the spouse or the spouse's estate. Estate of Smith v. Commissioner, 79 T.C. 974, 977 (1982). As noted above in the discussion of the application of § 20.2056(b)-5(f)(6), Spouse can receive corpus distributions to provide for Spouse's needs regarding maintenance, education, health or support, only if trust income is not sufficient to provide for these purposes. The instrument goes on to explicitly state that the

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distributions, although based on amounts “desired” by Spouse, are to be determined “in consultation with the trustee” and are to be made “solely for [Spouse’s] maintenance, education, health, and support.” Further, the trustee is directed to take into consideration all the sources of income or other capital available to the trustee. Thus, any power possessed by Spouse to withdraw corpus is not exercisable by Spouse, alone, nor is it exercisable in all events as required by the statute. See, Estate of Davis v. Commissioner, cited above.

Decedent’s estate contends that under Article SEVENTH(a), income distributions are to be made to Spouse for maintenance, education, health or support “in such amounts and at such times as [Spouse] in her sole discretion . . . shall desire.” The Estate argues that this language demonstrates Decedent’s intent that Spouse possess the unrestricted right to receive trust net income at any time she “desires,” without limitation. The language limiting distributions to maintenance, etc. as determined in consultation with the trustee, contradict this intent and, at the very least, creates an ambiguity. The Estate contends that the letters, discussed above, written by Decedent’s attorney during the period the will was being drafted, evidence that Decedent intended that Spouse have unrestricted access to the trust assets.

However, we disagree that the will is ambiguous. In Estate of Nicholson v. Commissioner, 94 T.C. 666 (1990), the decedent bequeathed his estate in trust and directed that the trustee distribute to the surviving spouse “. . . so much of the net income . . . as [she] may from time to time require to maintain [her] usual and customary standard of living.” The trustee was also authorized to invade corpus for “these purposes.” The petitioner argued, as does the estate in the instant case, that the will was ambiguous and therefore extrinsic evidence should be considered to determine the testator’s intent. The court found that there was no ambiguity regarding the dispositive provisions and that distributions to the spouse that she “require[d] to maintain her usual and customary standard of living” was only such income as she may reasonably need, rather than all the income that she may demand. As long as the trustees carried out their duties to maintain the spouse’s usual and customary standard of living, the court concluded that the spouse had no right to demand all the income or any particular amount. Estate of Nicholson, 94 T.C. at 675. Thus, the court concluded that in view of the limits fixed by the testator, the spouse was not “unqualifiedly designated as the life beneficiary” under § 20.2056(b)-5(f) and was not “entitled to all the income” within the meaning of § 2056(b)(7)(B)(ii).

In the instant case, in arguing that Article Seventh(a) is ambiguous, the estate relies on the use of the phrases “as [Spouse] in her sole discretion . . . shall desire”, while ignoring the clear and controlling language limiting the purpose of the distributions to providing for Spouse’s maintenance, education, health or support, to be determined in consultation with the trustee. In this regard, we note that the language “maintenance, health education or support” contained in Article Seventh(a) is virtually identical to the language used in § 2041(b)(1)(A) and the applicable regulations that have been

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universally recognized as a limitation on an individual's power sufficient to create a limited power of appointment and avoid inclusion of the property in the power holder's gross estate. The use of virtually identical language in Article Seventh(a) can't be viewed as a coincidence. Rather, use of this language was clearly intended to provide a limit on the Spouse's ability to access income and corpus. Thus, we believe that Decedent's intent is clear and we do not believe that the dispositive terms of Trust A are ambiguous. See Estate of Nicholson, cited above. See also, Estate of Aronson v. Commissioner, T.C. Memo 2003-189 (trust language "as much income from trust assets as she needs, for as long as she lives" entitled spouse to only the income that she may need, and not necessarily all the income she may *demand*); Estate of Davis v. Commissioner, T.C. Memo 2003-55 (spouse was not entitled to all trust income for purposes of § 2056(b)(7) where trust income was payable to spouse as the trustee determined "to be proper for spouse's health, education, support, maintenance, comfort, and welfare, in light of her accustomed manner of living."); Estate of Rapp v. Commissioner, T.C. Memo 1996-10 (trust language directing trustee to distribute principal and income as the trustee deemed necessary for the spouse's proper health, education and support was clear and unambiguous and could not be construed as giving the spouse the right to all the income from the property).

Consequently, we do not believe the Article Seventh(a) is ambiguous. Accordingly, under Cite 1, Cite 2, and Cite 3, supra, the letters submitted by the estate, would not be given any effect in determining Decedent's intent. Accordingly, we conclude that the interest passing to Spouse under Article SEVENTH(a) does not satisfy the requirements of either § 2056(b)(5) or § 2056(b)(7).

- END -

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.