The Not-So Irrevocable Trust

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The author shows how the irrevocable trust may be structured to avoid taxes on trust property passing at grantor's death, even upon the demise of his spouse and descendants.

A LEGITIMATE OBJECT of estate planning is to provide for the most efficient disposition of property after death. This encompasses transferring property to beneficiaries with the least amount of grief and expense to them. This paper discusses transferring insurance proceeds and other property to beneficiaries through a trust.

The objects of this trust are: (1) to pass property to beneficiaries without imposition of death taxes; (2) to use this property (through loans or purchase of estate assets) to pay death taxes on property in estate of the trust grantor; and (3) to assure grantor of the immediate availability of this property for distribution to family members (beneficiaries) in event of need.

Death Tax on Life Insurance

Proceeds of life insurance owned by a decedent at death are includible in his gross estate for federal estate tax purposes.[1] It is worth consideration, therefore, for an insured to transfer all policy incidents of ownership [2] during his lifetime and avoid this tax. If all incidents of ownership are transferred to insured's wife and he predeceases her, she will collect all insurance proceeds at his death. The insured may object to entrusting a large sum of money to his surviving spouse, particularly if there are minor children involved. Also, the insurance proceeds remaining at wife's death are added to her gross estate. If large enough, this would attract more federal estate tax than in insured's estate if he owned the policies—this because the marital deduction is available to him, but not to the wife after husband's death.[3]

The Irrevocable Trust

To avoid this tax on both husband's and wife's estates, an insured might consider an irrevocable trust. An irrevocable trust is a person

[1] Sec. 2032. All section references are to the Internal Revenue Code of 1954.

[2] Reg. Sec. 20.2042-1(c)(2) states "incidents of ownership":

". . . includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc."

[3] Sec. 2056. Bush, "Husband and Wife Transfers," 30 *New York University Annual Institute on Federal Taxation* 695, 721-724.

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separate from its grantor.[4] It is treated for tax purposes similar to an independent individual.[5]

An insured, therefore, as grantor could establish an *inter vivos*, irrevocable trust and transfer all insurance policy incidents of ownership to that trust. The usual beneficiaries of this trust are grantor-insured's wife for her life and remainder to descendants and others selected by him.

Lessening Federal Estate Tax Burden: Generation Skipping

Transferring insurance to an irrevocable trust avoids federal estate taxation on insurance proceeds at insured's death. This is simply because at death he owns no interest in the insurance policy or proceeds. (See discussion on gifts in contemplation of death, however, below.) The proceeds could escape such tax at his wife's death too since she owns no such interest. In fact, if the trust instrument carefully provided, and subject to the statute of limitation, the proceeds could be passed to his great grandchildren free of estate tax.[6]

The disadvantage of transferring an insurance policy (or any other property) to an irrevocable trust is immediate subjection to gift tax laws.[7] The gift tax laws are designed to supplement the estate tax laws.[8] If one does not apply, the other does. Sometimes both apply.[9]

Gift tax laws pertain to transfers in trust. The following discussion, however, suggests their relatively insignificant tax effect when compared to the advantageous estate tax effect. Specifically, the value of the policy is slight when transferred by gift compared to the full face value of the policy, includible in insured's estate, if not so transferred.[10] Further, note that the gift tax rate is merely 75 per cent of the estate tax rate in the corresponding bracket. The gift tax starts in the 2.25 per cent bracket.

The Gift Tax Laws

An insurance premium is a gift.[11] A gift is subject to gift tax based on its value[12] at the gift date. A donor, however, is entitled to a lifetime ex-

[4] It may be treated, however, as a "grantor trust" under Section 671 for income tax purposes. See discussion below.

[5] Reg. Sec. 1.641(a)-1 and Reg. Sec. 301.7701-1.

[6] Littenberg, "How to Use Trusts and Powers of Appointment to Skip Successive Estate Taxes," P-H, *Successful Estate Planning Ideas and Methods*, ¶ 6008.

[7] Secs. 2501-2524.

[8] See Lowndes and Kramer, *Federal Estate and Gift Taxes* ¶ 28.2 (2nd ed. 1962).

[9] For example, a gift in contemplation of death. Also, see Lowndes and Kramer, cited at footnote 8.

[10] Rocco, "How to Handle Gifts of Life Insurance Outright or in Trust," P-H, *Successful Estate Planning Ideas and Methods*, ¶ 5503.

[11] 1 CCH FEDERAL ESTATE AND GIFT TAX REPORTS ¶ 3020.40, citing Bureau Release March 6, 1933.

[12] Sec. 2512(a).

emption of $30,000 [13] and may be entitled to a $3,000 annual exclusion.[14] The annual exclusion obtains only if the trust beneficiary has a "present interest" in the trust.[15] Although not a large sum, generally gifts valued under $3,000 may be made in any year without the necessity of preparing a gift tax return.[16] Also, importantly, without that exclusion, the value of any gift diminishes the $30,000 lifetime exemption.

If the instrument provided the wife to receive "an unrestricted right to the immediate use, possession or enjoyment of property," under the Regulations,[17] the donor could exclude the first $3,000 of premiums paid each year.

Language granting the wife a noncumulative, annual power to invade, commencing at trust inception, for her life of $5,000 or 5 per cent of principal, whichever is greater, appears to satisfy the above present interest regulatory test.[18]

It has been suggested that the wife pay the premiums for the trust and utilize her lifetime exemption and low gift tax bracket. This raises other, theoretically more serious, problems. Since she is normally the life beneficiary, a transfer (payment of premiums) by her could activate Section 2036 (Transfers with Retained Life Estate).[19] This might result at her death in the inclusion in her estate of the insurance proceeds attributable to her premium payments.

In short, in many instances the grantor-insured is the most logical and practical candidate to pay the premiums. He may, therefore, wish to utilize language along the above lines to obtain the annual exclusion.

Federal Estate Tax Consequences of Wife's Power of Invasion

Under Section 2041, this $5,000 or 5 per cent power is not includible in grantor-husband's estate at his death.[20] On the other hand, under Section 2036, it might be includible in grantor-husband's estate if it discharged his legal obligation of support.[21]

In *Wishard* [22] decedent while alive bought an annuity which he transferred to his wife and sister. This was payable to them during their lives. The Commissioner questioned whether this annuity discharged the decedent's legal obligation to his dependent wife and sister. The Court of Appeals held:

"The annuitants had unfettered right to use the payments in any manner

[13] Sec. 2521.

[14] Sec. 2503(b).

[15] Reg. Sec. 25.2503-3(b) states:

"An unrestricted right to the immediate use, possession or enjoyment of property or the income from property . . . is a present interest in property. An exclusion is allowable with respect to a gift of such an interest. . . ."

[16] Sec. 6019(a).

[17] Reg. Sec. 25.2503-3(b), above.

[18] Yohlin, "Ownership and Transfer of Life Insurance," 28 *New York University Annual Institute of Federal Taxation* 765, 792. See also *Crummey v. Commissioner*, 68-2 USTC ¶ 12,541, 397 F. 2d 82 (CA-9).

[19] *Eva M. Miller*, CCH Dec. 31,475, 58 TC 699 (1972).

[20] The greater of 5 per cent of trust value or $5,000 is includible in wife's estate at her death. Reg. Sec. 20.2041-3(d). Vol. 1, Casner, *Estate Planning*, p. 717 (1962 ed.).

[21] Reg. Sec. 20.2036-1(b)(2) states:

"The 'use, possession, right to the income or other enjoyment of the transferred property' is considered as having been retained by or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment *is to be applied* toward the discharge of the legal obligation of the decedent, or otherwise for his pecuniary benefit. The term 'legal obligation' includes a legal obligation to support a dependent during the decedent's lifetime."

[22] *Wishard v. United States* 44-2 USTC ¶ 10,135, 143 F. 2d 704, 709 (CA-7). Also see Mertens, *Law of Federal Gift and Estate Taxation*, Cum. Supp. 1972, p. 225.

they saw fit. No obligation was placed upon them to use the money to support themselves, nor was there any showing that this was the purpose of the annuity. An independent income is different from an income to be used for support."

The value of the annuity therefore was not includible in decedent's estate.

The Court of Appeals for the Tenth Circuit in *Richards*[23] stated:

"A husband may make a gift to his wife without affecting his duty or support, and there is no presumption that such a gift is in discharge of the donor's marital duty."

In *Bel*[24] the decedent while alive made a gift of mineral interests and stocks to his minor daughter. The Commissioner argued that the value of that property should be included in the decedent's gross estate under Section 2036(a)(i).

The District Court, disagreeing with the Commissioner, held:

"Here Mr. Bel made outright gifts of the mineral interests and stock to Jeanne [his daughter]. He did not stipulate the purpose for which the stock or mineral interests were to be used. The gifts were donations inter vivos with no strings attached and the decedent had no right to use the mineral interests and stocks or their revenues to discharge any legal obligation which he might have owed to his daughter. He attached no strings to the gifts. The gifts were irrevocable and unconditional. The only authority Mr. Bel had with respect to these interests under the law of Louisiana resulted from his being administrator of his children's estate during the marriage. This authority did not give Mr. Bel the right to use the money for Jeanne's support and education. Considering his financial condition, if Mr. Bel had applied to the court for authority to sell his daughter's property to pay for her support, the court would have dismissed his application out of hand."

Gift Splitting

Upon occasion the insurance transferred in trust is fully paid up, or has sufficient cash surrender value to pay all remaining premiums. The $3,000 annual exclusion would not then be so important to the grantor. This is because after transferring the policies he need make no further gifts (for premium payments) to this trust.

On the other hand, reducing the amount of the initial gift of the insurance policies is very important. The reason for this is gift tax applies to the value of the policy transferred,[25] which could be very substantial. To reduce this value, compliance with the gift splitting provisions of the Code is necessary. Specifically, Section 2513 permits gifts by one spouse to a third party to be treated as though the donor and his spouse each made a gift of one-half the total value:

"The gift splitting privilege . . . makes it possible for one spouse to make a gift and have it treated for gift tax purposes as though it had been made one-half by each spouse. This permits the application of two $30,000 tax exemptions and increases the effective annual exclusion to $6,000 on account of each person (other than

[23] *Richards*, 67-1 USTC ¶ 12,463, 375 F. 2d 997 (CA-10); also *Colonial-American National Bank, etc.*, 57-1 USTC ¶ 11,689, 243 F. 2d 312 (CA-4).

[24] *Bel v. United States* 70-1 USTC ¶ 12,670, 310 F. Supp. 1189 (DC La.), aff'd, rev'd and rem'd on another issue 72-1 USTC ¶ 12,818, 452 F. 2d 683, cert. denied 406 U. S. 919.

[25] Generally the value is its interpolated terminal reserve value. Reg. Sec. 25.2512-6 (a). That is the amount the insurance company holds in reserve to cover its liability on the policy. Simmons, "Federal Taxation of Life Insurance," *ALI-ABA Taxation/Practice Handbook*, p. 44 (1966 ed.).

a spouse) to whom a gift is made."[26] Parentheses added.

It is conceivable, therefore, for grantor to transfer property valued at $66,000 to an irrevocable trust in one year completely free of gift tax. In order to do this, his spouse must consent to such gift splitting, and the amount directed to the third-party donee must be ascertainable. Reg. Sec. 25.2513-1(b)(4) on point states:

"If one spouse transferred property in part to his spouse and in part to third parties, the consent is effective with respect to the interest transferred to third parties only insofar as such interest is ascertainable at the time of the gift and hence severable from the interest transferred to his spouse."

Practical Considerations

Practical considerations most certainly should govern the instrument. As later discussed, a provision should appear allowing the trustee to distribute principal to the beneficiary wife at any time for her support, maintenance, health, medical attention and other external standards, first taking her other assets and sources of income into account. Any remainder will then go to children or other "third parties."

This occasions the difficulty of determining the value of the remainder to these third parties. If unascertainable, no gift splitting is allowed. There have been several cases on this subject. A brief analysis of two might be useful.

In *Robertson*[27] Mr. Robertson transferred $59,388 of stock to his newly created irrevocable trust. The trust provided for Mr. Robertson's wife, as follows:

"The Trustees shall pay over the net income, and so much of the principal as the corporate trustee in its sole discretion but with due regard to her other sources of funds, shall deem necessary for her maintenance and support . . . so long as she may live."

The trust provided that after her death, the remainder was to go to third parties.

The Commissioner urged that there should be no gift splitting. This was because the value of her interest could not be determined, since the trustee could distribute all principal to her and thereby "destroy the income interest of the wife." If her life interest could not be determined, it follows that the remainder (to third parties) was not "ascertainable at the time of the gift and hence severable from the interest transferred to his spouse."[28]

The Tax Court stated:

"We concluded (in earlier cases) on principle and authority that the solution of this problem depended on whether the power to invade principal was absolute or was limited by certain standards by which the possibility of invasion could be gauged, and on whether, if there were standards of limitation, there was a likelihood of the exercise of such power as disclosed by the facts. . . .

"In the instant case, unlike the cases cited and relied on by respondent, an invasion of the trust corpus for the benefit of the life beneficiary could be made only if the corporate trustee should deem it *'necessary for her maintenance and support' 'with due regard to her other sources of funds,'* . . . and there is also in the record

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[26] 2 CCH Federal Estate and Gift Tax Reports ¶ 7056.

[27] *Robertson,* CCH Dec. 21,726, 26 TC 246 (1956).

[28] 1939 Code Reg. 108, Sec. 86.3(a)(4); 1954 Code Reg. Sec. 25.2513-1(b)(4). Also see *Stark v. United States* 73-1 USTC ¶ 12,921 (CA-8).

here evidence as to what were the standards of living of petitioner's wife. In the instant case we are of the opinion that the power to invade principal is limited by standards by which the possibility of such invasion can be gauged. Cf. *Merchants Bank v. Commissioner, supra,* where 'introducing the element of the widow's happiness and instructing the trustee to exercise its discretion with liberality' to her and to 'consider her welfare, comfort and happiness prior to the claims of residuary beneficiaries . . .' 'brought into the calculation elements of speculation too large to be overcome notwithstanding the widow's previous mode of life was modest and her own resources substantial.'" (Parentheses added.)

The Court then considered the likelihood of the exercise of the trustee's power to invade. Based upon the ages of Mr. Robertson (61) and spouse (60) at the date of gift in trust, the family wealth and their relatively modest life style, the court there was concluded little likelihood of exercise of the power to invade.

Mr. Robertson, therefore, was allowed a $3,000 exclusion for the lifetime gift of income to his wife. He was also allowed to split the remainder value of the gift (to third parties) in half with his wife.

In the 1972 *Wang*[29] case, on the other hand, the Tax Court determined gift splitting unavailable.

Mr. Wang transferred insurance policies plus real estate to an irrevocable trust. The beneficiaries of this trust were his wife for life and remainder to descendants. The trustees had the power to invade for the wife "for her proper support, care and health, or for any emergency affecting the donor's said wife or her family, first having regard to her other sources of income. . . ."

The Tax Court in disallowing the gift splitting claim of Mr. Wang stated:

"It has been held that an ascertainable standard exists when the language of the will or trust allows invasion of the principal only to the extent necessary to maintain the life tenant's present standard of living. Thus, words such as 'comfort and support,' 'maintenance and support,' 'comfort and welfare,' 'proper care, support and maintenance,' and 'support, maintenance, welfare and comfort' have been held to constitute an ascertainable standard based upon the life tenant's present standard of living."

"We think that this language (in the instant case) does not constitute an ascertainable standard. The 'emergency' is not limited whatsoever. It is broad enough to cover any type of emergency which might affect her or her family. It would seem that by this language the petitioner had something more in mind than merely ensuring the preservation of his wife's customary standard of living. It should be observed that it is well-settled that proof of extrinsic circumstances cannot supply the necessary element of ascertainability if the wording of the instrument does not furnish the basis for an objective standard." (Parentheses added.)

In the event that gift splitting were desired, language granting the spouse a power to invade to the extent of $5,000 or 5 per cent might make the remainder unascertainable, since this is not limited by an ascertainable standard.

Gifts in Contemplation of Death

Section 2035(b) raises the presumption that a gift of property (in-

[29] *Stanley L. Wang v. Commissioner,* CCH Dec. 31,448(M), 31 TCM 719 (1972).

surance or otherwise) within three years of date of death is "deemed to have been made in contemplation of death." Section 2035(a) includes the value of the gift so made in the decedent's gross estate.[30] If the insurance policies were transferred more than three years before death, only the premiums will be so includible.[31]

The danger is that if the proceeds are includible in the deceased grantor's estate, they will not qualify for the marital deduction. The reason for this is, although the decedent's will provides for the maximum marital deduction, that only applies to property passing to his wife. The insurance proceeds deemed includible in decedent's estate pass not to his wife, but in fact to a trust. This trust most probably would not qualify for the marital deduction under Section 2056, unless specific qualifying language were employed. To remedy this, language could provide that if insurance proceeds are includible in decedent's estate for any reason, the wife will have such powers, interests and rights (specified in the instrument) to qualify for the maximum marital deduction.[32]

Grantor Trusts

A grantor-insured may transfer an insurance policy with cash surrender value to an irrevocable trust. He may then wish the trustee to pay premiums by using (borrowing) that cash surrender value. This is important if the trust were otherwise unfunded. The trustee must pay interest on that borrowed money. The interest deduction is useless to an unfunded trust since it offsets no income. That deduction, however, is useful to a high-bracket grantor. If the trust were considered a "grantor trust," the grantor must include in computing his taxable income "those items of income, *deduction* and credit against tax" of the trust (italics added).[33]

A "grantor trust" results when a grantor retains such dominion and control over the trust that he is considered the owner thereof.[34] He is the owner, however, solely for income tax purposes.[35] Reg. Sec. 1.671-2(a) states the general rule:

"Under section 671 a grantor or another person includes in computing his taxable income and credits those items of income, deduction, and credit against tax which are attributable to or included in any portion of a trust of which he is treated as the owner."

Thus, if that Section applies, "the income will be included in the income of the grantor and he will be allowed those deductions for such expenses which he would have been entitled to if the trust had not been created." [36] As the Regulations state:

"An item of income, deduction or credit included in computing the taxable income and credits of a grantor . . . under Section 671 is treated as if it had been received or paid directly by the grantor. . . ." [37]

[30] *Bel v. United States*, cited at footnote 24.

[31] Rev. Rul. 71-497, 1971-2 CB 329; *Coleman*, CCH Dec. 29,734, 52 TC 921 (1969).

[32] See Woolfolk, "How to Control Spouse-owned Life Insurance, etc.," *Journal of Taxation*, July 1971, p. 24.

[33] Reg. Sec. 1.671-2(a).

[34] Reg. Sec. 1.671-2(b); also see the forerunner of Code Subpart E, *Clifford v. Helvering*, 40-1 USTC ¶ 9265, 309 U. S. 331; and Volume 6 Mertens *Law of Federal Income Taxation*, ¶ 37.05.

[35] Senate Committee Reports on Sec. 671; also see Lowndes and Kramer, *Federal Estate and Gift Taxes*, Incomplete Transfers, Sec. 28.2 (2nd ed., 1962); and BNA *Tax Management Series* 50-2, A-16.

[36] Senate Committee Reports on Sec. 671; also see *United States v. Green*, 59-2 USTC ¶ 9595, 170 F. Supp. 359 (DC N. Y.), involving the predecessor of Section 671.

[37] Reg. Sec. 1.671-2(c).

The interest deduction item, therefore, is treated as if it had been paid directly by grantor. Of course, with or without this trust, grantor must satisfy the Section 264 specific provision on deductibility of interest on insurance loans.

Reclaiming Proceeds or Trustee's Power of Invasion for Emergencies

The practical problem with an irrevocable trust is its irrevocability: assets once committed are irrevocably committed. It behooves a grantor, therefore, to establish an irrevocable trust providing for every possible distribution contingency, while retaining the independent tax status of the trust.

A prudent grantor could vest trustee at trust inception with power to distribute income or principal to a beneficiary for: comfortable support, maintenance in accustomed standard of living, education, health needs, medical care, extraordinary circumstances, such as for weddings, graduations, births, purchase of a residence or purchase of a business, in the event of accident or disability and other objective, external standards. This power should be exercised, however, only when the property and all sources of income of or available to the beneficiary are inadequate for such purpose, in the sole judgment of the trustee.

Thus, upon a later change of circumstance, the trustee could distribute part or all corpus of the trust to the grantor's spouse, children or other beneficiaries. It is conceivable then for the trustee to effectively terminate the trust if an unforeseen practical (nontax) circumstance did arise in the distant future.

To achieve greater flexibility, the grantor may wish to directly grant a beneficiary (for example, his spouse) a power to invade for that beneficiary's sole benefit. This power must be limited by an ascertainable standard relating to health, education, support or maintenance. If so limited, the value of this power will not be includible in beneficiary's estate upon his or her demise.[38] The beneficiary, therefore, will be empowered to demand payments during his or her lifetime for the above purposes. This may be a wise move diplomatically, besides providing assurance of that beneficiary's control of his or her basic needs.

Mandatory Support Trusts

If the trustee were mandated to distribute trust income and principal for the maintenance and support of dependent beneficiaries, it is clear that the proceeds of the trust would be includible in the grantor's estate at his demise. This is because the trust discharged a legal obligation of the decedent.[39]

In *Richards*[40] grantor established a trust which said:

"My trustees shall pay unto my wife . . . for her maintenance and support the net income from my trust estate at such times as they in their sole discretion shall determine. . . .

"This is a trust for maintenance, and I direct the payments to my said wife and children hereinbefore specified be made by my trustees. . . ."

The Court of Appeals stated:

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[38] Sec. 2041(b)(1)(A). Also see Alessandroni, "Tax and Other Implications of Powers Measured by a Definite or Ascertainable Standard," *University of Miami Fourth Institute on Estate Planning*, ¶ 70.900.

[39] Reg. Sec. 20.2036-1(b)(2), see footnote 21 above. Also, see Section 2038 on Revocable Transfers.

[40] *Richards*, cited at footnote 23.

". . . that the gift to the wife must not be restricted and that if the donor reserves unto himself the right to have the income applied to his wife's support, it is linked to relief for himself from his financial responsibilities as a husband. . . .

"These (above) provisions clearly indicate a restricted trust whose purpose was maintenance and support. The only discretion granted the trustees was the determination of the time when payment should be made.

"We are of the opinion that the value of trust corpus is includible in decedent's estate."

A mandatory support trust, therefore, will be regarded as a reserved life estate, includible under Section 2036, if the grantor dies during the period of dependency.[41]

Discretionary Support Trusts

A trustee may possess a discretionary power to invade for dependent beneficiaries (for example, wife and minor children). If circumscribed by an external standard, Section 2036 will not apply.

In *Jennings*[42] the Court of Appeals stated:

"Since the trustees were not free to exercise untrammeled discretion but were to be governed by determinable standards, their power to invade capital, conditioned on contingencies which had not happened, did not in our opinion bring the trust property within the reach of Section 811(d)(2)."

In essence, the theory is that if the exercise of the power is subject to an external standard, the power in the trustee is properly circumscribed.[43] That is, the trustee has no more power that that of a court of equity, since that court could administer the standard. As one commentator pertinently stated, the trustee under this reasoning has no power at all, but is a mere ministerial functionary of the equity court.[44]

In these discretionary support cases, the courts emphasize the importance of an "independent trustee."[45] (Although the grantor in *Jennings* was one of three trustees.) In *Abner W. Mitchell*[46] the grantor's son was the trustee for the grantor's wife. The grantor's son was also a remainderman. The trust instrument provided:

"The trust shall pay over to my wife . . . during the term of her

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[41] The converse is that if the beneficiary becomes independent (child reaching majority) before grantor's death, there was no obligation to support at death. Therefore, the applicable proceeds are not includible in grantor's estate. Lowndes and Kramer, *Federal Estate and Gift Taxes*, p. 146 (2nd ed., 1962).

[42] *B. B. Jennings, et al., Exrs. v. Smith*, 47-1 USTC ¶ 12,751, 161 F. 2d 74, (CA-2). The trustees had the power to invade capital if the beneficiary or his issue "should suffer prolonged illness or be overtaken by financial misfortune which the trustees deem extraordinary." This was considered an appropriate external standard. Also see *Delancey v. United States*, 67-1 USTC ¶ 12,459, 264 F. Supp. 904, where the *grantor* retained the power to pay corpus when "necessary or advisable to provide for the comfortable care, maintenance and support of the income beneficiary." This was held an appropriate standard, not includible in grantor's estate under Sections 2036 and 2038.

[43] O'Connell, "Tax Consequences to the Grantor," 13 *Arizona Law Review*, 284 (1971).

[44] Pedrick, "Desultory Comments on Irrevocable Trusts and Federal Estate Taxation," *University of Miami 2nd Institute on Estate Planning*, ¶ 68.1904. See Mertens, *Law of Federal Gift and Estate Taxation*, Cum. Supp., ¶ 24.10 et seq. on determination of an external standard.

[45] Rev. Rul. 73-143, I. R. B. 1973-12, 27. Where grantor-trustee holds a power of invasion limited only by "special needs" of beneficiary, the trust value is includible in his gross estate under Section 2038 (Revocable Transfers); Mertens, *Law of Federal Gift and Estate Taxation*, Cum. Supp., ¶ 24.13.

[46] *Abner W. Mitchell*, CCH Dec. 30,478, 55 TC 576 (1970), acq. 1971-18, 5.

natural life, such amounts of the net income, and principal of said trust fund if required as said trustee shall in his unrestricted discretion determine to be necessary for the comfortable support and maintenance of my wife . . . taking into consideration her other sources of income. . . ."

The grantor was 70 years of age when he established that trust. The court determined that the grantor and wife at all times lived conservatively and that while he was alive, he was able to support his wife. The trustee at no time made any payments to or for her benefit.

The Tax Court in holding the trust property not includible in decedent's estate said:

"It is to be noted that the provision of the estate tax regulations states that the use, possession, right to the income, or other enjoyment of the transferred property is considered as having been retained by or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment *is to be applied* toward discharge of a legal obligation of decedent. And it is well established that where the right to income from, or other enjoyment of, the trust property *is to be applied* for the support and maintenance of the decedent's wife, the decedent is considered to have retained the possession of enjoyment of or the right to the income from the transferred property within the meaning of section 2036(a)(i). Here, however, there was no direction in the trust instrument that either the principal or the income of the trust was to be so applied. *It has been held that the language of the regulations 'is to be applied' is not to be read to mean 'may be applied,' the situation which exists where the discretion with respect to distributions is vested in an independent trustee.*

"It is true that in the *Douglass* and *Chrysler* cases the trustee was not a member of the decedent's family, whereas here the trustee was the decedent's son. However, in a similar situation where the trustees were the wife and son of the settlor, it was held that the same reasoning is applicable (citations omitted). The court there stated that to 'assume that the donor could control the trustees because they were his wife and another son is but to speculate.'" (Italics and parentheses added.)

Does the line of cases culminating in the acquiesced *Mitchell* case mean:

(1) Where an independent trustee has a discretionary power to distribute, the Regulation immediately discussed above is inapplicable?

(2) Where an independent trustee has a discretionary power to distribute and does not, the Regulation is inapplicable?

(3) Where an independent trustee has a discretionary power to distribute based on external standards, the Regulation does not apply?

(4) Where an independent trustee has a discretionary power to distribute based on external standards and does not distribute, the Regulation does not apply?

It seems prudent, therefore, when there is one or more dependent beneficiaries, to consider:

(1) A truly "independent" trustee;

(2) Discretionary language;

(3) Naming a number of external distribution events;

(4) Limiting distribution to the extent the beneficiary's sources of income and property, including anyone supporting him, are inadequate for the purpose intended;

(5) Limiting distribution discretion to the sole judgment of the trustee.

If the beneficiaries were financially independent of grantor (or upon their becoming independent) a disinterested trustee could invade for their benefit for any purpose.[47] No part of the undistributed principal will be includible in any beneficiary's estate.[48]

Limited Power of Appointment

To assure further flexibility, a limited power of appointment vested in one or more beneficiaries should be considered. This enables the holder of the power to distribute all or any part of the trust property subject to the power to other beneficiaries—the objects of the power. Trust property subject to a limited power of appointment is not includible in the estate of the holder of the power.[49] A limited power of appointment is a power by which the holder can appoint the designated property to anyone other than (1) himself, (2) his creditors, (3) his estate and (4) creditors of his estate.[50] This, coupled with the power of invasion by the trustee, provides additional flexibility with respect to future distributions based on unforeseen circumstances.[51]

Conclusion

An *inter vivos,* irrevocable trust permits a transfer to grantor's beneficiaries in a most efficient manner. Specifically, it avoids death taxes on insurance proceeds and other trust property passing at grantor's death. It may be structured to avoid death taxes on this property upon the demise of his spouse and descendants. The insurance proceeds and other property could be used (by loans or purchase of estate assets) to pay death taxes on estate property. These benefits obtain, yet at all times from inception the trust property is available for immediate distribution to family members (beneficiaries) for unforeseen financial needs. **[The End]**

[47] Littenberg, "How to Use Trusts and Powers of Appointment to Skip Successive Estate Taxes," P-H, *Successful Estate Planning Ideas and Methods* ¶ 6008 and 6008.4.

[48] Littenberg, ibid; Mertens, *Law of Federal Gift and Estate Taxation,* Cum. Supp., p. 247 states:

"Where, however, the trustee is independent and has sole discretion as to the distributions and/or use of the trust property including distributions which might or might not serve to discharge a legal obligation of the transferor, such property is not normally includible in the transferor's gross estate."

[49] Sec. 2041(a).

[50] Sec. 2041(b)(1) and Reg. Sec. 20.2041-1 (c)(1).

[51] Wiley, "Achieving Flexibility," *Powers of Appointment Resource Materials for Estate Planning in Depth,* ALI-ABA 1972, p. 327.