

within the terms of section 20.2032-1(c)(2)(iii) of the regulations.

It is accordingly held that when the trustee divided the corpus of the original trust into separate trusts, he effectuated a "distribution" within the meaning of section 2032 of the Code.

This is to be distinguished from the situation in Revenue Ruling 57-495, 1957-2 C.B. 616. There the instrument provided that, upon the death of the settlor, the corpus of the trust was to be divided into two equal parts and the income therefrom paid to the two beneficiaries for their joint lives, the remainder payable to others upon the death of the survivor of the income beneficiaries. Since the trust continued uninterrupted for the lives of the income beneficiaries, there was no distribution of the property within the meaning of section 2032(a) of the Code, until the last income beneficiary died. Only upon the death of the surviving income beneficiary was the trust terminated and the trust corpus distributed to those named as remaindermen.

Revenue Ruling 57-495 is hereby distinguished.

Section 2036.—Transfers with Retained Life Estate

26 CFR 20.2036-1: Transfers with retained life estate.

The value of property transferred in trust under which the trustee determines the distribution or accumulation of income and the decedent retained a life power to appoint a successor, including himself, if the trustee was unable to serve is includible in the decedent's gross estate.

Rev. Rul. 73-21

Advice has been requested whether the value of the corpus of an inter vivos trust created by a decedent is includible in his gross estate under section 2036 of the Internal Revenue Code of 1954, under the circumstances described below.

The decedent transferred property in trust for the benefit of A, B, and C for their lives. Upon the death of the survivor of the life tenants, the remainder is payable to D. The trust instrument authorized the trustee to distribute income to such of the life tenants and in such amounts as he deemed appropriate. Any undistributed income is to be accumulated and added to corpus annually. The decedent reserved the power to appoint a successor (which, under state law applicable to the administration of the trust, included the power to appoint himself) upon the death, resignation, or inability to serve of the original trustee. At the time of decedent's death, the original trustee was still serving in that capacity.

Section 2036(a)(2) of the Code provides that the value of the gross estate shall include the value of any interest in property transferred by the decedent where he has retained for his life, or for any period not ascertainable without reference to his death, or for any period which does not in fact end before his death, the right, either alone or in conjunction with any other person, to designate the person or persons who shall possess or enjoy the property or the income therefrom.

Section 20.2036-1(b)(3) of the Estate Tax Regulations provides that "The phrase 'right * * * to designate the person or persons who shall possess or enjoy the transferred property or the income therefrom' includes a reserved power to designate the person or persons to receive the income from the transferred property * * * during the decedent's life or [for any period not ascertainable without reference to his death]." It also provides that "With respect to such a power, it is immaterial * * * whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (e.g., the death of another person during the decedent's lifetime.)"

The power granted the trustee in

this case to determine whether to distribute or accumulate income, and in what amounts, is a power to designate who shall possess or enjoy the income within the meaning of the Code and the regulations. Inasmuch as the decedent had the contingent right to appoint himself successor trustee upon the failure of the original trustee to serve in that capacity, he is considered to have retained a contingent right to designate beneficial enjoyment of the trust income. It does not matter that the power to determine the beneficial interests was exercisable by the decedent only if he appointed himself successor trustee. Nor is it material that the decedent could appoint himself only in the event of the death, resignation, or incapacity of the original trustee, a contingency beyond the decedent's control which did not in fact occur prior to the decedent's death.

In view of the foregoing, it is held that the decedent retained for a period not ascertainable without reference to his death the right to designate the person or persons to receive the income from the transferred property. Accordingly, the value of the property is includible in his gross estate under section 2036(a)(2) of the Code.

*26 CFR 20.2036-1: Transfers with retained life estate.
(Also Section 2038; 20.2038-1.)*

The value of trust property is not includible in the grantor-decedent's gross estate where his power to appoint himself as trustee was effectively extinguished by a lower court decree that was not appealed even though the decree was inconsistent with decisions of the state's highest court.

Rev. Rul. 73-142

Advice has been requested whether the value of certain property transferred in trust by the grantor-decedent is includible in his gross estate under section 2036 or section 2038 of the

Internal Revenue Code of 1954, under the circumstances described below.

The decedent made substantial gifts of property in trust for the benefit of his wife and children. Under the terms of the trust instrument, the decedent reserved the unrestricted power to remove or discharge the trustee at any time and appoint a new trustee, with no express limitation on so appointing himself. The trustee was given unrestricted power to withhold distribution of income or principal and to apportion between income and principal notwithstanding any rules of law to the contrary. In 1965, in a non-adversary action in which the decedent was petitioner, a lower state court construed the trust instrument to mean that the decedent had reserved the right to remove and appoint a trustee only once, that this power did not include the right to appoint himself; and that once having exercised that power, decedent would have exhausted his reserved powers. The decedent, subsequent to the decree, did remove the original trustee and appoint another (not himself) so that under the interpretation of the court he no longer had such a right as of the date of his death in 1970. It appears that the decree is contrary to the decisions of the highest court of the state.

In light of the holding in *Commissioner v. Estate of Herman J. Bosch*, 387 U.S. 456 (1967), Ct. D. 1915, 1967-2 C.B. 337, the specific question asked is the effect to be given the above-mentioned court decree in determining the estate tax consequences of the trust.

Section 2036(a)(2) of the Code 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, under which he has retained for

his life the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2038 of the Code 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 at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by a decedent alone or in conjunction with any other person to alter, amend, revoke or terminate.

If the decedent reserved the unrestricted power to remove or discharge a trustee at any time and appoint himself as trustee, the decedent is considered as having the powers of the trustee. Section 20.2036-1(b)(3) of the Estate Tax Regulations. See also section 20.2038-1(a)(3).

In *Bosch* the Supreme Court of the United States held that where the Federal estate tax liability turns upon the character of a property interest held and transferred under state law, federal authorities are not bound by a determination made of such property interest by a state trial court. Recognizing that state law as announced by the highest court of the state is to be followed, the Court held that, where there is no decision by the highest court, the federal court must apply what it finds state law to be, after giving proper regard to decisions of other courts of the state.

A close reading of the *Bosch* decision discloses that it does not in any way indicate that a lower court decree that is inconsistent with the ruling by the state's highest court on the particular issue is void as between the parties to the action. The problem involved in *Bosch* concerns the effect to

be given such lower court decree where the same issue is critical in the determination of a Federal tax question. The Court concluded that "federal authorities are not bound" by a determination of a property interest by a state trial court. This does not mean that the parties to the state court action are not bound by the decree.

In this case the lower court had jurisdiction over the parties and over the subject matter of the proceeding. Thus, the time for appeal having elapsed, its judgment is final and conclusive as to those parties, regardless of how erroneous the court's application of the state law may have been. Consequently, after the time for appeal had expired, the grantor-decedent did not have the power to appoint himself as successor trustee. The aforesaid rights and powers which would otherwise have brought the value of the trust corpus within the provisions of sections 2036 and 2038 of the Code were thus effectively cut off before his death.

Unlike the situation in *Bosch*, the decree in this case was handed down before the time of the event giving rise to the tax (that is, the date of the grantor's death). Thus, while the decree would not be binding on the Government as to questions relating to the grantor's power to appoint himself as trustee prior to the date of the decree, it is controlling after such date since the decree, in and of itself, effectively extinguished the power. In other words, while there may have been a question whether the grantor had such power prior to the decree, there is no question that he did not have the power thereafter.

Accordingly, it is held that the value of the property transferred to the inter vivos trust is not includible in the grantor-decedent's gross estate under section 2036 or section 2038 of the Code.