

## Section 2036.—Transfers With Retained Life Estate

26 CFR 20.2036-1: Transfers with retained life estate.  
(Also §§ 672, 2038, 2511; 20.2038-1; 25.2511-2.)

**Transfers; trust; power to appoint successor trustee.** A decedent-grantor's reservation of an unqualified power to remove a trustee and appoint an individual or corporate successor trustee that is not related or subordinate to the decedent (within the meaning of section 672(c) of the Code) is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent-grantor to the trust. Rev. Ruls. 79-353 and 81-51 revoked; Rev. Rul. 77-182 modified.

### Rev. Rul. 95-58

The Internal Revenue Service has reconsidered whether a grantor's reservation of an unqualified power to remove a trustee and appoint a new trustee (other than the grantor) is tantamount to a reservation by the grantor of the trustee's discretionary powers of distribution. This issue is presented in Rev. Rul. 79-353, 1979-2 C.B. 325, as modified by Rev. Rul. 81-51, 1981-1 C.B. 458. An analogous issue is presented in Rev. Rul. 77-182, 1977-1 C.B. 273. The reconsideration is caused by the recent court decisions in *Estate of Wall v. Commissioner*, 101 T.C. 300 (1993), and *Estate of Vak v. Commissioner*, 973 F.2d 1409 (8th Cir. 1992), *rev'g* T.C. Memo 1991-503.

Section 2036(a) of the Internal Revenue Code, in general, provides that the value of the gross estate includes the value of all property to the extent of any interest in the property that was transferred by the decedent (for less than adequate consideration) if the decedent has retained for life the right, alone or in conjunction with any person, to designate the person who shall possess or enjoy the property or the income therefrom.

Section 2038(a)(1), in general, provides that the value of the gross estate

includes the value of all property to the extent of any interest in the property that was transferred by the decedent (for less than adequate consideration) if the decedent held a power, exercisable alone or in conjunction with any person, to change the enjoyment of the property through the exercise of a power to alter, amend, revoke, or terminate.

Section 25.2511-2(c) of the Gift Tax Regulations provides that a gift of property is incomplete to the extent that the donor reserves the power to revest the beneficial title to the property in himself or herself or the power (other than a fiduciary power limited by a fixed or ascertainable standard) to name new beneficiaries or to change the interest of the beneficiaries among themselves. *See also* § 25.2511-2(f).

For purposes of §§ 2036 and 2038, it is immaterial in what capacity the power was exercisable by the decedent. Thus, if a decedent transferred property in trust while retaining, as trustee, the discretionary power to distribute the principal and income, the trust property will be includible in the decedent's gross estate under §§ 2036 and 2038. The regulations under §§ 2036 and 2038 explain that a decedent is regarded as having possessed the powers of a trustee if the decedent possessed an unrestricted power to remove the trustee and appoint anyone (including the decedent) as trustee. Sections 20.2036-1(b)(3) and 20.2038-1(a) of the Estate Tax Regulations.

Rev. Rul. 79-353 concludes that, for purposes of §§ 2036(a)(2) and 2038(a)(1), the reservation by a decedent-settlor of the unrestricted power to remove a corporate trustee and appoint a successor corporate trustee is equivalent to the decedent-settlor's reservation of the trustee's discretionary powers.

Rev. Rul. 81-51 modifies Rev. Rul. 79-353 so that it does not apply to a transfer or addition to a trust made before October 29, 1979, the publication date of Rev. Rul. 79-353, if the trust was irrevocable on October 28, 1979.

Rev. Rul. 77-182 concludes that a decedent's power to appoint a successor corporate trustee only in the event of the resignation or removal by judicial process of the original trustee did not amount to a power to remove the original trustee that would have endowed the decedent with the

trustee's discretionary control over trust income.

In *Estate of Wall*, the decedent had created a trust for the benefit of others and designated an independent corporate fiduciary as trustee. The trustee possessed broad discretionary powers of distribution. The decedent reserved the right to remove and replace the corporate trustee with another independent corporate trustee. The court concluded that the decedent's retained power was not equivalent to a power to affect the beneficial enjoyment of the trust property as contemplated by §§ 2036 and 2038. *See also Estate of Headrick v. Commissioner*, 93 T.C. 171 (1989), *aff'd* 918 F.2d 1263 (6th Cir. 1990).

In *Estate of Vak*, the decedent had created a trust and appointed family members as the trustees with discretionary powers of distribution. The decedent reserved the right to remove and replace the trustees with successor trustees who were not related or subordinate to the decedent. The decedent was also a discretionary distributee. Three years later, the trust was amended to eliminate both the decedent's power to remove and replace the trustees and the decedent's eligibility to receive discretionary distributions.

The issue considered in *Estate of Vak* was whether the decedent's gift in trust was complete when the decedent created the trust and transferred the property to it or, instead, when the decedent relinquished the removal and replacement power and his eligibility to receive discretionary distributions. The Eighth Circuit concluded that the decedent had not retained dominion and control over the transferred assets by reason of his removal and replacement power. Accordingly, the court held that under § 25.2511-2(c) the gift was complete when the decedent created the trust and transferred the assets to it.

In view of the decisions in the above cases, Rev. Rul. 79-353 and Rev. Rul. 81-51 are revoked. Rev. Rul. 77-182 is modified to hold that even if the decedent had possessed the power to remove the trustee and appoint an individual or corporate successor trustee that was not related or subordinate to the decedent (within the meaning of § 672(c)), the decedent would not have retained a trustee's discretionary control over trust income.

## EFFECT ON OTHER DOCUMENTS

Rev. Rul. 79-353 and Rev. Rul. 81-51 are revoked. Rev. Rul. 77-182 is modified.

### Section 2038.—Revocable Transfers

26 CFR 20.2038-1: *Revocable transfers.*

If a decedent-grantor makes a transfer to a trust and reserves an unqualified power to remove a trustee and appoint an individual or corporate successor trustee that is not related or subordinate to the decedent-grantor (within the meaning of § 672(c) of the Code), is the reservation of the power tantamount to a reservation by the decedent-grantor of the trustee's discretionary powers of distribution? See Rev. Rul. 95-58, page 191.

#### Part IV.—Taxable Estate

### Section 2056.—Bequests, etc., to Surviving Spouse

26 CFR 20.2056-0: *Table of contents.*

T.D. 8612

#### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 20, 25 and 602

#### Income, Gift and Estate Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

**SUMMARY:** This document contains final regulations relating to the income tax imposed under chapter 1, the estate tax imposed under chapter 11, and the gift tax imposed under chapters 12 and 14 of the Internal Revenue Code of 1986. Changes to the marital deduction provisions of the estate and gift tax chapters were made by the Technical and Miscellaneous Revenue Act of 1988. Further amendments were made by the Revenue Reconciliation Act of 1989, and the Revenue Reconciliation Act of 1990. These final regulations will provide guidance needed to comply with the changes to the marital deduction provisions of the estate and gift tax chapters.

**DATES:** These regulations are effective August 22, 1995.

These regulations apply to decedents dying and to gifts made after August 22, 1995.

### SUPPLEMENTARY INFORMATION:

#### *Paperwork Reduction Act*

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1360. The estimated annual burden per respondent/recordkeeper varies from 30 minutes to 3 hours, depending on individual circumstances, with an estimated average of 2 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

#### *Background*

A notice of proposed rulemaking was published in the Federal Register (58 FR 305 [PS-102-88, 1993-1 C.B. 885]), on January 5, 1993, reflecting amendments made to the Code by the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100-647 [1988-3 C.B. 1]) (the 1988 Act), the Revenue Reconciliation Act of 1989 (Pub. L. 101-239 [1990-1 C.B. 210]) (the 1989 Act), and the Revenue Reconciliation Act of 1990 (Pub. L. 101-508 [1991-2 C.B. 481]) (the 1990 Act). The 1988, 1989, and 1990 Acts impose restrictions on the allowance of the estate and gift tax marital deduction where the surviving spouse (in the case of a transfer at death) or the donee spouse (in the case of a lifetime transfer) is not a citizen of the United States. In addition, the gift tax annual exclusion allowable in the case of a transfer to a noncitizen spouse was increased to \$100,000. The statutory amendments also changed the tax rate and the amount of the unified credit applicable in the case of the estate of a decedent nonresident not a citizen of the United States (nonresident alien). The IRS

received written comments on the proposed regulations and, on April 2, 1993, held a public hearing on the regulations.

After consideration of the written and oral comments received, §20.2056A-2(d) of the proposed regulations, which provides additional requirements for qualification as a qualified domestic trust to ensure the collection of the section 2056A estate tax, was substantially modified. In view of these substantial modifications, §20.2056A-2(d) has been reissued as proposed and temporary regulations in order to afford the public a further opportunity to comment on these security arrangements. See the proposed rules and the rules portion \*\*\* [PS-25-94 and T.D. 8613, pages 502 & 216], respectively. The balance of the proposed regulations are revised and adopted as final regulations by this Treasury decision.

The following is a discussion of the more significant comments received (other than those comments pertaining to §20.2056A-2(d) of the proposed regulations) and the reasons for accepting or rejecting those comments in the final regulations.

#### *A. §1.1015-5 Increased basis for gift tax paid in the case of gifts made after December 31, 1976.*

This section of the proposed regulations has been revised to better conform to the existing regulations and to clarify the determination of the amount of the gift tax paid in situations where the donor's unified credit is applied against the gift tax liability.

#### *B. §20.2056A-1 Restrictions on allowance of marital deduction if surviving spouse is not a United States citizen.*

Under section 2056(d)(4), if the surviving spouse becomes a citizen of the United States before the day on which the estate tax return is filed, property passing from the decedent to the surviving spouse either outright or in trust need not be transferred to a qualified domestic trust (QDOT) (or the trust need not be reformed to qualify as a QDOT) in order to qualify for the estate tax marital deduction. It is possible that the naturalization process may not be completed before the due date, including extensions, for