Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1621
Date: 25-Mar-10
From: Steve Leimberg's Estate Planning Newsletter
Subject: **The Ascertainable Standard Pill Does Not Cure All Estate Inclusion Diseases - Who Can Be a Trustee – Part IV**

LISI members are no doubt familiar with the informative commentary that **Mark Merric** has provided as part of his continuing series he refers to as the Modular Approach to Estate Planning.™ Mark's commentary in this **LISI** newsletter is the fourth installment of Mark's "Modular Approach to Estate Planning.™[1]" and is a follow-up to Mark's "Who Can Be A Trustee, Part I" (**Estate Planning Newsletter # 1414**) "Who Can Be a Trustee Part II" (**Estate Planning Newsletter # 1444),** and "Do Savings Clauses or Statutes Mitigate Estate Inclusion Issues of Choosing the Wrong Trustee for a Discretionary Trust?" (**Estate Planning Newsletter # 1610**).

Mark's fourth installment in the series focuses the following question: Does an "ascertainable standard cure all estate inclusion issues?

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http://www.internationalcounselor.com/webinarsignup.html

Here is Mark's commentary:

EXECUTIVE SUMMARY:

Occasionally, when one is at an estate planning conference, he or she may hear someone state that he or she always drafts trusts

using a distribution based on an ascertainable standard. When making this statement, many practitioners are under the impression that an ascertainable standard cures all evils.

As previously discussed in **LISI** Estate Planning Newsletters #1334, #1352, #1379, an ascertainable standard will not cure an estate inclusion issue that is attributable to the improper drafting of a spousal lifetime access trust. Also, see Estate Planning Newsletter #1387 by **Mitchell Gans** and **Jonathan Blattmachr**, noting agreement in some areas, but disagreement on a couple of issues.[2] Further, while an ascertainable standard cures a few estate inclusion issues in the Who Can be a Trustee context, unfortunately it does not cure all estate inclusion issues.

The first installment of this article began with the "Who Can Be Trustee Matrix™[3]." This matrix appears in previous installments and can be accessed by clicking any of the following Estate Planning Newsletters #1334, #1352, #1379

The previous installments of this series discussed the discretionary sub-table when there is a sole trustee. Part IV discusses the ascertainable standard sub-table when someone is serving a sole trustee.

The Ascertainable Standard Table

Similar to the discretionary standard sub-table, the ascertainable standard sub-table is analyzed based on the following five relationships of the trustee, which is the third dimension of the matrix.

(1) an independent person within the meaning of IRC § 672(c);
(2) the settlor;
(3) a trustee/beneficiary;
(4) the settlor's spouse when he or she is serving as a trustee, but not a beneficiary; and
(5) brother, sister or parents.

Independent Person Within the Meaning of IRC § 672(c)

As noted in the first installment of this series, an independent trustee seldom, if ever, creates a "Who Can Be a Trustee" estate inclusion issue. This is true whether the distribution standard is discretionary and not limited by an ascertainable standard or one that is based on an ascertainable standard. In general, an independent person is anyone who is not the settlor's brother, sister, spouse, parents, descendant by blood or adoption or an employee (i.e. W-2 employee). An independent person generally is a trust company, CPA, attorney, aunt, uncle, cousin, spouse's brother or sister, or any friend.

The Settlor Serving as a Trustee Pursuant to an Ascertainable Standard

Many estate planners espouse the rule of thumb that one should never appoint the settlor as a trustee of an irrevocable trust. In some respects, this rule of thumb has some merit. First, the previous installments of this series demonstrated the estate inclusion issues to the settlor if the distribution standard was discretionary and not limited by an ascertainable standard. In this case, the drafter's only hope was that an ascertainable standard savings statute or clause changed the distribution standard to an ascertainable standard. Assuming this is the case, even if the trust's distribution standard is based on an ascertainable standard, there are still estate inclusion issues if the settlor has a support obligation for a beneficiary.

At this point, it is probably advisable to review what an external standard (i.e. ascertainable standard)[4] fixes, and discuss what it does not fix. An external standard fixes a "Who Can Be a Trustee" issue for:

(1) an IRC § 2036(a)(2) issue; and

(2) an IRC § 2038 issue.

A lay person definition of the IRC § 2036(a)(2) rule may be stated as the settlor, alone or in conjunction with any person, can determine who receives distributions from a trust without limitation (the "who gets what rule").[5] Similarly, the lay person

definition for IRC § 2038 may be stated as the settlor has the ability to alter the timing and manner of enjoyment between the beneficiaries ("timing and manner of enjoyment rule").[6] In the capacity of a trustee, the settlor may decide who receives a distribution between the beneficiaries. This triggers both the "who can get what rule" (IRC § 2036(a)(2)) and the "timing and manner of enjoyment" rule (IRC § 2038). However, by case law, an external standard (i.e. ascertainable standard) cures both of these estate inclusion issues.[7]

Conversely, an external standard does nothing to fix an IRC § 2036(a)(1) "Who Can Be a Trustee" issue. Unfortunately, IRC § 2036(a)(1) is one of the more complex estate inclusion rules. This is because there are the following three separate estate inclusion rules under this paragraph:

(1) the life interest rule;

(2) implied promise rule; and

(3) the legal obligation rule.

The author often refers to the last two estate inclusion issues as "hidden rules." This is because nowhere in the IRC are they mentioned. Rather, one day the Service created these estate inclusion rules by issuing regulations under IRC § 2036. Fortunately for this part of the "Who Can Be a Trustee" analysis, we are only concerned with one of the three estate inclusion issues – the legal obligation estate inclusion issue.[8]

The term legal obligation includes a support obligation, and under state law, a person almost always has a support obligation in at least two situations:

(1) A parent has an obligation to support a child until age of majority (i.e. emancipation); and
(2) A husband has an obligation to support a wife, and visa versa.[9]

In the event the settlor is serving as a trustee pursuant to an ascertainable standard, if the settlor passes away when the child

beneficiary is a minor, there is an estate inclusion issue.[10] The same would be true if the trust and the settlor's spouse is a beneficiary of an inter vivos irrevocable trust.[11]

Further, it does not matter whether or not the settlor/trustee invades the trust for the spouses benefit, the mere existence of the power causes an estate inclusion issue.[12] In addition it does not matter whether or not the settlor/trustee has substantial property of his or her own and has no need to exercise the power.[13] Finally, the amount included in the settlor's estate may be limited to the amount needed to fund the decedent's obligation of support.[14] Please note that the support obligation issue does not apply to testamentary trusts. This is because the settlor's obligation of support terminates upon the settlor's death.

In summary, the rule of thumb stating "never have the settlor serve as a trustee of an irrevocable trust" is a wise rule of thumb. If the distribution is based on an ascertainable standard, the settlor's spouse is not a beneficiary, and if there are no children/beneficiaries that are minors, with one caveat, the settlor may serve as the trustee without a "who can be a trustee" estate inclusion issue.

The one caveat is that there are some special inclusion issues that still need to be discussed in an upcoming LISI when the settlor is a trustee of an irrevocable life insurance trust. Further, even if the settlor has been appointed as the sole trustee and he or she passes away when his or her spouse is a beneficiary or a minor child is a beneficiary, it is still not time to throw in the towel. Rather, will a support obligation savings clause prevent an estate inclusion? This will be the topic of the next installment of this series.

Trustee/Beneficiary Serving as a Trustee Pursuant to an Ascertainable Standard

In the event that a beneficiary in his or her capacity as trustee may make a distribution to himself or herself that is not limited by an ascertainable standard, the trustee/beneficiary holds a general power of appointment.[15] Regardless of whether or not the trustee/beneficiary exercises such power in favor of herself or

himself, should the beneficiary pass away when he or she is serving as a trustee, then the trust property is included in her or his estate.

Fortunately, there is a relatively simple method to cure the general power of appointment issue where a trustee is making a distribution to herself or himself. This is done by having distributions be based on an ascertainable standard, and then the trustee is deemed to not hold a general power of appointment as to the ability to make distributions to himself or herself.[16] The prior installment of this article discussed how an ascertainable standard savings statute or clause should convert a discretionary distribution standard to one based on an ascertainable standard. This installment of this series assumes either the discretionary standard was converted or the original distribution standard was based on an ascertainable standard.

One might hope that the ascertainable standard would be a cure all pill. Unfortunately, this is not the case. Similar to the regulations under IRC § 2036(a)(1), under the IRC § 2041 regulations, the Treasury Department created the legal obligation theory of estate inclusion.[17] Therefore, if a trustee owes a support obligation to a minor child[18] and passes away when such child is a minor, the trust property is included in the settlor's spouse's estate.[19]

The same issue occurs with one of the three common ways of drafting discretionary dynasty trusts.[20] With the trustee/beneficiary method, a dynasty sub-trust is created at each generation level where each sub-trust has one child and that child's descendants are also beneficiaries. The child is typically referred to as the oldest or primary beneficiary, and he or she is also appointed as sole trustee.

Should this child trustee, who is obviously an adult, pass away when his or her children are minors, he or she has a support obligation for such children and the trust property is included in his or her estate.[21] The good news is that most spouses serving as trustees as well as a child/trustees pass away after his or her children are no longer a minor. At that time, there is no gift tax issue, and the estate inclusion issue disappears.[22]

On the other hand, the estate planner does not just throw in the towel if a sole trustee passes away when he or she owes a support obligation to a beneficiary. Rather, as mentioned above, the planner needs to evaluate whether a support obligation savings clause will cure the issue, which is the topic of the next installment of this series. Further, some additional nuances of irrevocable life insurance trusts (ILITs) are discussed in an upcoming installment of this LISI.

Spouse of a Trustee (Not a Beneficiary) Pursuant to an Ascertainable Standard

When a spouse is a trustee, but he or she is not a beneficiary, the only "Who Can Be a Trustee" issue aside from some ILIT nuances, is the support obligation issue. The same is true for a child who has been appointed as a trustee where one or more of the child's children are beneficiaries, but he or she is not a beneficiary. Again, the primary issue is whether the spouse of a trustee or a child trustee passes away when he or she owed a support obligation to one of the beneficiaries (e.g. the trustee's children were minors). If so, then there is an estate inclusion issue. In this respect, the analysis of the support obligation estate inclusion issue is the exact same as detailed in the trustee/beneficiary section above.

UGMA and UTMA Accounts

An often overlooked estate inclusion rule is when a parent creates a Uniform Gift to Minor Account (UGMA) or Uniform Transfer to Minor Account (UTMA) and appoints himself or herself as the custodian. The same is true when a grandparent creates an UGMA or UTMA account for a grandchild and appoints the parent as the custodian. The UGMA states,

"[The parent] shall pay over to the minor for expenditure by him, or expend the minor's benefit, so much of or all the custodial property as the custodian deems advisable for support, maintenance, education and benefit of the minor . . ."[23]

The parent has a support obligation for a minor child, and he or she is serving as custodian (i.e., trustee). In the event the parent dies while administering the UGMA, the parent has a general power of appointment under IRC 2041.[24] The amount included in the parent's estate "is not the full value of the custodial account, but rather the value of the custodial account that the parent could use to discharge a legal obligation under state law."[25]

Article 14 of the Uniform Transfer to Minors Act provides that a parent cannot make a distribution that would constitute a support obligation. This provision is a statutory support obligation savings clause, and should prevent an estate inclusion issue in almost all situations as discussed in the next installment of this series.

Brother, Sister, or Parent as a Trustee Pursuant to an Ascertainable Standard

As long as a brother, sister, or parent has not adopted one or more of the settlor's children, he or she has no legal obligation of support for the settlor's children. Further, there should not be any attribution analogy under Rev. Rul. 95-58 applied to discretionary trusts. Rev. Rul. 95-58 does not speak of any attribution for a trust based on ascertainable standards. Therefore, when a brother, sister, or parent is appointed as a trustee pursuant to an ascertainable standard, there is not an estate inclusion issue under the "Who Can Be a Trustee" rules.

COMMENT:

The ascertainable standard pill cures the estate inclusion issue when a trustee/beneficiary is making distributions to himself or herself. If the settlor is appointed as trustee, it also cures the IRC § 2038 "timing and manner of enjoyment" estate inclusion issue as well as the IRC § 2036(a)(2) "who can receive what" estate inclusion rule. However, the ascertainable standard savings clause does not cure a support obligation issue for the settlor, a settlor/trustee, a trustee/beneficiary, or any person who is appointed as a trustee that owes a support obligation to a beneficiary.

In this respect, the conservative view is to know the "Who Can Be a Trustee" rules, and only appoint trustees that do not create estate inclusion issues. For example, if husband passed away at an early age and wife was appointed as trustee when the children were minors, the conservative view would be for the wife to resign and appoint someone that did not have a potential estate inclusion issue. A summary of the sole trustee ascertainable standard table appears below:

Sole Trustee Matrix					
	Independent Trustee	**Settlor**	**Trustee/ Beneficiary** (settlor's spouse)	**Settlor's Spouse** (not a beneficiary)	**Brother, Sister, Parents**
Ascertainable Standard	No estate Inclusion	Check for a Support Obligation	Check for a Support Obligation	Check for a support obligation	No Estate Inclusion Issue

Conversely, some of the more aggressive drafters may choose to rely on savings clauses. More likely the drafter is simply unaware of the "Who Can Be a Trustee" rules, and now the wife/trustee passes away when there is a minor beneficiary. In this case, does a support obligation savings clause prevent an estate inclusion issue? Stay tuned for the next issue in Merric's Mad World of Who Can Be a Trustee.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Mark Merric

TECHNICAL EDITORS: Mitchell Gans & Jonathan Blattmachr

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CITATIONS:

[1] The Modular Approach to Estate Planning is trademarked by Mark Merric.

[2] Mark Merric, who had previously spoken with his co-author Rod Goodwin, had the opportunity to speak with Mitchell Gans, who had spoken with his co-author Jonathan Blattmachr. The four noted the following areas of agreement and disagreement regarding spousal lifetime access trusts. All four agree that a provision to the effect that distributions will not discharge the settlor's support obligation should cure a spousal lifetime access trust estate inclusion issue. All four agree that a discretionary trust that does not create an enforceable right under common law does not create a spousal lifetime access trust estate inclusion issue. All four agree that under common law a trust that does not contain any standard that could be interpreted as support does not create a spousal lifetime access trust estate inclusion issue.

Conversely, the first area of disagreement is if a trust does not contain any standard whether under a Restatement Third interpretation some type of distribution standard may be imputed in favor of a beneficiary. Restatement (Third) of Trusts, Reporter Notes Section 50 and 60 comment a. Restatement (Third) of Trusts, Section 50 comment under subsection (1): b., third paragraph last line; comment under subsection (2): first and second paragraphs. Since the trust has no mention of a support standard, Mitchel Gans and Jonathan Blattmachr see no spousal lifetime access trust estate inclusion issue. Mark Merric and Rod Goodwin are not certain regarding the result. Mark Merric notes that in the 350+ cases regarding the discretionary/support distinction, in the over 200 cases he has reviewed he has not found one case, nor has another author yet produced a case, that discussed a discretionary trust that did not have some type of standard. In this respect, Mark Merric finds no support in case law for the Restatement Third's position of imputing some type of distribution standard for a trust that never contained a standard in the first place. However, playing the devil's advocate, in the event a court did someday adopt the imputation theory espoused by the Restatement Third, it most likely would be for some minimal level of subsistence level of living, which is in essence an imputation of a "support" type standard. Merric views whether a court will ever adopt the Restatement Third's position in imputing a distribution standard when a trust contains no standard is uncertain, as well as whether it will be deemed a support standard creating an estate inclusion issue absent a provision (by the trust document or common law) looking to a beneficiary's resources. It is for this reason that Mark Merric and Rod Goodwin suggested the highly discretionary language in Estate Planning Newsletter # 1379.

The second area where the four may disagree, but did not have time to discuss, was whether the Restatement Third and possibly the UTC converted a number of trusts that would have been classified as a discretionary trust with no enforceable right in a beneficiary under the Restatement Second view of a discretionary trust to an enforceable rights under the Restatement Third view.

[3] The "Who Can Be Trustee Matrix" is trademarked by Mark Merric.

[4] When one reads the IRC or the regulations, there is no mention of an exception if there is a limitation such

as an external standard. Rather, the external standard limitation was created by case law in *Jennings v. Smith*, 161 F.2d 74 (2nd Cir. 1947); *Hurd v. Comm'r*, 160 F.2d 610 (1st Cir. 1947); *Estate of McTighe*, TC Memo 1977-410. While there are some differences between an external standard under IRC § 2036(a)(2) and § 2038 when compared with an ascertainable standard under § 2041, an ascertainable standard as defined in § 2041 and the regulations there under should always qualify as an external standard.

[5] IRC § 2036(a)(2) actually states "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."

[6] Treas. Reg. § 20.2038-1(a).

[7] *See endnote 3.*

[8] Treas. Reg §. 20.2036-1(b)(2).

[9] In many states, a parent has an obligation to support a disabled child, even after the child has reached age of majority. In New Mexico, a child also has a support obligation for his or her parents. So let's all move our families to Santa Fe so we can legally be a burden to and get even with our children.

[10] *Estate of Pardee*, 49 TC 140 (1967). Also see Rev. Rul. 59-357, Rev. Rul. 70-348 and *Prudowsky v. Commr.*, 55 T.C. 890 (1971) regarding an UGMA account. However, the obligation to support a child ceases upon the children obtaining age of majority. *Townsend v. Thompson*, 50-2 USTC P 10,8780 (Ark. W.D. 1950), 1950 WL 6770. Also *see* by analogy to a spouse trustee Rev. Rul. 79-154.

[11] The spouse as a beneficiary estate inclusion issue under the "Who Can Be a Trustee" rules is different than the estate inclusion issue discussed under the three part LISI series on Spousal Access Trusts #1334, #1352, and #1379 coauthored by Mark Merric and Rod Goodwin. The spousal access trust estate inclusion issue deals with the situation when a settlor creates a trust and the settlor by suing the trustee may force a distribution pursuant to the distribution standard for the settlor's obligation of support. The "Who Can Be a Trustee" issue discussed in this LISI is generated because the settlor is the trustee, and can make a distribution to his or her spouse for a support obligation.

[12] *Richards v. Commr.*, 375 F.2d 997 (10th Cir. 1967); PLR 9122005.

[13] *Jenkins v. U.S.*, 428 F.2d 538 (5th Cir. 1970).

[14] *Estate of Virgil C. Sullivan*, TC Memo 1993-531; *Estate of Pardee*, 49 T.C. 140 (1967); Rev. Rul. 70-348.

[15] The technical definition of a general power of appointment is any power exercisable in favor of the holder of the power, his or her estate, his or her creditors, or the creditors of his or her estate. IRC § 2041(b)(1).

[16] Since health, education, maintenance, and support is universally recognized as an ascertainable standard, it is only this ascertainable standard that will be used in this article. This series does not discuss the nuances when drafters attempt to use other less defined words such as comfort and welfare hoping that this also may be an ascertainable standard. For a detailed discussion of this issue see Richard W. Harris, *Ascertainable Standard Restrictions and Trust Powers Under the Estate, Gift, and Income Tax*, the Tax Lawyer, Spring of 1997, pg. 18-21.

[17] Treas. Reg. §20.2041-1(c).

[18] *See* endnote 9.

[19] Rev. Rul. 79-154 and GCM 32799 (1977). Also see *Townsend v. Thompson*, 50-2 USTC P 10,8780 (Ark. W.D. 1950), 1950 WL 6770 where by analogy to the IRC § 2036(a)(1) rules, the settlor held such power in his capacity as trustee.

[20] Mark Merric, *Drafting Discretionary Dynasty Trusts Parts I – III*, Estate Planning Magazine, Jan. 2009 – Mar. 2009. This article may be downloaded at www.InternationalCounselor.com.

[21] Please note that the child/trustee or primary beneficiary trustee is not limited to just dynasty trusts, it occurs anytime a child/trustee is serving as the sole trustee and his or her minor children are beneficiaries.

[22] Rev. Rul. 79-154. Also see *Townsend v. Thompson*, 50-2 USTC P 10,8780 (Ark. W.D. 1950), 1950 WL

6770 where the settlor held such power in his capacity as trustee, but upon age of a child attaining age of majority there is no longer an estate inclusion issue.

[23] Uniform Gift to Minor Act Section 4(b).

[24] General Counsel Memorandum 37299 (1977); Also, as applied to the donor (i.e. in concept the settlor) *see Prudowsky v. Commr.*, 55 T.C. 890 (1971); Rev. Rul. 59-357; Rev. Rul. 70-348. Conversely, if the parent is not the custodian, and his or her only right is to petition the court (i.e. sue the trustee) to make a distribution for support, education, maintenance, and benefit, then there is no estate inclusion issue. Rev. Rul 77-460. *But See Esate of Jack Chrysler*, 361 F.2d 508 (2nd Cir. 1966) where the Second Circuit reversed the Tax Court on the estate inclusion issue under Uniform Gift to Minors Act.

[25] GCM 37840.