
SUPREME COURT OF THE UNITED STATES

October Term 2010

COMMISSIONER OF INTERNAL REVENUE,

Petitioner

v.

No. 2010-15

Estate of Inka Pleat

Respondent

On Writ of Certiorari to the Court of Appeals

for the Thirteenth Circuit

UNITED STATES COURT OF APPEALS

For the Thirteenth Circuit

COMMISSIONER OF INTERNAL REVENUE SERVICE

Appellant

No. 2009-46

v.

Estate of Inka Pleat,

Appellee

Before: Madden, Lukenbactosy, and Shirter, Circuit Judges

Shirter, Circuit Judge

The issue in this case is whether, under § 2041(a)(2) of the Internal Revenue Code, Inka Pleat, a member of the “Distribution Committee” of a trust, possessed at her death a general power of appointment over any part of the trust property.

The facts are undisputed and turn, specifically, on the application of §2041(b)(1)(C) of the Code to the provisions of a trust established by decedent’s father (Kantcom Pleat [hereinafter the Grantor]) in 2006.

The trust provides, essentially and pertinently, as follows:

Article Second, Paragraph 2.1 provides that during the lifetime of the Grantor, the trust property shall be held by the Trustees for the following uses and purposes: To manage and invest the same, and to pay over or apply the net income and principal thereof to such extent, if any, including the whole thereof, as (a) the Distribution Committee, by unanimous agreement, shall appoint, or (b) the Grantor and one member of the Distribution Committee by unanimous

agreement shall appoint, to or for the benefit of such one or more members of the class consisting of the Grantor, the Grantor's spouse, the Grantor's siblings, and the Grantor's descendants, until the death of the Grantor. Any net income not so paid over or applied shall be accumulated and added to the principal of the trust.

***Article Second, Paragraph 2.2** provides that upon the death of the Grantor, the principal of the trust, and any accumulated income, shall be paid over to such persons or organizations (other than the Grantor, the Grantor's estate, the Grantor's creditors and the creditors of the Grantor's estate), as the Grantor may appoint by Last Will and Testament. The Grantor may, at any time during his life by a written, acknowledged instrument delivered to the Trustees, release such power of appointment with respect to any or all of the property subject to such power or may further limit the persons or entities in whose favor or the extent to which this power may be exercised. If such power of appointment is not effectively exercised in whole or in part by the Grantor, the trust principal, together with any accumulated income, to the extent not effectively appointed by the Grantor, shall, upon the Grantor's death, be paid to the Grantor's then living descendants per stirpes. If no descendant of the Grantor is then living, such property shall be disposed of in accordance with the terms and conditions set forth in Article Fourth.*

***Article Fourth** provides that any property which is directed to be disposed of in accordance with Article Fourth shall be paid over to such one or more members of the class consisting of (i) the then-living descendants of the Grantor's parents and (ii) qualified charitable organizations as the Trustees, in the exercise of their sole and absolute discretion, shall select.*

***Article Twelfth, Paragraph 12.5** provides that the Distribution Committee shall initially consist of the Grantor's sister Dora, and the Grantor's children Inka [the decedent herein] and David. At all times, at least two persons who are beneficiaries under the trust (other than the Grantor, the Grantor's spouse or any successor spouse of the Grantor), or who are parents or guardians of such beneficiaries if there are less than two adult beneficiaries, shall be members of the Distribution Committee. In the event that either Dora, or Inka, or David shall die before the death of the Grantor, the Grantor's then eldest living descendant (who is not then a member of the Distribution Committee) who is also a beneficiary under the trust shall become the successor member of the Distribution Committee. Any member of the Distribution Committee shall exercise the power of appointment granted under Article Second only in a non-fiduciary capacity, by an acknowledged instrument in writing delivered to the Trustees.*

Inka (hereinafter the decedent) died unexpectedly on January 2, 2007, survived by, among others, her father (the Grantor) and her brother John, who, as the Grantor's then eldest living adult descendant, succeeded the decedent as a member of the Distribution Committee.

When decedent's executor did not include any of the trust property in the decedent's gross estate on the estate tax return, the Commissioner, in reliance on Reg. §20.2041-3(c), and Rev. Rul. 76-503, 1976-2 C.B. 275, assessed an estate tax deficiency against the decedent's estate (hereinafter the taxpayer), determined by including in the decedent's estate 1/3 of the value of the trust property at decedent's death.

Taxpayer petitioned the Tax Court for a redetermination of the deficiency and the Tax Court ruled against the Commissioner.

In holding for the taxpayer, the Tax Court concluded that at the decedent's death the power exercisable by each of the members of the Distribution Committee could only be exercised with the consent of a person with a "substantial" and "adverse" interest within §2041(b)(1)(C)(ii), i.e., the other members of the Distribution Committee. The Tax Court reasoned as follows:

"Each of the three members of the Distribution Committee would have to realize that, by agreeing to a plan whereby each member would receive 1/3 of the trust property, he or she would thereby be surrendering the chance to receive at least 1/2 of the trust property by virtue of an agreement between the Grantor and such member. If, under §2041(b)(1)(C)(ii) (2d sentence), as explained by Rev.Rul. 76-503, 1976-2 C.B. 275 , the chance of succeeding to the power of another member of the Distribution Committee upon such member's death is sufficient to constitute a substantial adverse interest, surely the chance to receive at least 1/2 the property (rather than 1/3) under an arrangement between the Grantor and such member constitutes a substantial adverse interest."

This Court also holds for the taxpayer, but we do not do so on the rationale adopted by the Tax Court. Rather, a majority of this panel is of the opinion that even if the Tax Court's rationale is incorrect, §2041(a)(2) would not require inclusion of any of the trust property in the

decedent's gross estate because, at the time of decedent's death, there had not been a completed gift, for gift tax purposes, by the Grantor.

It is axiomatic that if an owner of property has not made a completed gift of such property to another person, the design of the estate and gift tax system is to tax the transfer by such owner either upon completion of the gift during the owner's life or at the owner's death. The system is not designed to tax the other person under the gift or estate tax before the owner has completed the gift during lifetime or at death. Put another way, the estate and gift taxes are transfer taxes and until the owner of property has transferred the property to another party that other party cannot be considered to have transferred the same property either during life or at death.

Consider, for example, the following colloquy that occurred in the oral argument before this Court, between Judge Madden and Ms. Veradicta, the attorney for the Commissioner:

“Judge Madden:

Suppose that I executed a power of attorney in which I permitted my attorney-in-fact to make gifts of up to \$50,000 to certain persons, including herself. If she died before I died, without exercising the power, would \$50,000 be included in her estate?

Ms. Veradicta:

Probably not Your Honor, but in that case the power is completely revocable by you.

Judge Madden:

Isn't such a power tantamount to a power requiring the consent of the donor, which is safe under §2041(b)(1)(C)(i)?

Ms. Veradicta:

That is a point well taken, Your Honor, but once again, that power is completely revocable.”

The point, of course, is not that a power of attorney is completely revocable; it is that such revocability renders any transfer, prior to its exercise, incomplete, and if, as here, it is not exercised and the power holder dies while any transfer remains incomplete, the power does not require inclusion in the power holder's estate.

In this case, under Reg. §25.2511-2(b) and (f) and the decision of the Supreme Court in Estate of Sanford v. Commissioner, 308 U.S. 39 (1939), the Grantor, by virtue of his retained testamentary power of appointment, had not made a completed gift of any of the trust property at the decedent's death. Therefore, even if the decedent's power came within the literal language of §2041(a)(2) as a general power of appointment at death, it cannot, as a matter of fundamental systemic design and purpose, be included in her estate.

Affirmed.

Madden, Circuit Judge (concurring),

I agree with the majority's position that §2041(a)(2) should not be read to require inclusion in the decedent's estate if the Grantor has not made a completed gift. In my opinion, however, the Grantor did make a completed gift upon establishment of the trust.

The Grantor's retention of a special testamentary power of appointment is not determinative in this case, under either the Sanford case or Reg. §25.2511-2(b) and (f). Under both of those authorities the grantor had maintained dominion and control both during lifetime and at death. In this case, by giving the Distribution Committee the power to appoint the property away from the Grantor, the Grantor parted with all dominion and control before he died.

I, nevertheless, concur in the result, and in so doing, I also find it unnecessary, as did the majority, to wade into the behavioral thicket on which the Tax Court's decision is based.

The reason I concur is that, in my opinion, basic fairness requires the Commissioner to be consistent and not change positions retroactively.

In a series of Private Letter Rulings issued between 2005 and 2007, taxpayers were led to believe that under so-called “Distribution Committee” trusts, exemplified by the trust in this case, (1) there was no completed gift on the establishment of the trust, (2) the trust was not a grantor trust for income tax purposes, and (3) members of the Distribution Committee did not have a general power of appointment. See PLRs 200502014, 200612002, 200637025 200647001, 200715005, 200729025 (publicly available after July 9, 2007) and 200731019.

Then, on July 9, 2007 the Commissioner issued the following Press Release:

IR- 2007-127

*Internal Revenue Service (I.R.S.)
News Release*

*CHIEF COUNSEL SEEKING COMMENT ON GIFT TAX CONSEQUENCES OF TRUSTS EMPLOYING
DISTRIBUTION COMMITTEE
For Release: July 9, 2007*

WASHINGTON — The Internal Revenue Service announced today that it is reconsidering a series of private letter rulings (PLRs) issued by the Office of the Associate Chief Counsel, Passthroughs & Special Industries.

The PLRs address, in part, the gift tax consequences under sections 2511 and 2514 of the Internal Revenue Code of trusts that utilize a distribution committee consisting of trust beneficiaries who direct distributions of trust income and corpus. It has come to the Office of Chief Counsel's attention that the conclusions in the PLRs regarding the application of section 2514 may not be consistent with Rev. Rul. 76-503, 1976-2 C.B. 275, and Rev. Rul. 77-158, 1977-1 C.B. 285. Accordingly, the Office of Chief Counsel is requesting comments as to whether the conclusions in these PLRs regarding section 2514 can be reconciled with the revenue rulings.

These PLRs involve a situation where trust distributions are made at the unanimous consent of a distribution committee that consists of trust beneficiaries, or at the discretion of an individual committee member with the consent of the grantor. If a distribution committee member resigns or dies, the committee member is replaced with another person. The PLRs conclude that the distribution committee members have substantial adverse interests to each other for purposes of section 2514. Therefore, they do not possess general powers of appointment over the trust. Accordingly, distributions from the trust will not be subject to gift tax with respect to the distribution committee members.

However, the holdings in Rev. Rul. 76-503 and Rev. Rul. 77-158 indicate that because the committee members are replaced if they resign or die, they would be treated as possessing general powers of appointment over the trust corpus. It has been suggested that the facts presented in the PLRs are

distinguishable from the revenue rulings because in the PLRs, the grantor's gift to the trust is incomplete since the grantor retains a testamentary special power of appointment. See, however, section 25.2514-1(e), Example (1) of the Gift Tax Regulations, and Rev. Rul. 67-370, 1967-2 C.B. 324.

Before the Office of Chief Counsel takes any action with respect to the PLRs, the Office of the Associate Chief Counsel, Passthroughs & Special Industries is requesting comments regarding the question of whether the distribution committee members possess general powers of appointment under section 2514. The comments could also include suggestions for a substantially similar trust structures that would achieve the intended income, gift, and estate tax objectives of the transactions described in the PLRs.

Comments should be provided within ninety (90) days of the date of this news release. Send written comments to: Internal Revenue Service, Attn: CC:PA:LPD:PR (CC:PSI:4), room 5203, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (CC:PSI:4), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave, N.W., Washington, DC, or sent electronically, via Notice.comments@irscounsel.treas.gov (indicate CC:PSI:4).

Several organizations responded to the above request, including the American Bar Association Section of Real Property Trust and Estate Law (2007 TNT 195-41), the New York State Bar Association Tax Section (2007 TNT 198-14), and the New York City Bar Association Committee on Estate and Gift Taxation (2007 TNT 200-10). As of the present time, however, no further action has been taken by the IRS. Nonetheless, the Commissioner has asserted the present deficiency.

In my opinion, the Commissioner's action should not be permitted to go forward. See Hoffer, Hobgoblin of Little Minds No More: Justice Requires an IRS Duty of Consistency, 2006 Utah L. Rev. 317; Zelenak, Should Courts Require the Internal Revenue Service to Be Consistent?, 40 Tax L. Rev. 411, 439-43 (1985). Therefore, I concur in the Court's result.

ORDER
SUPREME COURT OF THE UNITED STATES

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

No. 2010-15

v.

Estate of Inka Pleat, Respondent

The petition herein for a writ of certiorari to the Court of Appeals for the Thirteenth Circuit is granted in order that this court may consider all of the questions raised by the record, and it is

ORDERED, that this case be set down for argument in the October 2010 term of this Court.

June 15, 2010