



WEALTH PLANNING > ESTATE PLANNING

## Beware Frankenstein Trusts

*Even a skilled attorney can be rushed or careless in drafting.*

Beth L. Fox | Mar 10, 2020

Private Letter Ruling 202009012 (released Feb. 28, 2020), reads as a cautionary tale for young attorneys (as well as counsel of all ages). Decedent and Spouse, residents of a community property state, executed a joint revocable trust (the Joint Trust). As typical of such trusts, the Joint Trust provided that on the passing of the first spouse, his (or her) separate property and share of the community property were to allocated to a marital share (the Marital Trust) and a non-marital share (the Family

Trust), and the property of the surviving spouse was to be held as a revocable Survivor's Trust.

## **Non-contested Terms of Trust**

Under the terms of the Joint Trust,

1. *Marital Trust*: The survivor was granted a testamentary limited power of appointment (POA) over the Marital Trust, exercisable in favor of the grantors' descendants, spouses of such descendants, and charities. On the survivor's passing, any non-appointed property was to be divided into a charitable share, distributable outright to charities, and a non-charitable share, to be divided and held in trust for descendants.
2. *Family Trust*. On the survivor's passing, the Family Trust was to be divided between the charitable and non-charitable shares.
3. *Survivor's Trust*. The Survivor's Trust became irrevocable on the passing of the survivor and was includible in the survivor's taxable estate and subject to the survivor's creditors' claims. The survivor was granted a general POA over the Survivor's Trust. The trust failed to address the disposition of the unappointed property, if any, but permitted the trustee to make qualified terminable interest property (QTIP) elections, reverse QTIP elections and allocate available generation-skipping transfer (GST) tax exemption.

## **Restatement Issues**

Attorney 1 restated the Joint Trust twice before the passing of Decedent. In the final restatement of the Joint Trust (the Joint Restatement), Attorney neglected to include language stating that on the passing of the first spouse, the trust would become irrevocable with respect to his or her trust property. Such language was included in the penultimate restatement.

After the passing of Decedent, Attorney 2 restated the Survivor's Trust (the Survivor's Restatement). In such restatement, Spouse exercised a POA over the Marital and Family Trusts, appointing the assets of each to the Survivor's Trust.

## **State Court Trust Reformation of Scrivener's Errors**

On the passing of Spouse, the trustee discovered the various scrivener's errors and filed a petition in State court for interpretation and reformation of the Joint Trust and related subtrusts. In sworn affidavits, Attorneys 1 and 2 attested to a number of scrivener's errors in the Joint Restatement and Survivor's Restatement, including:

1. Exercise of a general POA over the Marital Trust where a limited POA was granted;
2. Exercise of a general POA over the Family Trust where no POA was granted; and
3. Failure to provide that on the passing of the first spouse, the Marital and Family Trusts were irrevocable.

Subsequently, the State court issued an order reforming the Joint Restatement and Survivor's Restatement, providing that:

1. Spouse exercised a limited POA over the Marital Trust in favor of the charitable and non-charitable shares described in the Joint Restatement;
2. Spouse's exercise over the Family Trust was void; and
3. The Marital and Family Trust became irrevocable on Decedent's death.

## **IRS' Analysis**

The trustee requested rulings that, based on the court-ordered reformation of the Joint Restatement and Survivor's Restatement:

1. The exercise of Spouse's reformed POA neither rendered the Marital Trust includible in Spouse's estate nor disqualified the QTIP election over the Marital Trust property;
2. The void exercise of a non-existent testamentary POA over the Family Trust didn't render it includible in Spouse's estate;

3. The Marital Trust was irrevocable on Decedent's passing and therefore, both the reverse QTIP election and the allocation of Decedent's GST exemption were valid;
4. The Family Trust was irrevocable on Decedent's passing and accordingly wasn't includible in Spouse's estate.

Citing to *Commissioner v. Estate of Busch*, 387 U.S. 456 (1967), the IRS emphasized that a federal agency must give proper regard to a state trial court's determination of property rights, but isn't bound thereby, in a federal estate tax controversy. Based on state law and the evidence supporting the state court's decision to reform the Joint Restatement and Survivor's Restatement, the IRS accepted the reformed terms of both restatements for purposes of determining the estate and GST tax implications of Joint Trust and ruled for the taxpayer trustee on each issue.

## **Takeaways**

This ruling is striking more from a factual perspective than from a legal one. After all, every competent estate-planning attorney is aware, for example, that a surviving spouse shouldn't be granted a general POA over the trust intended to shelter the decedent's estate tax exemption amount. However, even a skilled attorney can be rushed or careless in drafting, particularly in an effort to reduce client costs by streamlining drafting through adapting form documents or existing client documents. A Frankenstein trust, cobbled together by lifting relevant provisions from existing documents, can easily come back to haunt its maker.

Despite the extra time and attention involved, it behooves us as drafters to, after finishing a document, set it aside for a day and revisit it with fresh eyes. Attorney 1 may have noticed the missing provision in an (additional) round of review and evaded involvement in this debacle.

In addition to exhibiting the importance of attentive writing, this ruling also emphasizes the significance of assiduous reading. In drafting Survivor's Restatement, Attorney 2 drafted based on assumed POA provisions of the Joint

Restatement. Unfortunately, in daily practice involving innumerable comparable documents, one can easily slip into the quicksand of modifying instruments or exercising powers granted under instruments, based on presumed procedures or limitations. As an illustrative example, an attorney may draft an appointment of successor trustee without confirming the appointer's ability to do so, possible limitations of the pool of appointees and the procedure established for such appointment. Both the appointer and appointee will believe they have successfully transmitted the yoke of trusteeship, but a disgruntled beneficiary may later challenge the appointment based on discrepancies between the governing instrument and the appointment process.

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