

Internal Revenue Service

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
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Date:
November 30, 2006

In Re:

Legend:

Grantor	=
Trust	=
Trustees	=
Court	=

Dear _____ :

This is in response to your letter dated July 26, 2006, requesting rulings on the gift and generation-skipping transfer (GST) tax consequences of a certain modification to a trust.

The facts submitted and the representations made are as follows. Prior to September 25, 1985, Grantor established Trust for the benefit of his four children, their spouses, and their children.

Article I, section (2) of Trust provides that after Grantor's death, the trust estate is to be divided into four equal shares one for each of Grantor's children.

Article I, section (4) provides that trust net income is to be distributed equally to or for the benefit of each of Grantor's children. Upon the death of each child, that share of the trust net income is to be paid to that child's spouse. Upon the death of each child's spouse, the child's share of the trust net income is to be paid to the child's then living issue in equal shares, per stirpes. Article I, section (9) provides the trustees with the discretion to distribute trust principal to an income beneficiary in the event the trustees determine that trust net income is not sufficient to provide for the beneficiary's health, maintenance, and support.

Article I, section (7) provides that upon the death of the survivor of certain named individuals, the trust estate is to be distributed in equal shares, per stirpes, to Grantor's then living lawful issue. Article I, section (7) further provides that Trust will terminate upon the death of certain named individuals and all of Grantor's lawful issue alive on the date Trust was created.

The Trust agreement, as executed, was not clear regarding whether a child's spouse to whom the child was married at the time of the child's death (regardless of whether such spouse was named in the Trust agreement) was entitled to receive income from Trust. As a result, the trustees petitioned Court to resolve this ambiguity in the Trust agreement. In response, the Court issued an order reforming Trust to provide that upon the death of a child, the child's share of trust net income is to be paid to the spouse the child is married to at the time of the child's death rather than the spouse specifically named in Trust. It has been represented that there have been no actual or constructive additions to Trust since September 25, 1995.

Trustees are requesting rulings that the modification by judicial reformation of Trust (1) will not cause Trust to lose its exempt status under § 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) subjecting Trust or distributions from Trust to GST tax, and (2) will not result in any transfers from Trust to be subject to gift tax under § 2501.

Law and Analysis:

Section 2501 imposes a tax on the transfer of property by gift by an individual.

Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) provides that as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.

Section 2601 imposes a tax on every GST made after October 26, 1986.

A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term taxable termination means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in trust where the property passes to a skip person with respect to the transferor of the property.

Section 2612(b) provides that the term taxable distribution means any distribution from a trust to a skip person other than a taxable termination or a direct skip. Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax made by a transferor to a skip person.

Under § 1433(a) of the Act and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the GST does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct scrivener's error will not cause an exempt trust to lose its exempt status provided the judicial action involves a bona fide issue, and the construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(E), Example 3, provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of A and B, or per capita among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates. The court's construction resolves a bona fide issue regarding the proper interpretation of the instrument and is consistent with applicable state law as it would be interpreted by the highest court of the state. Therefore, the trust will not be subject to the provisions of chapter 13.

Section 2651(c)(2) provides that an individual who has been married at any time to an individual described in § 2651(b) (relating to lineal descendants) shall be assigned to the generation of the individual so described.

In the present case, Trust was irrevocable on September 25, 1985. It has been represented that no additions, actual or constructive, have been made to Trust after that date. The Court's order reforming Trust resolved an ambiguity relating to the distribution of trust income and principal. The judicial action involved a bona fide issue and the construction is consistent with applicable state law. Accordingly, based upon the facts submitted and the representations made, we conclude that the Court's reformation of Trust did not cause Trust to lose its status as a trust that is exempt from the GST tax by reason of §1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), subjecting Trust or distributions from Trust to GST tax, and (2) will not result in any transfers from Trust to be subject to gift tax under § 2501.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

Enclosures: Copy for § 6110 purposes