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Department of the Treasury
Washington, DC 20224

[Third Party Communication:
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-111937-05

Date:
June 07, 2005

In Re:

Legend:

Husband =
Wife =
Trust =

Trustee =
Date 1 =
Date 2 =
State Court =

Dear :

This is in response to your letter dated February 28, 2005, requesting rulings on the estate and generation-skipping transfer (GST) tax consequences of certain proposed modifications to a trust.

The facts submitted and the representations made are as follows. On Date 1, prior to September 25, 1985, the grantors, Husband and Wife, created an irrevocable trust (Trust) for the benefit of their children and grandchildren. Trustee is the current sole trustee of the Trust

Paragraph 3(a) of the Trust provides that a "primary beneficiary" or "primary beneficiaries" as those terms are used in the Trust refers to a child or children of Husband and Wife. Paragraph 3(b) provides that the term "issue" refers to all children born of or adopted by a primary beneficiary or the primary beneficiaries.

Paragraph 4(a)(i) provides the trustees with the discretionary authority to distribute income to a primary beneficiary while the beneficiary is under age 33. Paragraph

4(a)(ii) provides the trustees with the discretionary authority to distribute income to the issue of a primary beneficiary who is deceased, or who has attained age 33, while the issue is under age 25. Paragraph 4(a)(ii)(i) provides that no primary beneficiary or issue of a primary beneficiary is to receive distributions of income after attaining age 33 and 25, respectively.

Paragraph 4(a)(ii)(ii) provides that, in any one year, a primary beneficiary cannot receive income that exceeds an amount of money that is more than the annual net income divided by the number of primary beneficiaries living and primary beneficiaries deceased survived by issue.

Paragraph 4(a)(ii)(iii) provides that in the event a primary beneficiary dies prior to attaining age 33 survived by other primary beneficiaries under age 33, then no net income can be distributed to the issue of the deceased primary beneficiary which exceeds in any one year an amount of money that is more than the fractional share of the annual net income to which the deceased primary beneficiary would have been entitled, if living, divided by the number of living issue of the deceased primary beneficiary.

Paragraph 4(a)(ii)(iv) states that:

After the last Primary Beneficiary attains thirty-three (33) years of age or dies prior thereto, no net income shall be paid to or applied for the benefit of an issue of a Primary Beneficiary which exceeds in any one year an amount of money which is more than the annual net income divided by the number of the then living issue of all of the Primary Beneficiaries.

Paragraph 4(b) states that:

This Trust shall terminate as to each issue of the Primary Beneficiaries as hereinafter set forth, upon the first to occur of either one of the following events: (i) [t]he thirty-second (32^d) birthday of each issue of the Primary Beneficiaries; or (ii) [t]he twenty-first (21st) year after the date of the last to die of the Primary Beneficiaries.

Paragraph 4(c) states that:

The TRUSTEES shall make a distribution to each of the issue of the Primary Beneficiaries on the twenty-fifth (25th) birthday and thirty-second (32nd) birthday of each issue as hereinafter set forth and after each of such distributions, the TRUSTEES shall retain the then remaining balance of the trust fund as one undivided fund subject to the terms and conditions of this Agreement.

(i) On the twenty-fifth (25th) birthday of each issue, the TRUSTEES shall separate a pro rata share of the principal and accumulated income of the Trust according to the number of issue then living and one-half (1/2) of such pro rated share shall be paid over to the issue who then celebrates his or her twenty-fifth (25th) birthday.

(ii) On the thirty-second (32^d) birthday of each issue, the TRUSTEES shall separate a pro rata share of the principal and accumulated income of the Trust according to the number of issue then living and, after deducting an amount of money equal to that paid to such issue under subparagraph (c)(i) hereof, the TRUSTEES shall pay the remaining balance of such share to the issue who then celebrates his or her thirty-second (32^d) birthday.

(iii) In the event any of such issue shall die during the continuance of the Trust, then the share that such deceased issue would have been entitled to receive upon the termination of this Trust shall be held in trust until such deceased issue would have attained thirty-two (32) years of age, and at that time such share shall be paid over to the lineal descendants of such deceased issue, but if no lineal descendants, then such share shall be held for the benefit of or distributed to the then remaining issue as provided in this paragraph 4.

(iv) In the event this Trust should terminate by reason of the twenty-first (21st) year after the date of death of the last to die of the Primary Beneficiaries, the TRUSTEES shall divide the then remaining balance of the Trust and any accumulated income thereon into equal shares according to the number of the then living issue of the Primary Beneficiaries and shall pay over such shares to such issue absolutely freed and discharged of this Trust.

On Date 2, the Trustee filed a Complaint for Declaratory Judgment (Complaint) in State Court requesting the court construe Paragraph 4. In the Complaint, the Trustee represents that the method for distributing assets in Paragraph 4 has a number of ambiguities that must be resolved. First, it is not clear how the phrase “the number of issue then living” should be read. It could mean all of the living issue or only the living issue who are beneficiaries of the Trust.

Second, it is unclear whether a deceased issue who is survived by descendants is counted in determining the “number of issue then living.” The literal language suggests that it should not.

Third, when the Trustee “separates a pro rata share” of the Trust under Paragraph 4(c)(i), it is not clear what is to be done with the portion not distributed. Fourth, if an issue dies before receiving his or her full distribution, Paragraph 4(c)(iii) directs that the

share shall be paid to his or her lineal descendants when the deceased issue would have reached age 32. It is unclear when the share is to be calculated.

The Complaint contains proposed changes to Paragraph 4 intended to resolve the ambiguities in this paragraph. Husband and Wife, as the grantors of the Trust, have provided affidavits to support the change in the language to the Trust. Section 4(a)(iv) will state that:

After the last Primary Beneficiary attains thirty-three (33) years of age or dies prior thereto, no net income shall be paid to or applied for the benefit of an issue of a Primary Beneficiary which exceeds in any one year an amount of money which is more than the annual net income divided by the number of the then living issue of all of the Primary Beneficiaries who have not yet attained the age of thirty-two (32).

Section 4(c) will state as follows:

The TRUSTEES shall make a distribution to each of the issue of the Primary Beneficiaries on the twenty-fifth (25th) birthday and thirty-second (32nd) birthday of each issue as hereinafter set forth and, after each of such distributions, the TRUSTEES shall retain the then remaining balance of the trust fund as one undivided fund subject to the terms and conditions of this Agreement.

(i) On the twenty-fifth (25th) birthday of each issue, the TRUSTEES shall separate for such person a pro rata share of the principal and accumulated income of the Trust, and one-half (1/2) of such pro rated share shall be paid over to the issue who then celebrates his or her twenty-fifth (25th) birthday, with one-half (1/2) share not so paid remaining as part of the undivided fund. For purposes of this subparagraph, the pro rata share of an issue reaching his or her twenty-fifth (25th) birthday shall be calculated by dividing the Trust fund by the sum of:

(aa) The number of then living issue (including deceased issue who have living lineal descendants for which a share has not yet been created as provided in subparagraph (c)(iii)) who have not previously become entitled to a distribution under this subparagraph (c)(i) (including, for the avoidance of doubt, the issue then reaching his or her twenty-fifth (25th) birthday) at the relevant time, and

(bb) One-half of the number of then living issue (including deceased issue who have living lineal descendants for which a share has been created as provided in subparagraph (c)(iii), but who are not yet entitled to a distribution of that share) who have previously become entitled to a distribution under this subparagraph (c)(i) but have not previously become entitled to a distribution under subparagraph (c)(ii) below.

(ii) On the thirty-second (32nd) birthday of each issue, the TRUSTEES shall separate for such person a pro rata share of the principal and accumulated income of the Trust, and one-half (1/2) of such pro-rated share shall be paid over to the issue who then celebrates his or her thirty-second (32nd) birthday. For purposes of this paragraph, the pro rata share of an issue reaching his or her thirty-second (32nd) birthday shall be calculated by dividing the Trust fund by the sum of:

(aa) The number of then living issue (including deceased issue who have living lineal descendants as provided in subparagraph (c)(iii)) who have not previously become entitled to a distribution under subparagraph (c)(i) at the relevant time, and

(bb) One-half (1/2) of the number of then living issue (including deceased issue who have living lineal descendants as provided in subparagraph (c)(iii)) who have previously become entitled to a distribution under subparagraph (c)(i) above, but have not previously become entitled to a distribution under this subparagraph (including, for the avoidance of doubt, the issue then reaching his or her thirty-second (32nd) birthday).

(iii) In the event any of such issue shall die prior to having received his or her distributions under both subparagraphs (i) and (ii) above, then, if such deceased issue is survived by lineal descendants, the share or shares that such deceased issue would have been entitled to but

did not receive under subparagraphs (i) and (ii) above, and subparagraph (iv) below, had such issue not died, shall be created at such time and in such amount as if such issue had not died (which, for the avoidance of doubt, shall be when such deceased issue would have reached the ages of twenty-five (25) and thirty-two (32) as to the shares to which such deceased issue would have been entitled under subparagraphs (i) and (ii) above, respectively, and, if earlier, at the date of termination of the Trust as provided in subparagraph (iv) below, and shall equal in value the shares that would have been created for the deceased issue at such times had such issue not died), and such shares shall be held in a separate trust until such deceased issue would have attained thirty-two (32) years of age, or until the earlier termination of the Trust as provided in subparagraph (iv) below. At that time such shares shall be paid over to the then living lineal descendants of such deceased issue in equal shares, per stirpes. . . .

It has been represented that all of the primary beneficiaries have reached age 33 and their respective interests in the Trust have terminated. It has been further represented that there have not been any additions, actual or constructive, to the Trust after September 25, 1985.

The Trustee has requested rulings that the adoption of the proposed language set forth in the Complaint

(1) will not cause the Trust to lose its status as a trust that is exempt from the GST tax by reason of §1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations;

(2) will not cause Husband, Wife, or any beneficiary of the Trust to be deemed to have made a gift or to be subject to gift taxes under chapter 12 of subtitle B of the Internal Revenue Code;

(3) will not cause any of the property of the Trust to be included in the gross estate of any grantor or beneficiary of the Trust for federal estate tax purposes under chapter 11 of subtitle B of the Code, except to the extent of property that is distributed to such person and remains in his or her estate at the date of death; and

(4) will not cause any beneficiary of the Trust to be a transferor for GST tax purposes with respect to any property of the Trust.

Law and Analysis:

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death – (1) the possession or enjoyment of, or the right to the income from, the property, or (2) 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.

Section 2038(a)(1) provides that to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period on the date of the decedent's death.

Section 2041(a)(2) provides that to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

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) of the Gift Tax Regulations 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), 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 2652(a)(1) provides that, except as provided in this subsection or § 2653(a), the term "transferor" means the decedent, in the case of property subject to the tax imposed by chapter 11, and the donor, in the case of any property subject to the tax imposed by chapter 12. An individual shall be treated as transferring any property with respect to which such individual is the transferor.

Section 26.2652-1(a)(1) provides that, except as otherwise provided in § 26.2652-1(a)(3), the individual with respect to whom property was most recently subject to Federal estate or gift tax is the transferor of that property for purposes of chapter 13. An individual is treated as transferring any property with respect to which the individual is the transferor. Thus, an individual may be a transferor even though there is no transfer of property under local law at the time the Federal estate or gift tax applies.

Section 26.2652-1(a)(2) provides that a transfer is subject to Federal gift tax if a gift tax is imposed under § 2501(a) (without regard to exemptions, exclusions, deductions, and credits). A transfer is subject to Federal estate tax if the value of the property is includible in the decedent's gross estate as determined under § 2031 or § 2103.

In Domo v. McCarthy, 66 Ohio 3d 312, 612 N.E. 2d 706 (1993), the Ohio Supreme Court stated, "[w]e are mindful that one of the fundamental tenets for the construction of a will or trust is to ascertain, within the bounds of law, the intent of the grantor or settlor." The court also indicated that when the language of the trust instrument is uncertain or ambiguous, the court may consider extrinsic evidence to ascertain the grantor's intent.

In the present case, the Trust was irrevocable on September 25, 1985. It has been represented that no additions, actual or constructive, have been made to the Trust after that date. The Complaint contains proposed language to Paragraph 4 of the Trust intended to resolve ambiguities relating to the distribution of Trust income and principal. Husband and Wife, as the grantors of the Trust, have presented affidavits in support of the proposed language. Adoption of the proposed language clarifies the interests of the Trust beneficiaries rather than creating new interests.

Therefore, based upon the facts submitted and the representations made, we conclude that the proposed language in the Complaint 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. Accordingly, we rule that adoption of the proposed language set forth in the Complaint:

(1) will not cause the 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);

(2) will not cause Husband, Wife, or any beneficiary of the Trust to be deemed to have made a gift or to be subject to gift taxes under chapter 12 of subtitle B;

(3) will not cause any of the property of the Trust to be included in the gross estate of Husband, Wife, or beneficiary of the Trust for federal estate tax purposes under chapter 11, except to the extent of property that is distributed to such person and remains in his or her estate at the date of death; and

(4) will not cause any beneficiary of the Trust to be a transferor for GST tax purposes with respect to any property of the Trust.

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,

James F. Hogan

James F. Hogan
Senior Technician Reviewer, Branch 9
(Passthroughs & Special Industries)

Enclosures: Copy for § 6110 purposes

cc: