Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

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Date:
April 20, 2017

Legend

Decedent
Son
Date 1
Date 2
Date 3
Date 4
Trust
Trustee
Grandson 1
Grandson 2
Granddaughter
County Court
State Statute
State

Dear :

This letter responds to your authorized representative's letter dated November 14, 2016, and subsequent correspondence, requesting gift, estate, and generation-skipping transfer (GST) tax rulings with respect to the proposed reformation and modification of Trust.

The facts and representations submitted are summarized as follows:

Decedent executed Trust on Date 1, a date that is prior to September 25, 1985. The laws of State apply to Trust.

Article Third, Paragraph 4b of Trust provides, in relevant part, that after the death of Decedent and Decedent's wife, the trustee is to continue to hold the assets of Trust for the benefit of Decedent's son, Son, and Son's children during the lifetime of Son. The trustee, in its sole discretion, may accumulate or distribute the net income at any time and from time to time. The trustee may elect to distribute income to a class of beneficiaries composed of Son and Son's children. The distributions of income may be made in amounts which are unequal or disproportionate. The trustee may invade the principal to provide for the care, comfort, support, maintenance, or education of any one or more of the class of beneficiaries.

Article Third, Paragraph 4c provides, in relevant part, that upon the death of Son, the assets of Trust are to be "divided into separate trusts equal in number to the surviving children of [Son] until each child reaches the age of 30 years, at which time, [the trustee] shall distribute to such child one-half of the principal of the trust for such child, and upon reaching age 35 the balance, including any undistributed income."

Article Third, Paragraph 5 provides, in relevant part, that after the death of Son and prior to the final distribution of any of the separate trusts described in paragraph 4c, in the event of the death of any of the children of Son leaving issue surviving, the trust applicable to such deceased child is to terminate and be distributed to the descendants of such child in equal shares.

Article Third, Paragraph 6 provides, in relevant part, that in the event of the death of the last survivor of Decedent's wife, Son, Son's children, and the descendants of a deceased child of Son, any trust or trusts then being held are to terminate and the trustee is to distribute the assets thereof to and among such persons as shall then constitute Decedent's heirs at law.

Article Sixth provides, in relevant part, that at any time, Decedent will have the right to alter, amend, or revoke all or any part or parts of Trust as specified by a written instrument executed by Decedent and delivered to the trustee before Decedent's death.

On Date 2, a date that is prior to September 25, 1985, Trust was amended to name Trustee as the corporate trustee of Trust. It is represented that Decedent died prior to September 25, 1985 and Trust became irrevocable upon Decedent's death. It is also represented that no person has contributed any assets to Trust since September 25, 1985, and there have been no additions (actual or constructive) to Trust since September 25, 1985.

At the present time, Decedent's wife is deceased. Son is still alive. Son has three children, Grandson 1, Grandson 2, and Granddaughter. Grandson 1 and

Grandson 2 have children. Granddaughter died on Date 3, survived by three children. Trustee represents that Decedent intended that any share of a predeceased child of Son be distributed to the predeceased child's descendants. This intent is demonstrated in the language of Article Third, Paragraph 5 which provides that after the death of Son, in the event of the death of any child of Son leaving issue surviving, the proceeds of that trust are to be distributed to the descendants of the deceased child. However, Article Third, Paragraph 4c, as currently drafted, provides that upon the death of Son, the assets of Trust are to be divided into separate trusts equal in number to the surviving children of Son. This means that upon Son's death, the assets of Trust are to be divided into shares for Grandson 1 and Grandson 2, but that there will be no share for Granddaughter or Granddaughter's children, since Granddaughter predeceased Son. The trustee represents that the inclusion of the word "surviving" appears to be a scrivener's error.

In order to correct this scrivener's error, Trustee has petitioned County Court to reform the provisions of Trust. On Date 4, County Court reformed Article Third, Paragraph 4c by removing the word "surviving" from the paragraph. County Court's order is conditioned on a favorable private letter ruling by the Internal Revenue Service.

You have requested the following rulings:

1. The proposed reformation by County Court will not cause Trust to lose its GST exempt status under § 2601 of the Internal Revenue Code or result in any GST tax liability to any beneficiary or Trust.

2. The proposed reformation by County Court will not result in any gift tax liability to any beneficiaries under § 2501.

3. The proposed reformation by County Court will not result in any estate tax liability to any beneficiaries under § 2001.

LAW AND ANALYSIS

Ruling 1

Section 2601 imposes a tax on every GST, which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (Act), the GST tax 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) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, provided no additions (actual or constructive) were made to the trust after that date.

Section 26.2601-1(b)(2) provides that the GST tax does not apply to any generation-skipping transfer under a will or other revocable trust executed before October 22, 1986, provided that the document in existence on October 21, 1986, is not amended at any time after October 21, 1986, in any respect which results in the creation of, or an increase in the amount of, a generation-skipping transfer, and the decedent dies before January 1, 1987. This paragraph also provides that the rules contained in § 26.2601-1(b)(1)(iii) apply to any will or revocable trust within the scope of this paragraph.

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 under § 26.2601-1(b) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

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 a scrivener's error will not cause an exempt trust to be subject to the GST provisions if: (1) the judicial action involves a bona fide issue; and (2) 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)(i)(E), Example 3 considers a situation where, 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 GST tax.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court’s characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

State Statute provides that a court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor's intention if it is proved by clear and convincing evidence that both the settlor's intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement. Thus, courts in State will reform a trust when it can be shown by clear and convincing evidence that provisions were inserted or omitted because of a mutual or unilateral mistake and that, as written, the instrument does not truly reflect the settlor's desires and intention at the time of execution and delivery.

In this case, an examination of the relevant Trust instruments, affidavits, and representations of the parties indicate that Decedent intended that any share of a predeceased child of Son be distributed to the predeceased child's descendants. This intent was not carried out in the Trust agreement due to scrivener's error. As discussed above, the judicial action involves bona fide issues and the reformation based on scrivener's error is consistent with applicable State law that would be applied by the highest court of State. Accordingly, based on the facts presented and the representations made, we conclude that the reformation of Trust is consistent with applicable State law that would be applied in the highest court of State. Thus, we rule that the proposed reformation will not cause Trust to lose its GST exempt status under § 2601 or result in any GST tax liability to any beneficiary or Trust.

Rulings 2 and 3

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

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, generally, 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 an 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 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 the case of a bona fide sale for an 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 ending 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 2041(b)(1) provides, in relevant part, that for purposes of § 2041(a), the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts: (A) $5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

Section 2501(a)(1) provides, generally, that a tax is imposed for each calendar year on the transfer of property by gift by any individual, resident or nonresident. Section 2511(a) provides that the gift tax shall apply 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 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift. Section 2512(b) provides that where property is transferred for less than an adequate consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed a gift.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that for purposes of § 2514, the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

Section 2514(e) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The rule of the preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of the following amounts: (1) $5,000, or (2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied.

In order for §§ 2036 and 2038 to apply, the decedent must have made a transfer of property of any interest therein (except in the case of a bona fide sale for adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. In this case, an examination of the relevant Trust instruments, affidavits, and representations of the parties indicate that Decedent intended that any share of a predeceased child of Son be distributed to the predeceased child’s descendants. This intent was not carried out in the Trust agreement due to scrivener's error. The proposed reformation does not constitute an exercise by Decedent of any right to an interest in Trust or control over Trust property. The purpose of the proposed reformation is to correct the scrivener’s error, not to alter or modify the trust instrument. Accordingly, based on the facts presented and the representations made, we conclude that the reformation of Trust is consistent with applicable State law that would be applied in the highest court of State. Thus, we rule that the proposed reformation will not result in any gift tax liability to any beneficiaries under § 2501. We also rule that the proposed reformation will not result in any estate tax liability to any of the beneficiaries under § 2001.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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.

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.

Sincerely,

Leslie H. Finlow

____
Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures
Copy for § 6110 purposes
Copy of this letter