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Date:
July 13, 2020

In Re:

Legend

Date 1

Date 2

Date 3

Date 4

Date 5

Date 6

Donor

Spouse

Trust

State

a

State Court

State Statute

Citation 1

Citation 2

Trust 1

Trust 2

Trust 3

Beneficiary 1

Beneficiary 2

Beneficiary 3

Dear _____ :

This letter responds to your authorized representative's letter, dated December 5, 2019 and other correspondence, requesting income, estate, gift, and generation-skipping transfer (GST) tax rulings regarding the construction of Trust to correct scrivener's errors and resolve the ambiguities in Trust's terms.

The facts and representations made are as follows:

On Date 1, Donor established Trust, a revocable trust, for the benefit of Spouse, and issue. Trust was most recently amended on Date 2, a date prior to September 25, 1985. On Date 3, a date prior to September 25, 1985, Donor died, and Trust became irrevocable. The trustees represent that no additions, actual or constructive, have been made to Trust after that date. Trust is governed by the laws of State.

Article III of Trust provides, in relevant part, that upon the death of Spouse, the trustees are directed to divide the corpus of Trust and to establish as many separate trusts, equal in value, as there are children of Donor who are living or who are deceased leaving issue at the time of Donor's death. The trustees are to pay the net income from each trust to the referred child living at Donor's death and to the issue then living of a deceased child (*per stirpes*) at least as often as quarterly. Additionally, the trustees are to pay over or apply for the benefit of each beneficiary so much of the principal of that beneficiary's trust as the trustees, in the exercise of their uncontrolled discretion, deem needful or desirable for the education of that beneficiary, and for medical, surgical, hospital, or other institutional care.

Article IV provides, in relevant part, that upon the death of Donor's children who survive him, the Trustees are to retain the balance of any undistributed income and/or principal in trust upon the same terms of trust as heretofore recited in Article III for the then living issue of the deceased child (*per stirpes*) until no great-grandchild of Donor (who is descended from that child) is living and under the age of years (provided that same does not violate the Rule Against Perpetuities). At which time, the trust for that great-grandchild's share shall terminate and the undistributed income and principal shall be paid over outright and free from all trusts to that great-grandchild's then living issue by right of representation, and in default of such issue, to the Donor's then living issue (*per stirpes*) provided that any beneficiary so receiving property and then a beneficiary under another trust hereunder shall not receive his share outright but shall have it added to such other trusts. In default of any issue of Donor, the property shall be distributed as provided in Article X. The provisions of this Article IV shall also apply to a share for the issue of any child of the donor who may predecease the donor.

Article V provides, in relevant part, that during the minority and after attaining majority of any beneficiary of the several trusts hereinabove created, the trustees are to pay over to each beneficiary so much of the income and principal of that beneficiary's

trust as the trustees, in the exercise of their uncontrolled discretion, deem needful or desirable for the maintenance, support, and education of that beneficiary or of any member of that beneficiary's immediate family.

Article X provides that in the event that Donor's children survive Donor, but all die without leaving issue surviving then the principal and undistributed income of the trust is to be paid over to two specified charities.

Spouse died on Date 4. Pursuant to the terms of Trust, Trust has been divided into three trusts, for the three children of Donor: Trust 1 for the benefit of Beneficiary 1, Trust 2 for the benefit of Beneficiary 2, and Trust 3 for the benefit of Beneficiary 3.

Due to various scrivener's errors, Article IV contains certain ambiguities. Article IV refers to trusts for a great-grandchild's share even though there is no direction in the instrument to further divide a trust for Donor's child. The trust language provides no indication of when a great-grandchild's share is to be established. Furthermore, the trust for each child is to terminate when the great-grandchild reaches the age of a and then the trustees are directed to distribute that great-grandchild's share to his or her living issue, rather than directly to that great-grandchild, who may still be alive at that point. Finally, if any of the great-grandchildren have no issue, the property will be divided among Donor's issue, *per stirpes*, which will cause property to be distributed to other family lines, even when there are still living descendants in that family line.

On Date 5, the trustees of Trust 2 filed an equity complaint in State Court for a judicial construction to correct the scrivener's errors and resolve the ambiguities in the trust instrument. In connection with the equity complaint, the three children of Donor have each executed affidavits swearing that it is their respective understanding that Donor intended that Trust property be held in trust for future generations, to divide into separate trusts for each grandchild (not great-grandchild) upon a child's death, and to benefit a child's family line as long as there were descendants living in that family line. Furthermore, it is their understanding that the separate trusts were intended to terminate on the deaths of Donor's grandchildren and to be paid out to great-grandchildren.

On Date 6, State Court ruled that Article IV of Trust instrument, due to scrivener's errors, contained patent ambiguities, and that those errors are contrary to the intent of Donor. State Court issued an order, contingent on the trustees obtaining a favorable private letter ruling from the Internal Revenue Service, that amended Article IV. The amended Article IV provides, in relevant part, that upon the death of the children of Donor, the trustees are directed to divide the balance of any undistributed income and/or principal of such child's share so as to establish as many separate trusts, equal in value, as there are grandchildren (descended from that child) then living or then deceased with issue then living, and retain the share of each such grandchild in trust. Until the Termination Date, the Trustees are to pay the net income from each such trust to such grandchild at least as often as quarterly, and, in addition, so much of the

principal to or for the benefit of such grandchild as the Trustees in the exercise of their uncontrolled discretion deem needful or desirable for each person's education and medical, surgical, hospital or institutional care. The Termination Date for each such trust shall be the later of (i) the date of death of the grandchild for whom the trust was set apart and (ii) the date on which no living beneficiary of such trust who is a great-grandchild of Donor is under the age of a years (provided that the same does not violate the Rule Against Perpetuities). On the Termination Date, the undistributed income and principal of such trust is to be paid over outright and free from all trusts to that grandchild's then living issue *per stirpes*, and in default of such issue, to the deceased child's then living issue *per stirpes*, and in default of such issue, to Donor's then living issue *per stirpes*, provided that any beneficiary so receiving property who is then a beneficiary under another trust hereunder shall not receive his share outright but shall have it added to such other trust. In default of any issue of Donor, the property shall be distributed as provided in Article X. The provisions of this Article IV shall also apply to a share for the issue of any child of Donor who may predecease Donor. Notwithstanding the foregoing, and consistent with the Rule Against Perpetuities, if any property is held in any trust hereunder 21 years after the death of the survivor of Donor's issue as are living on the date of my death, the Trustees shall distribute all such property held in such trust outright and free of trust as directed above, as though the Termination Date had then occurred.

You have requested the following rulings:

- 1) The amendment to Trust, pursuant to State Court's order, will not cause Trust 2 to lose its status as exempt from the provisions of chapter 13 of the Internal Revenue Code or cause distributions from Trust or terminations of interests in Trust to be subject to the GST tax;
- 2) The amendment to Trust, pursuant to State Court's order, will not cause any beneficiary to be treated as making a taxable gift of any portion of Trust 2;
- 3) The amendment to Trust, pursuant to State Court's order, will not cause any portion of Trust 2 to be includible in the gross estate of any beneficiary prior to termination; and
- 4) The amendment to Trust, pursuant to State Court's order, will not give rise to taxable income or cause any beneficiary to recognize gain or loss from a sale or other disposition of property.

LAW AND ANALYSIS

Ruling 1

Section 2601 of the Internal Revenue Code 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 intervene in the administration of a trust to the extent its jurisdiction is invoked by an interested person or as provided by law.

The Supreme Court of State has ruled that a court may require a trust to be reformed on clear and decisive proof that the instrument fails to embody the settlor's intent because of scrivener's error. To ascertain the settlor's intent, a court looks to the trust instrument as a whole and the circumstances known to the settlor on execution. Citation 1. In addition, courts may accept extrinsic evidence, such as an attorney's affidavit, that demonstrates that there has been a mistake. Citation 2.

In this case, an examination of the relevant Trust instruments, affidavits, and representations of the parties indicate that Donor intended that Trust property be held in trust for future generations, to be divided into separate trusts for each grandchild upon a child's death, and to benefit a child's family line as long as there were descendants living in that family line. This intent was not carried out in the Trust instrument agreement due to scrivener's error. The proposed judicial action will remedy these bona fide issues. As discussed above, the proposed judicial action 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 rule that the proposed amendment to Trust, pursuant to State Court's order, will not cause Trust 2 to lose its status as exempt from the provisions of chapter 13 or cause distributions from Trust or terminations of interests in Trust to be subject to the GST tax.

Ruling 2

Section 2501(a) imposes a gift tax for each calendar year on the transfer of property by gift during the year by an individual.

Section 2511 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.

In this case, an examination of the relevant Trust instruments, affidavits, and representations of the parties indicate that Donor intended that Trust property be held in trust for future generations, to be divided into separate trusts for each grandchild upon a child's death, and to benefit a child's family line as long as there were descendants living in that family line. This intent was not carried out in the Trust instrument agreement due to scrivener's error. The proposed amendment to the language of Trust does not constitute an exercise by Donor of any right to an interest in Trust or control over Trust property. The purpose of the proposed amendment 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 amendment of Trust is consistent with applicable State law that would be applied in the highest court of State. Thus, we rule that the proposed amendment to Trust, pursuant to State Court's order, will not cause any beneficiary to be treated as making a taxable gift of any portion of Trust 2.

Ruling 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.

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 Donor intended that Trust property be held in trust for future generations, to be divided into separate trusts for each grandchild upon a child's death, and to benefit a child's family line as long as there were descendants living in that family line. This intent was not carried out in the Trust instrument agreement due to scrivener's error. The proposed amendment to the language of Trust does not constitute an exercise by Donor of any right to an interest in Trust or control over Trust property. The purpose of the proposed amendment 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 amendment of Trust is consistent with applicable State law that would be applied in the highest court of State. Thus, we rule that the proposed amendment to Trust, pursuant to State Court's order, will not cause any portion of Trust 2 to be includible in the gross estate of any beneficiary prior to termination.

Ruling 4

Section 61(a)(3) provides that gross income includes all income from whatever source derived, including gains derived from dealings in property and under § 61(a)(15), from an interest in a trust.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c) the entire amount of gain or loss on the sale or exchange of property shall be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. *Cottage Savings Association v. Commissioner*, 499 U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements different in kind or extent or if they confer different rights and powers. *Id.* at 565.

Accordingly, based on the information submitted and the representations made in the ruling request, we conclude that there will be no sale or other disposition because there will be no transfer of money or property. The beneficiaries will possess the same interests before and after State Court's order. The proposed changes to Trust clarify the original intent of Donor and do not create material differences in the interests of the beneficiaries. Accordingly, neither the trusts nor their beneficiaries will recognize gain or loss under § 1001 after issuance of State Court's order. The proposed amendments to Trust will not cause Trust 2, or its beneficiaries to recognize any gain or loss from sale or other disposition of property under §§ 61 and 1001.

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,

Melissa C. Liquerman

Melissa C. Liquerman
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures:

Copy for § 6110 purposes
Copy of this letter

cc: