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LEGEND

Trust A	=
Trust B	=
Husband	=
Date 1	=
Wife	=
Date 2	=
Bank	=
Son	=
Son's Wife	=
Grandchild A	=
Grandchild B	=
Superior Court	=
State	=
Date 3	=
Date 4	=
Date 5	=
State Supreme Court	=
x	=
y	=

Dear

This responds to your June 25, 2009, letter requesting rulings regarding the effect of the reformations of Trust A and Trust B for federal gift, estate, and generation-skipping transfer (GST) tax purposes.

The facts submitted are as follows:

Trust A is a testamentary trust, created under the residuary clause of Husband's will. Husband died on Date 1, survived by Wife. Trust B is a testamentary trust, created under the residuary clause of Wife's will. Wife died on Date 2, shortly after the death of Husband. Trust A and Trust B are substantially identical, both having been created under the reciprocal wills of Husband and Wife.

Bank was appointed as the original Trustee of Trust A and the original Trustee of Trust B. Both trusts originally provide as follows.

The first paragraph of Section 2 of Item III of the Wills of Husband and Wife provides that upon the death of the survivor of Husband and Wife, the Trustee may pay trust income to Son and Son's Wife and also may pay to Son and Son's Wife such sums from principal as the Trustee deems necessary or advisable from time to time for their medical care, comfortable maintenance, and welfare, considering the income of either from all sources known to the Trustee.

The second paragraph of Section 2 provides that upon the death of the survivor of Son and Son's Wife, the Trustee shall distribute whatever balance remains in the respective trusts in equal shares to Grandchild A and Grandchild B, such share to be held in further trust until that grandchild reaches age 35. From the share of the respective grandchild, the Trustee may make discretionary distributions of income payable until that grandchild reaches age 21, mandatory distributions of income payable after that grandchild reaches age 21, and discretionary distributions of principal payable until the final distribution of that grandchild's share. The Trustee must distribute one-third of each grandchild's share to such grandchild at age 27, one-half of the balance at age 31, and the balance at age 35.

Both Trust A and Trust B also provide that in the event any trustee resigns or is unable or refuses to act or whenever a majority of the beneficiaries of the current income decide for any reason whatsoever to remove the trustee, any person or another corporation authorized under federal or state law to administer trusts may be appointed as trustees by written instrument.

Son is the executor of the estate of Husband and the estate of Wife. Son was advised by an attorney hired to assist with the management of the trust that the first paragraph of Section 2 of Item III of the respective wills of Husband and Wife potentially creates a general power of appointment over trust principal for federal estate tax purposes. Son, in separate petitions, petitioned Superior Court in State to reform Trust A and Trust B, respectively, on the basis of scrivener's error. On the basis of Superior Court's findings, Superior Court entered an Order reforming Trust A on Date 3 and an Order reforming Trust B on Date 4.

The first paragraph of Section 2 of Item III of the respective Wills of Husband and Wife was reformed to provide that in addition to discretionary distributions of income, the Trustee may distribute to Son and Son's Wife such sums from principal of the respective trust "as the Trustee deems necessary from time to time for either of their health and maintenance, considering the income of either from all sources known to the Trustee."

Subsequent to the reformations of Trust A and Trust B by Superior Court, the beneficiaries of Trust A and Trust B instituted an action against the scriveners of the wills of Husband and Wife. The judgment of the trial court in that action was eventually appealed to the highest court of State. On Date 5, the State Supreme Court in a written opinion concluded that (1) the record shows by clear and convincing evidence there was a mistake in the trust language of the original wills, and (2) that Trust A and Trust B were reformed consistent with State law.

At the time of Husband's death, the value of the property available for distribution to Trust A was $x. Husband made no lifetime allocation of his GST exemption and no direct skips of property occurred at his death.

At the time of Wife's death, the value of the property available for distribution to Trust B was $y. Wife made no lifetime allocation of her GST exemption and no direct skips of property occurred at her death.

You have requested the following rulings:

1. The judicial reformations of Trust A and Trust B will not be treated for purposes of § 2514 as the exercise or release of general powers of appointment by Son and Son's Wife.

2. As a result of the judicial reformations of Trust A and Trust B, Son and Son's Wife will not possess a general power of appointment over the principal of Trust A and Trust B that would cause the entire value of the principal of such trusts to be includible in the gross estate of Son or Son's Wife under § 2041 for federal estate tax purposes.

3. For GST tax purposes, under § 2632(c) (redesignated as § 2632(e), effective June 7, 2001), any portion of Husband's unused GST exemption is deemed to have been allocated at his death to Trust A and any portion of Wife's unused GST exemption is deemed to have been allocated at her death to Trust B.

LAW AND ANALYSIS

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 2041(a)(2) provides that the value of the gross estate includes the value of all

property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment, or with respect to which the decedent has at any time exercised or released the power of appointment by a disposition which is of the nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate under sections 2035 to 2038 inclusive.

Section 2041(b)(1) provides that the term “general power of appointment” means a power exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate.

Section 2041(b)(2) provides that the lapse of a power of appointment during the life of the individual possessing the power shall be considered a release of the power.

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

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 2514(b) provides that the exercise or release of a general power of appointment shall be deemed a transfer of property by the individual possessing the power. Section 2514(c) provides that the term “general power of appointment” means a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

Section 2601 imposes a tax on every generation-skipping transfer (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 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term “applicable rate” means with respect to any GST, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the “applicable fraction”. The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator of which is the value of the property transferred to the trust or involved in the direct skip.

Section 2631(a), as in effect during the years of the deaths of Husband and Wife, provided that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of $1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a) provides that any allocation by an individual of his or her GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed. Section 2632(c), as in effect during the years of the deaths of Husband and Wife, § 2632(c)(1) (redesignated as § 2632(e)(1)) provides that, in general, any portion of an individual's GST exemption that has not been allocated within the time prescribed by § 2632(a) is deemed to be allocated as follows: (A) first, to property that is the subject of a direct skip occurring at such individual's death, and (B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

Section 26.2632-1(d)(2) of the Generation-Skipping Transfer Tax Regulations provides that a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date. Unused exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for estate tax purposes (the chapter 11 value), first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. However, no automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the trust.

Under § 2652(a)(1) and § 26.2652-1(a)(1), the “transferor” of the property for GST tax purposes is the individual with respect to whom the property was last subject to federal estate or gift tax.

In Commissioner v. Estate of Bosch, 378 U.S. 456 (1967), the Supreme 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.

Based on the facts submitted and the representations made, we conclude that the reformations of Trust A and Trust B are consistent with applicable State law, as applied by the highest court of State. Accordingly, we conclude that: (1) the judicial reformation of Trust A and Trust B as described above will not constitute an exercise, release, or

lapse of a general power of appointment that would result in a taxable gift under § 2514; and (2) as a result of the judicial reformation of Trust A and Trust B, Son and Son's Wife will not possess nor will ever have possessed a general power of appointment over the principal of Trust A and Trust B that would cause the entire value of the principal of such trusts to be includible in the gross estate of Son or Son's Wife under § 2041 for federal estate tax purposes.

In addition, we conclude that, as a result of the judicial reformation of Trust A and Trust B, neither trust will be considered to have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to that trust. Accordingly, we conclude that Husband's unused GST exemption is deemed to have been allocated at his death to Trust A to the extent Husband is considered the transferor of Trust A. Further, we conclude that Wife's unused GST exemption is deemed to have been allocated at her death to Trust B to the extent Wife is considered the transferor of Trust B.

Notwithstanding the above rulings, we note that under the provisions of Trust A and Trust B, unaffected by the subsequent reformations of the trusts, the survivor of Son or Son's Wife may possess a general power of appointment over the trust income of Trust A and Trust B, which may cause the values of the income interests in the trusts to be includible in the estate of the survivor of Son or Son's Wife.

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 taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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
Senior Technician Reviewer
(Passthroughs & Special Industries)

cc: