Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201723003**
Release Date: 6/9/2017

Index Number: 2036.00-00, 2038.00-00, 2501.00-00, 2601.00-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-123334-16

Date:
January 23, 2017

Re:

LEGEND:
Grantor =

Representative =
Attorney =
A =
Plan =

Trust =
Revocable Trust =
State Court =
Citation 1 =

Citation 2 =
Citation 3 =
Citation 4 =
Citation 5 =
State Statute =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =

Dear :

This letter responds to your personal representative's letter of July 22, 2016, and subsequent correspondence, regarding the federal gift, estate, and generation-skipping transfer tax consequences of a judicial reformation of a trust.

The facts submitted and representations made are as follows. Grantor, with her representative (Representative), worked with Attorney to structure her life insurance plan. On Date 1, Representative and Attorney discussed the possibility of creating a trust to hold life insurance policies insuring Grantor's life, the proceeds of which would be payable on Grantor's death to separate trusts for her children.

On Date 2, Attorney presented a detailed analysis taking into account premium payments, income tax consequences and potential estate and gift tax consequences. The analysis concluded that: (i) under this plan (the Plan), the greatest amount of net insurance proceeds would be available for distribution at Grantor's death; (ii) Grantor would pay gift tax during life for her gifts of the annual insurance premiums; and (iii) there would not be any estate tax payable at Grantor's death. The detailed analysis specifically concludes that the net insurance proceeds would not be includible in Grantor's gross estate.

Grantor and Representative agreed that this Plan represented Grantor's intent and that such plan would be implemented. With these specifications, Attorney drafted the trust agreement. On Date 3, Grantor executed the irrevocable trust (Trust). A currently serves as the trustee.

Paragraph B of Article I of Trust states that Grantor intends that the value of the Trust shall not be included in her gross estate at death for federal estate tax purposes. Under Paragraph B of Article V, at Grantor's death, the trustee is to divide the trust estate into as many separate shares as are then required to provide one share for each then living child of Grantor and one share for the then living descendants, collectively, of any child who died. The amounts of the shares are to be determined by multiplying the total value of Trust by a fraction of which: (i) the numerator is the value of property distributable to the child or the child's descendants under Grantor's Last Will and Testament (Will) and Grantor's revocable trust (Revocable Trust), and (ii) the denominator is the total value of property distributable to all of Grantor's children and their descendants under the Will and Revocable Trust.

Grantor made an initial transfer to Trust, and the trustees used this to purchase policies insuring her life. She periodically made additional transfers to Trust, and these were applied to the life insurance premiums. Grantor reported each transfer on a timely filed

Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. She allocated a portion of her generation-skipping transfer tax exemption amount to each transfer.

Grantor recently discovered that, notwithstanding her expressed intention and decision to create Trust in accordance with the Plan so that the trust property would not be includible in her gross estate, it is possible that the trust property might be included in her gross estate, due to a drafting error made by Attorney. In conflict with Grantor's intent (as set forth in Paragraph B of Article I), Paragraph B of Article V erroneously provides that a child's (or a child's descendants') share of Trust assets (at Grantor's death) is to be determined in accordance with Grantor's Will and Revocable Trust.

On Date 4, Grantor filed a petition in State Court to retroactively reform (to Date 3) Paragraph B of Article V. In her declaration to the court, Grantor represented that: (i) she directed Attorney to draft a trust instrument consistent with the Plan, (ii) she believed each of her gifts was a completed gift for federal gift tax purposes, and (iii) the proposed reformation reflects her true intentions in establishing Trust. In his declaration to the court, Attorney represented that the language of Paragraph B of Article V is the result of his scrivener's error. He further represented that the reformation was necessary to correct the error to reflect Grantor's true intentions in establishing a trust that would not be includible in her estate.

State Court granted the petition on Date 5. As reformed, Paragraph B of Article V provides that, following Grantor's death, the trustee shall divide the trust estate into as many separate and equal shares as are required to provide one share for each then living child of Grantor and one share for the then living descendants, collectively, of any child who has died.

You have asked us to rule that:

(1) As a result of the retroactive reformation of Paragraph B of Article V, Grantor's transfers to Trust will be completed gifts for gift tax purposes.

(2) As a result of the reformation, the assets of Trust will not be includible in Grantor's gross estate at her death.

(3) For generation-skipping transfer tax purposes, in determining the inclusion ratio under § 2642 with respect to transfers of property made by Grantor to Trust, the value of the property will be determined under § 2642(b) as of the date of each gift to Trust.

Law and Analysis

Ruling 1 and Ruling 2

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

Section 2511 provides that the gift tax 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 2512(a) provides that if a gift is made in property, the value of the property at the date of the gift is considered the amount of the gift. Where property is transferred for less than an adequate and full consideration in money or money's worth, the gift is the amount by which the value of the property transferred exceeded the value of the consideration.

Section 2035(a) provides that if the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the three-year period ending on the date of the decedent's death, and the value of such property (or an interest therein) would have been included in the decedent's gross estate under § 2036, 3037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

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 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 there from.

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 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 three-year period ending on the date of the decedent's death.

Section 2042 provides, in part, that the value of the gross estate shall include the value of all property to the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.

It is well settled under State law that if by mistake, an instrument as written fails to express the true intention or agreement of the parties, a court of equity will grant reformation of the instrument to make it correctly express the agreement actually made. This rule applies to inter vivos trusts. Citation 1. It is immaterial whether the mistake is one of fact or law. Any mistake of the scrivener which could defeat the true intention may be corrected in equity by reformation. Citation 2; Citation 3. Reformation does not change the agreement. Rather, it enforces the agreement. It orders a change in the drafted instrument so that it will correctly express what has been the real agreement from its inception. Citation 4.

Under State Statute, a court may order that the terms of a trust be modified if it is necessary to achieve the settlor's tax objectives and is not contrary to the settlor's intentions. The court shall exercise its discretion to order a modification in the manner that conforms as nearly as possible to the probable intention of the settlor. See also Citation 5.

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.

In this case, the declarations made by Grantor and Attorney to State Court, together with contemporaneous correspondence and exhibits, provide clear and convincing evidence that Grantor intended Trust to conform to the details of the Plan, as presented to her by Attorney, most importantly, that the Trust property would not be included in her gross estate. The language of Paragraph B of Article V, providing for a reserved power,

directly controverts Grantor's clearly expressed intention that her gifts to Trust be completed gifts, such that there would be no inclusion of the Trust property in her gross estate. In further expressing her intent, Grantor filed timely gift tax returns reporting each of her transfers to Trust as a completed gift for which she paid gift tax and to which she allocated GST exemption. Attorney has explained that the inclusion of the reserved power in Paragraph B of Article V is the result of his scrivener's error in drafting.

In reforming Trust, State Court found that the reformation was necessary to correct the scrivener's error and to reflect Grantor's true intentions. Based on the information and documentation submitted, we conclude that State Court's order retroactively reforming Trust is consistent with applicable State law, as applied by the highest court of State. Accordingly, Paragraph B of Article V, as reformed, is effective as of Date 3, for estate and gift tax purposes.

Consequently, we conclude that as a result of the reformation, Grantor's transfers to Trust are completed gifts, for gift tax purposes. Moreover, Paragraph B of Article V, as reformed, does not reserve to Grantor any powers or interests for purposes of § 2035, § 2036 or § 2038, such that would result in inclusion of the Trust property in Grantor's gross estate. Likewise, Paragraph B of Article V, as reformed, does not give Grantor any incidents of ownership in insurance policies held by Trust for purposes of § 2042.

Ruling 3

Section 2601 imposes a tax on every generation-skipping transfer. A generation-skipping transfer 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 tax imposed by § 2601 is the taxable amount multiplied by the applicable rate. Section 2641(a) defines applicable rate as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2632(a)(1) provides that an individual's GST exemption may be allocated 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 return is required to be filed.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is the excess (if any) 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 the 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, reduced by the sum of any federal estate tax or state death tax actually recovered from the trust attributable to such property, and any charitable deduction allowed under § 2055 or 2522 with respect to

such property.

Section 2642(b)(1) provides that, except as provided in § 2642(f), if the allocation of the GST exemption to any transfers of property is made on a gift tax return filed on or before the date prescribed by § 6075(b) for such transfer or is deemed to be made under § 2632(b)(1) or (c)(1), the value of such property for purposes of § 2642(a) shall be its value as finally determined for purposes of chapter 12 (within the meaning of § 2001(f)(2), or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, its value at the time of the close of the estate tax inclusion period.

In this case, the reformation is effective as of Date 3, and Grantor's transfers to Trust were completed gifts on the dates of such gifts. Consequently, the inclusion ratio with respect to each transfer of property to Trust is determined under § 2642(b) based upon the gift tax value of the property on the date of the respective transfer.

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) of the Code 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
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:
Copy of letter for § 6110 purposes

cc: