Internal Revenue Service

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Department of the Treasury
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Person To Contact:
, ID No.

Telephone Number:

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Date:
November 26, 2018

Re:

Legend

Grantor =
Spouse =
Date 1 =
Trust A =

Trust B =

Trust C =

Grandchild A =
Grandchild B =
Grandchild C =
Grandchild D =
Grandchild E =
Grandchild F =
Grandchild G =
Date 2 =
Accountant =
Law Firm =
Son 1 =
Son 2 =
Daughter =
State =
State Statute =
Court =

Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Year 1 =
Year 7 =
Year 9 =
Year 11 =
Year 12 =
Year 19 =

Dear :

This letter responds to your letter dated November 6, 2018, and prior correspondence, submitted by your authorized representative, requesting rulings on the gift, estate, and generation-skipping transfer tax consequences of court orders to reform three trusts to correct scrivener's errors and to modify the trusts to clarify a provision in the trusts.

The facts and representations submitted are as follows.

On Date 1, in Year 1, Grantor created three irrevocable trusts, Trusts A, B, and C, for the benefit of his grandchildren. Son 1, Son 2, and Daughter are Grantor's children. Trust A is to be held for the benefit of Son 1's children, Grandchild A, B, and C. Trust B is to be held for the benefit of Son 2's children, Grandchild D and E. Trust C is to be held for the benefit of Daughter's children, Grandchild F and G. Grandchild A through G are referred to collectively as the "Beneficiaries" and individually as "Beneficiary." Year 1 is after September 25, 1985. The trustee of Trust A and C is Son 1. The trustee of Trust B is Son 2.

The terms of each trust are almost identical. Under Article III(b) of each trust, the trustee shall immediately divide the trust property into equal parts, setting aside one such part for the benefit of each Beneficiary. Article III(b)(1) provides that the trustee may distribute so much of the income and principal of the trust to or for the benefit of the Beneficiary for whom it has been set aside in such amounts, at such times and in such manner as the trustee in its sole discretion deems advisable for the Beneficiary's health, education (including college and professional education), welfare, and support in reasonable comfort and to permit the Beneficiary to enter into or engage in a business or profession in which the trustee believes the Beneficiary has reasonable prospects of success.

Article III(b)(2) provides that the separate trust held for a Beneficiary shall terminate upon the death of such Beneficiary. Upon termination, the remaining principal and any

undistributed income of such separate trust shall be distributed as the deceased Beneficiary may appoint by a provision of the Beneficiary's will which expressly refers to the power of appointment given by the trust agreement. Any portion of the remaining principal and any undistributed income of such separate trust that is not validly appointed in such manner shall be distributed to the then living lineal descendants of the Beneficiary, per stirpes; and, if there is none, then to the living lineal descendants of Son 1, Son 2, or Daughter, depending upon the Beneficiary's trust, per stirpes.

Article III(c) provides that notwithstanding the provisions of paragraph (b) of Article III, at the time any property is initially placed in or later added to the trust, each living Beneficiary shall have the unrestricted right to demand and receive from the trust that share of such property which is allocated to that Beneficiary's trust. The trustee shall notify each Beneficiary of the existence of this right within fourteen days from its receipt of such property. Beneficiaries must exercise such right by a written instrument delivered to the trustee within thirty days from the date such notice is given, or such right shall lapse.

Grantor and Spouse each made gifts to Trusts A, B, and C in Years 1 through 7 and Years 9 through 11. Grantor and Spouse elected to treat the gifts each made to each trust in Years 1 through 7 and Years 9 through 11 as made by both under § 2513. Grantor died on Date 2, in Year 11, and bequeathed a portion of his estate to each of the trusts. Following Grantor's death, in Years 12 through 19, Spouse continued to make gifts to each trust. Spouse died on Date 6, in Year 19.

Several years after Grantor's death, the trustees became aware that Article III(b)(2) lacked the language necessary to prevent an appointment of trust property to non-family members and that the broad language could be construed as granting a general power of appointment to the Beneficiaries. This would result in inclusion of trust property in each Beneficiary's gross estate. It is represented that such a result was contrary to Grantor's intent. On Date 3, Son 1, in his capacity as the trustee of Trust A and Trust C, and as representative by joinder of Trust B, petitioned Court to reform Trusts A, B, and C to include the necessary limiting language to qualify each Beneficiary's power of appointment as a limited power of appointment, expressly prohibiting the appointment of trust assets to a Beneficiary, such Beneficiary's estate, the creditors of such Beneficiary, and the creditors of such Beneficiary's estate.

The petition was supported by three affidavits, one each from Grantor's Accountant, Law Firm, and Son 1, in his capacity as the trustee of Trusts A and C and as representative by joinder of Trust B. Accountant swore that Grantor intended the trusts to be GST exempt. Law Firm swore that Grantor did not recognize that including the power of appointment language would result in including the trust assets in each Beneficiary's gross estate.

On Date 4, Court issued an order, effective Date 1, that limited the power of appointment language in Article III(b)(2) to exclude the Beneficiary, the Beneficiary's estate, the creditors of the Beneficiary, and the creditors of the Beneficiary estate. On Date 5, Court issued an amended order clarifying that the trusts terminate at the death of the named grandchild and that per stirpes distributions are to be outright and in fee. The amended order clarifies that each separate trust held for a Beneficiary shall terminate upon the death of such Beneficiary. This is consistent with the provisions of each trust, as originally executed. Further, the amended order clarifies that each trust shall provide that upon such termination, the remaining principal and any undistributed income of such separate trust shall be distributed as such deceased Beneficiary may appoint to or for the benefit of one or more of the lineal descendants of the child of the Grantor (Son 1, Son 2, or Daughter, depending upon the trust) who is a lineal ascendant of such beneficiary, but excluding such Beneficiary, such Beneficiary's estate, the creditors of such Beneficiary, and the creditors of such Beneficiary's estate. The default provisions of each trust remain unchanged. Both orders were issued contingent upon a ruling from the Internal Revenue Service.

On Date 7, Court issued a second amended order that reforms Article III(c) to limit the Beneficiary's withdrawal right to the lesser of (1) that amount equal to the greater of that amount which under § 2514(e) will not be considered a release of a power of appointment as the result of a lapse of the power (currently the greater of $5,000 or five percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied), or that amount that, under § 2503(b) may be excluded in computing the total amount of gifts made during such calendar year, or (2) the fair market value of any property, determined as of the date of the gift, added to this trust by gift during such calendar year. This order is also contingent upon a ruling from the Internal Revenue Service.

You have requested the following rulings:

1. The judicial reformation and modification of Trusts A, B, and C will not cause the corpus of such trusts to be included in the gross estate of Spouse for federal estate tax purposes.

2. Trusts A, B, and C, as reformed and modified, do not provide the Beneficiaries with general powers of appointment over the assets of such Beneficiary's trust under § 2514 or 2041, and upon the death of the Beneficiary, the assets of the deceased Beneficiary's trust will not be includible in such Beneficiary's gross estate under § 2041.

3. The judicial reformation and modification of Trusts A, B, and C do not constitute the exercise or release of any general powers of appointment by a Beneficiary resulting in a gift under § 2514.

4. Trust A, B, and C are "skip persons" as defined under § 2613(a)(2) and, accordingly, the deemed allocation rules of § 2632(b)(1) apply to allocate Grantor's and Spouse's GST exemption to the Year 1 through Year 7 and Year 9 through Year 19 gifts and bequests to Trust A, B, and C.

Ruling Request 1

Section 2001(a) imposes a tax 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 the decedent's death.

Section 2036(a) provides that the value of the decedent's gross estate includes the value of all property to the extent of any interest transferred by the decedent with respect to which the decedent has retained for life either an income interest in the property or the right to designate the persons who will possess or enjoy the property or have an interest in the income of the property.

Section 2038(a)(1) provides that, in the case of transfers after June 22, 1936, 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 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 when any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In the present case, Trusts A, B, and C are irrevocable trusts. During Year 1 through Year 7 and Year 9 through Year 11, Spouse and Grantor consented to treat their gifts as having been made one-half by each donor. Accordingly, Spouse and Grantor are each treated as the transferor of one-half of the total transfers to the trusts during those years. During Years 12 through 19, Spouse made gifts to each trust. Accordingly, Spouse is the transferor of those gifts to the trusts during those years. However, Spouse did not retain any right or interest in the trusts. Spouse did not retain a beneficial interest in the trusts and did not retain the right to alter, amend, revoke, or terminate any of the trusts. Further, Spouse did not retain the right to designate who would possess or enjoy the property or income derived from the trusts. The reformation and modification of Trusts A, B, and C were made pursuant to Court orders and not as a result of rights retained by Spouse. Accordingly, based upon the facts submitted and representations made, we conclude that the judicial reformation and modification of

Trusts A, B, and C will not cause the corpus of Trust A, B, and C to be included in the gross estate of Spouse for federal estate tax purposes.

Ruling Requests 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 2031(a) provides, generally, that the value of the gross estate of the decedent shall be determined by including to the extent provided for in §§ 2031 through 2046, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

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 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. For purposes of § 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

Section 2041(b)(1) provides 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.

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.

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.

For gift tax purposes, § 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 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 person possessing the power is considered a release of the power.

Section 25.2514-3(b)(4) of the Gift Tax Regulations provides, in part, that in any case where the possessor of a general power of appointment is incapable of validly exercising or releasing a power, by reason of minority, or otherwise, and the power may not be validly exercised or released on his behalf, the failure to exercise or release of his power is not a lapse of the power. However, section 2514(e) provides that a lapse during any calendar year is considered as a release so as to be subject to the gift tax only to the extent that the property which could have been appointed by exercise of the lapsed power of appointment exceeds the greater of (i) $5,000, or (ii) 5 percent of the aggregate value, at the time of the lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed power could be satisfied.

State Statute provides that upon application of a settlor or any interested person, the court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor's intent if it is proved by clear and convincing evidence that both the accomplishment of the settlor’s intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement. In determining the settlor’s original intent, the court may consider evidence relevant to the settlor’s intent even though the evidence contradicts an apparent plain meaning of the trust instrument.

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 the present case, an examination of the relevant trust instruments, affidavits, and representations of the parties strongly indicates that Grantor and Spouse did not intend for the Beneficiaries of Trusts A, B, and C to have inter vivos or testamentary general powers of appointment. In reforming the trusts, Court found that there was clear and convincing evidence that the language in Article III(b)(2) and Article III(c) were scrivener's errors and that the reformation and modification of the trusts was necessary and appropriate to achieve Grantor’s and Spouse’s objectives, and that the reformation was not contrary to Grantor's and Spouse’s intentions.

Consequently, based on the facts submitted and representations made, we conclude that the Court's Orders of Date 4, Date 5, and Date 7, reforming and modifying the trust instruments based on scrivener's errors, are consistent with applicable State law that would be applied by the highest court of that state. Trusts A, B, and C, as reformed and modified pursuant to the Court's Orders, do not provide the Beneficiaries with either inter vivos or testamentary general powers of appointment over the assets of each respective Beneficiary's trust under §§ 2041(b) and 2514(c). Accordingly, based on the facts submitted and the representations made, we conclude that the judicial reformation and modification of Trusts A, B, and C do not constitute the exercise or release of a general power of appointment by a Beneficiary resulting in a gift under § 2514 and that the assets of the deceased Beneficiary's trust will not be includible in such Beneficiary's gross estate under § 2041.

Ruling Request 4

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

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

Section 2652(a)(2) provides that if, under § 2513, one-half of a gift is treated as made by an individual and one-half of such gift is treated as made by the spouse of such individual, such gift shall be so treated for purposes of chapter 13.

Section 2652(c)(1)(A) provides that a person has an interest in property held in trust if (at the time the determination is made) such person has a right (other than a future right) to receive income or corpus from the trust.

Section 2631(a) provides that, for Years 1 through 5, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of $1,000,000 (adjusted for inflation) which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 2631(a) provides that, for Years 6 through 19, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption amount 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 2631(c) provides that, for Years 6 through 19, for purposes of § 2631(a), the GST exemption amount for any calendar year shall be equal to the basic exclusion amount under § 2010(c) for such calendar year.

Section 2632(b)(1) provides that if any individual makes a direct skip during his lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the direct skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

Section 26.2632-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that if a direct skip occurs during the transferor's lifetime, the transferor's GST exemption not previously allocated (unused GST exemption) is automatically allocated to the transferred property (but not in excess of the fair market value of the property on the date of the transfer).

Section 26.2632-1(b)(1)(ii) provides that the automatic allocation of GST exemption is irrevocable after the due date and is effective as of the date of the transfer to which it relates.

Section 2632(e)(1)(A) provides that any portion of an individual's GST exemption which has not been allocated within the time prescribed by § 2632(a) shall be deemed to be allocated first, to property which is the subject of a direct skip occurring at such individual's death.

Section 26.2632-1(e)(2) 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.

Section 2612(c)(1) provides that the term "direct skip" means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 2613(a) provides that for purposes of chapter 13, the term "skip person" means (1) a natural person assigned to a generation which is two or more generations below the generation assignment of the transferor, or (2) a trust if all interests in such trust are

held by skip persons, or if there is no person holding an interest in such trust, and at no time after such transfer may a distribution (including distributions in termination) be made from such trust to a non-skip person.

In the present case, Grantor and Spouse made gifts to Trusts A, B, and C. The primary beneficiaries of Trusts A, B, and C are the grandchildren of Grantor and Spouse. Pursuant to the reformation of Trusts A, B, and C, the Beneficiaries possess testamentary limited powers of appointment to appoint to one or more of the lineal descendants of Son 1, Son 2, or Daughter, depending upon which trust. In default of the exercise, the trust property passes to lineal descendants of that Grandchild, or if there are none, to the living descendants of Son 1, Son 2, or Daughter, depending upon which trust. The Beneficiaries, lineal descendants of the Beneficiaries of Son 1, Son 2, and Daughter are persons assigned to a generation which is two or more generations below the generation assignment of the Grantor and, accordingly, the Beneficiaries are skip persons as defined under § 2613(a)(1). Accordingly, we conclude Trust A, B, and C are "skip persons" as defined under § 2613(a)(2) and the gifts to Trusts A, B, and C are direct skips as defined in § 2612(c)(1).

Because Grantor and Spouse consented to split gifts under § 2513 for Year 1 through Year 7 and Year 9 through Year 11, Grantor and Spouse are treated as the transferor of one-half of the Year 1 through 7 and Year 9 through Year 11 gifts to the trusts under § 2652(a)(2). Therefore, based on the facts submitted and representations made, we conclude that, the deemed allocation rules under § 2632(b) apply to allocate Grantor's and Spouse's unused GST exemption to one-half each of the Year 1 through Year 7 and Year 9 through Year 11 gifts to the trusts and to allocate Grantor's unused GST exemption to the bequests to the trusts in Year 11, and to allocate Spouse's unused GST exemption to the Year 12 through Year 19 gifts to Trusts A, B, and C.

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.

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.

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.

Sincerely,

Lorraine E. Gardner
Lorraine E. Gardner
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy of this letter for section 6110 purposes