

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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PLR-120230-14

Date: NOVEMBER 12, 2015

Re:

LEGEND:

Settlor =
Trust =

Date 1 =
Date 2 =
Date 3 =
Date 4 =
Corporate Trustee =
Child =
Grandchild =
Grandchild A =
Grandchild B =
Grandchild A Trust =

Grandchild B Trust =

State Court =

Case 1 =

Case 2 =

x =

Dear :

This is in response to a letter dated May 12, 2014, and subsequent correspondence submitted by your authorized representative requesting rulings on the gift tax and generation-skipping transfer tax consequences of a judicial construction of a trust.

The facts and representations submitted are summarized as follows. Settlor created and funded Trust, an irrevocable trust, on Date 1 (a date before September 25, 1985) for the primary benefit of Grandchild. Corporate Trustee is the current trustee.

Under Article II(A) of Trust, the trustee is authorized to purchase and maintain insurance on the life of Child. The net income is to be accumulated. However, the trustee may, in its sole discretion, pay for the benefit of Grandchild so much of the net income as the trustee may deem necessary and proper to provide for the support, maintenance and education of Grandchild.

Article II(D) and Article III provide that Trust is to terminate five years after Child's death. Upon termination, the trustee is to distribute all of the Trust assets in equal shares to Grandchild's then surviving descendants. If all of Grandchild's descendants die before they would otherwise be entitled to receive the Trust assets, then the Trust is to terminate and the assets are to be distributed in equal shares to Grandchild's siblings, Grandchild A and Grandchild B, then surviving. However, if Grandchild A is then a current beneficiary of Grandchild A Trust, then her share is to be added to Grandchild A Trust. Likewise, if Grandchild B is then a current beneficiary of Grandchild B Trust, then his share is to be added to Grandchild B Trust.

Child died on Date 2. Trust will terminate on the earlier of Grandchild's death or Date 3, the fifth anniversary of Child's death. Grandchild, the income beneficiary of Trust, is living, but she has no descendants. Grandchild A is living and currently the beneficiary of Grandchild A Trust. Grandchild B is likewise living and currently the beneficiary of Grandchild B Trust. Trust, Grandchild A Trust, and Grandchild B Trust were created at the same time and have virtually identical provisions.

On Date 4, the parties petitioned State Court for an order construing and reforming Article II(D) and Article III of the Trust instrument to identify the contingent remainder

beneficiaries and to clarify the disposition of the Trust remainder upon its likely termination on Date 3. Under the proposed reformation, the Trust assets will be divided into two equal shares with one share being distributed to Grandchild A Trust and the other share being distributed to Grandchild B Trust upon either: (i) Grandchild's death before Date 3, or (ii) Trust's termination on Date 3. After such distribution, the one-half share distributed to Grandchild A Trust will continue to be held in Grandchild A Trust and administered pursuant to the terms of that trust. The one-half share distributed to Grandchild B Trust will be continue to be held in Grandchild B Trust and administered pursuant to the terms of that trust.

Requested rulings:

You have asked us to rule that:

1. The proposed reformation of Articles II(D) and III of Trust will not cause Trust to be subject to the tax on generation-skipping transfers under § 2601 of the Internal Revenue Code, and
2. The proposed reformation of Articles II(D) and III of Trust will not constitute a gift for purposes of § 2501

Rulings 1 and 2:

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 2601 imposes a tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 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, except to the extent the transfer is made out of principal added to the trust by an actual or constructive addition after September 25, 1985.

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 generation-skipping transfer tax under § 26.2601-1(b) will not cause

the trust to lose its exempt status. In general, unless specifically provided otherwise, these rules are applicable only for purposes of determining whether an exempt trust retains exempt status for generation-skipping transfer 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 lose its exempt status if the judicial action involves a bona fide issue, and 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)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph § 26.2601-1(b)(4)(i)(A)(B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(E), Example 3, provides as follows. 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 provisions of chapter 13.

Under applicable State law, a trust instrument may be reformed to conform to the settlor's intent. To ascertain the settlor's intent, the State courts look to the trust instrument as a whole and the circumstances known to the settlor on the date of execution. Cite 1; Cite 2.

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.

Based on the facts submitted and the representations made, we conclude that the the judicial action involves bona fide issues, and the judicial reformation of Trust to provide for the distribution of Trust assets to Grandchild Trust A and Grandchild Trust B, as described above, is consistent with applicable State law, as applied by the highest court of State.

Accordingly, we conclude that the judicial reformation of Trust, as described above, will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interest prior to the modification. Further, the reformation of Trust will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. Therefore, the reformation will not cause Trust to be subject to the tax on generation-skipping transfers under § 2601. In addition, the judicial reformation of Trust will not result in any change in the beneficial interests of the beneficiaries. Accordingly, no beneficiary will be regarded as making a gift as a result of the judicial reformation and distributions, described above.

Except as expressly provided herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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.

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

The ruling contained in this letter is 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
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:

Copy of letter for section 6110 purposes