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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-135591-18

In Re:

Date:
May 29, 2019

LEGEND

Date 1	=
Settlor	=
Spouse	=
Trust	=
Child 1	=
Child 2	=
Child 3	=
Child 4	=
Child 5	=
Child 6	=
Trust 1	=
Trust 2	=
Trust 3	=
Trust 4	=
Trust 5	=
Trust 6	=
State	=
Grandfather	=
Grandmother	=
x	=
y	=
Year 1	=

Year 2 =
Year 3 =
Year 4 =
Attorney =
Date 2 =
Date 3 =
Court =
Statute 1 =
Statute 2 =

Dear :

This letter responds to the letter dated December 7, 2018, and subsequent correspondence, submitted by your authorized representative, requesting rulings on the gift, estate, and generation-skipping transfer (GST) tax consequences of the proposed reformation of an irrevocable trust.

FACTS

The facts submitted and the representations made are as follows:

On Date 1 (a date after December 31, 2000), Settlor executed an irrevocable trust, Trust, with Spouse as Trustee, for the benefit of their six children, Child 1, Child 2, Child 3, Child 4, Child 5, and Child 6, and their descendants. Pursuant to the terms of Trust, six separate trusts, Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, and Trust 6, were established, one to benefit each child (collectively, the Children's Trusts; individually, a Child's Trust). The Children's Trusts are governed by the laws of State.

Under Paragraphs 1.02 and 2.01(2) of Trust, each child is the Primary Beneficiary of his or her Child's Trust. Property transferred to Trustee shall be allocated among the Children's Trusts equally between all of such trusts.

Paragraph 2.01(3) provides that during each Primary Beneficiary's life, the Trustee shall distribute all of the income of such beneficiary's Child Trust to the Primary Beneficiary; and may distribute such portion or all of the principal of such Child's Trust, to or for the support, maintenance, medical expenses, health and education of the Primary Beneficiary, as the Trustee, in her sole and absolute judgment and discretion, determines.

Under Paragraph 2.02(2), at the time of death of the Primary Beneficiary, such Child's Trust shall continue, in separate trust shares, *per stirpes*, for his or her lineal descendants; and upon the death of each of such respective lineal descendants, then

for such respective deceased lineal descendant's lineal descendants, in separate trust shares, *per stirpes*, for their respective lives; and so forth until such trusts terminate under Paragraph 7.01.

Paragraph 7.01 provides that any trust created under Trust, if not otherwise fully terminated, shall terminate fully and all principal and undistributed income shall be distributed to the respective income beneficiary at the end of twenty-one years after the death of the last to die of Settlor and all Primary Beneficiaries of the trusts created under Trust.

Paragraph 7.02 provides, generally, that the Trustee may receive property from the Settlor or any other person or persons, by lifetime gift, under a will or trust or from any other source. With respect to additions during any calendar year from any donor, each beneficiary may demand, for a period of thirty days immediately after each such initial contribution and any additions during any calendar year from each donor, up to the maximum amount allowable with respect to such donor as an annual exclusion for gift tax purposes within §§ 2503 and 2513, payable in cash or in kind immediately upon receipt by the Trustee of the demand in writing. Such payment shall be made from the gift of that donor for that year or from property purchased with such gift. If any such beneficiary is a minor at the time of such gift of any donor for that year, or if any such beneficiary fails in legal capacity for any reason at such time, then such beneficiary's guardian may make such demand on behalf of said beneficiary, and the property received pursuant to such demand shall be held by the guardian for the benefit of said beneficiary. The Trustee shall give written notice of the receipt of any property by the Trustee, to be held in trust hereunder, to all beneficiaries of the trust, or to the guardian of any minor beneficiary or any other beneficiary who fails in legal capacity, within thirty days of the receipt of such property.

Settlor transferred $x to each Child's Trust in Year 1, Year 2, Year 3, and Year 4. Settlor timely filed Forms 709, United States Gift (and Generation-Skipping Transfer) Tax Returns, for Year 1, Year 2, Year 3, and Year 4. On each Form 709, Settlor and Spouse signified consent to treat all gifts made by Settlor in Year 1, Year 2, Year 3, and Year 4 as having been made one-half by each spouse under § 2513. On each Form 709 for Year 1, Year 2, and Year 3, the transfers of $x to each Child's Trust were incorrectly reported on Forms 709, Schedule A, Part 1-Gifts Subject Only to Gift Tax, instead of Schedule A, Part 3-Indirect Skips. No affirmative allocation of GST exemption was made to the transfers to each Child's Trust. Furthermore, the automatic allocation of the GST exemption was not reported on Schedule C, Computation of Generation-Skipping Transfer Tax.

Grandfather transferred $y to each Child's Trust in Year 1 and Year 2. Grandfather and Grandmother timely filed Forms 709 for Year 1 and Year 2. On each Form 709, Grandfather and Grandmother signified consent to treat all gifts made by Grandfather in Year 1 and Year 2, as having been made one-half by each spouse under § 2513. On

each Form 709 for Year 1 and Year 2, the transfers of $y to each Child's Trust were incorrectly reported as an outright gift to each of Child 1 through Child 6, on Schedule A, Part 1-Gifts Subject Only to Gift Tax, instead of a gift to each Child's Trust on Schedule A, Part 2-Direct Skips. No affirmative allocation of GST exemption was made to the transfers to each Child's Trust. Furthermore, Accountant left blank Schedule C of Forms 709 for both Grandfather and Grandmother for Year 1 and Year 2.

Attorney drafted Trust. Settlor created and funded Trust relying on the advice of Attorney. Based on affidavits of Settlor and Attorney, Settlor created Trust to provide for his descendants of all generations, and to reduce the overall transfer taxes payable on Trust assets by ensuring that the assets held in Trust would not be includible in a Primary Beneficiary's gross estate upon his or her death, and to minimize the amount subject to GST tax by utilizing Settlor's and Spouse's GST exemption. Settlor also intended to ensure that the Primary Beneficiary would avoid incurring federal gift and estate tax in connection with a transfer to Trust.

The withdrawal provision in Paragraph 7.02 contains a drafting error. Each Primary Beneficiary's withdrawal right over the assets contributed to a Child's Trust in any given year is not limited to the greater of $5,000 or 5 percent of the value of the trust assets. Accordingly, any lapse of a Primary Beneficiary's withdrawal right would be treated as a taxable transfer by that Primary Beneficiary under § 2514 to the extent that the property that could have been withdrawn exceeds in value the greater of $5,000 or 5 percent of the aggregate value of the assets subject to withdrawal. Moreover, each Primary Beneficiary would become a transferor to his or her Child's Trust for GST tax purposes with respect to the portion of the Child's Trust constituting a gift by the Child, thereby preventing (i) an effective deemed allocation of GST exemption under § 2632(c) by Settlor and Spouse with respect to Settlor's transfers to that Child's Trust for each of Year 1, Year 2, Year 3, and Year 4; and (ii) an effective deemed allocation of GST exemption under § 2632(b) by Grandfather and Grandmother with respect to Grandfather's transfer to that Child's Trust for each of Year 1 and Year 2. In addition, the portion of each Child's Trust relating to the lapsed withdrawal right in excess of $5,000 or 5 percent of the value of the trust assets would be included in the Primary Beneficiary's gross estate for estate tax purposes.

The error was discovered when Settlor engaged new estate planning counsel who reviewed Settlor's current estate plan, including Trust. Settlor was informed of the drafting error that defeated the intent of the Settlor in establishing Trust. On Date 2, Trustee filed a petition in State Court requesting judicial reformation of the erroneous provision of Paragraph 7.02, effective as of the date Trust was originally created. On Date 3, State Court issued an order reforming Trust to eliminate the scrivener's error retroactive to the date of Trust's creation. The order is contingent upon the issuance of a favorable private letter ruling by the Internal Revenue Service.

As reformed, Trust limits the annual lapse of each Primary Beneficiary's withdrawal right to the greater of $5,000 or 5 percent of the value of the trust assets.
You have requested the following rulings:

1. As a result of the reformation, no Child will be deemed to have released a general power of appointment within the meaning of §§ 2514 and 2041 by reason of the lapse of any right of withdrawal held by the Child with respect to any transfers to his or her Child's Trust. Accordingly, no Child will be deemed to have made a taxable gift under § 2514 to his or her Child's Trust and no part of his or her Child's Trust will be included in his or her gross estate under § 2041.

2. As a result of the reformation, the only transferors to each Child's Trust for GST tax purposes are Settlor, Spouse, Grandfather and Grandmother.

3. As a result of the reformation, each of Settlor's and Spouse's GST exemption is automatically allocated to one-half of the transfers by Settlor to each Child's Trust and each of Grandfather's and Grandmother's GST exemption is automatically allocated to one-half of the transfers by Grandfather to each Child's Trust.

LAW AND ANALYSIS

Ruling 1

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, generally, 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 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. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts: (A) $5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

Section 2501(a)(1) provides, generally, that a tax is imposed for each calendar year on the transfer of property by gift by any individual, resident or nonresident. Section 2511(a) 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 created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that for purposes of § 2514, 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 individual possessing the power shall be considered a release of such power. The rule of the preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of the following amounts: (1) $5,000, or (2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied.

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 1 provides, in part, that a proceeding to approve or disapprove a proposed modification or termination of a trust, may be commenced by a trustee or a beneficiary.

State Statute 2 provides, in part, that the court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor's intention if it is proved by clear and convincing evidence that the settlor's intent or the terms of the trust were affected by a mistake of fact or law.

In this case, an examination of the relevant trust instruments, affidavits, and representations of the parties indicate that the original terms of Paragraph 7.02, resulting from a scrivener's error, were contrary to the intent of Settlor. The purpose of the reformation 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 as a result of the reformation of Trust, each of Settlor's children, Child 1 through Child 6, does not possess general powers of appointment over the assets of his or her respective Child's Trust, except to the extent of each Child's withdrawal right under the reformed trust instrument. As a result of the reformation, no Child will be deemed to have released a general power of appointment within the meaning of §§ 2514 and 2041 by reason of the lapse of any right of withdrawal held by the Child with respect to any transfers to his or her Child's Trust. Accordingly, no Child will be deemed to have made a taxable gift under § 2514 to his or her Child's Trust and no part of his or her Child's Trust will be included in his or her gross estate under § 2041.

Rulings 2 and 3

Section 2513(a)(1) provides, generally, that a gift made by one spouse to any person other than the donor's spouse is considered for purposes of the gift tax as made one-half by the donor and one-half by the donor's spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States.

Section 25.2513-1(b)(4) of the Gift Tax Regulations provides that the consent is effective only if both spouses signify their consent to treat all gifts made to third parties during that calendar period by both spouses while married to each other as having been made one-half by each spouse. Such consent, if signified with respect to any calendar period, is effective with respect to all gifts made to third parties during such calendar period except, in part, if one spouse transferred property in part to his or her spouse and in part to third parties, the consent is effective with respect to the interest transferred to third parties only insofar as such interest is ascertainable at the time of the gift and severable from the interest transferred to his spouse.

Section 25.2513-1(b)(5) provides that the consent applies alike to gifts made by one spouse alone and to gifts made partly by each spouse, provided such gifts were to third parties and do not fall within any of the exceptions set forth in § 25.2513-1(b)(1) through (b)(4). The consent may not be applied only to a portion of the property interest constituting such gifts. If the consent is effectively signified on either the husband's return or the wife's return, all gifts made by the spouses to third parties (except as described in subparagraphs (1) through (4) of this paragraph), during the calendar period will be treated as having been made one-half by each spouse.

Section 2601 imposes a tax on every generation-skipping transfer, which is defined under § 2611 as a taxable distribution, a taxable termination, and 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 GST 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 2631(a) provides that, 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 2652(a)(1) provides, in part, that the term "transferor" means in the case of any property subject to the tax imposed by chapter 12, the donor. Section 26.2652-1(a)(1) of the Generation-Skipping Transfer Tax Regulations provides that the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13.

Under § 26.2652-1(a)(5), *Example 5*, T transfers $10,000 to a new trust providing that the trust income is to be paid to T's child, C, for C's life and, on the death of C, the trust principal is to be paid to T's grandchild, GC. The trustee has discretion to distribute

principal for GC's benefit during C's lifetime. C has a right to withdraw $10,000 from the trust for a 60-day period following the transfer. Thereafter, the power lapses. C does not exercise the withdrawal right. The transfer by T is subject to federal gift tax because a gift tax is imposed under § 2501(a) (without regard to exemptions, exclusions, deductions, and credits) and, thus, T is treated as having transferred the entire $10,000 to the trust. On the lapse of the withdrawal right, C becomes a transferor to the extent C is treated as having made a completed transfer for purposes of chapter 12. Therefore, except to the extent that the amount with respect to which the power of withdrawal lapses exceeds the greater of $5,000 or 5 percent of the value of the trust property, T remains the transferor of the trust property for purposes of chapter 13.

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 this chapter.

Section 26.2652-1(a)(4) provides that in the case of a transfer with respect to which the donor's spouse makes an election under § 2513 to treat the gift as made one-half by the spouse, the electing spouse is treated as the transferor of one-half of the entire value of the property transferred by the donor, regardless of the interest the electing spouse is actually deemed to have transferred under § 2513. The donor is treated as the transferor of one-half of the value of the entire property.

Section 2632(a)(1) 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.

Under § 2632(b)(1), if an individual makes a direct skip transfer during his or her lifetime, any unused portion of such individual's GST exemption is automatically allocated to the property transferred to the extent necessary to make the inclusion ratio zero. Under § 2612(c)(1), the term "direct skip" means a transfer subject to tax imposed by chapter 11 or 12 of an interest in property to a skip person.

Section 26.2632-1(b)(1)(ii) provides, in part, that an automatic allocation of GST exemption is effective as of the date of the transfer to which it relates. A Form 709 need not be filed to report an automatic allocation.

Section 2632(c)(1) provides that if any individual makes an indirect skip during such individual's 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.

Section 2632(c)(3)(A) provides that for purposes of § 2632(c), the term "indirect skip" means any transfer of property (other than a direct skip) subject to the tax imposed by

chapter 12 made to a GST trust. Section 2632(c)(3)(B) provides, in part, that the term "GST trust" means a trust that could have a generation-skipping transfer with respect to the transferor unless the exceptions enumerated in (i) through (vi) apply.

Section 2642(b)(1)(A) provides, in part, 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)).

In this case, each Child's Trust is a GST Trust for purposes of § 2632(c). Settlor and Spouse timely filed Forms 709 for Year 1, Year 2, Year 3, and Year 4, signifying their consent to treat the gifts made in each of Year 1, Year 2, Year 3, and Year 4, to each Child's Trust as having been made one-half by each spouse under § 2513. Accordingly, under § 2652(a)(2), Settlor and Spouse will be treated as the transferor of one-half of the value of the entire property transferred to each Child's Trust in Year 1, Year 2, Year 3, and Year 4. Based on the facts presented and the representations made, we rule that the automatic allocation rules under § 2632(c)(1) apply to allocate Settlor's and Spouse's GST exemption to one-half of the transfers of property made to each Child's Trust in each of Year 1, Year 2, Year 3, and Year 4.

Grandfather and Grandmother timely filed Forms 709 for Year 1 and Year 2, signifying their consent to treat the gifts made in each of Year 1 and Year 2 to each Child's Trust as having been made one-half by each spouse under § 2513. Accordingly, under § 2652(a)(2), Grandfather and Grandmother will be treated as the transferor of one-half of the value of the entire property transferred to each Child's Trust in Year 1 and Year 2. Based on the facts presented and the representations made, we rule that the automatic allocation rules under § 2632(b)(1) apply to allocate Grandfather's and Grandmother's GST exemption to one-half of the transfers of property made to each Child's Trust in each of Year 1 and Year 2.

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

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.

Sincerely,

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

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

cc: