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Telephone Number: \_\_\_\_\_

Refer Reply To:  
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Date:  
January 21, 2022

Re: Ruling Request

Legend

Grantor	=
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	=
Trustee	=
Court	=
State A	=

State B =  
 State A Statute 1 =  
 State A Statute 2 =  
 Date 1 =  
 Date 2 =  
 Date 3 =  
 Date 4 =  
 Date 5 =  
 Date 6 =  
 Year 1 =  
 Year 2 =  
 Bank =  
 Individual =  
x =  
y =  
z =  
w =  
 Case 1 =  
 Case 2 =  
 Case 3 =

Dear :

This letter responds to your letter, dated July 12, 2021, submitted by your authorized representative, requesting income, gift, estate, and generation-skipping transfer (GST) tax rulings with respect to a judicial modification of certain trusts.

On Date 1, Grantor created an irrevocable trust, Trust, for the benefit of his children, Child 1 through Child 6, and their descendants. In Years 1 and 2, Grantor and his spouse, Spouse, made gifts to Trust and allocated their respective GST exemption to those gifts, resulting in an inclusion ratio of x. No additional contributions were made to Trust. Years 1 and 2 are years after September 25, 1985.

Article 2.01(a) of Trust provides that the trustee may distribute the net income and principal to Grantor's descendants, at such times and in such amounts, shares and interests as the trustee determines.

Article 2.03(a) provides that Trust will terminate on the earlier of (1) the exhaustion of the trust estate, or (2) the later of y years after Date 1 or the date of Grantor's death.

Article 2.03(b) provides that as soon as practical following termination of Trust, the trustee shall distribute any property remaining in the trust estate to Grantor's then living descendants. If none of Grantor's descendants is then living, the trustee shall

distribute the trust estate to one or more qualified charities selected by the trustee, in such amounts, shares and interests as the trustee shall determine.

Article 3.01 and 3.03 provides that if upon termination of Trust property is distributable to a person which is incapacitated, notwithstanding the provision under which such property is distributable, the trustee shall hold such property in trust for the beneficiary. Such trust shall terminate on the earlier of (1) the exhaustion of the trust estate, (2) the earliest on which the beneficiary is no longer incapacitated or (3) the date of the beneficiary's death.

Article 4.07 provides that the trustee's discretionary power to make outright distributions of principal to a beneficiary of a trust includes the power to make distributions in further trust for the beneficiary on such terms as the trustee determines. The trustee may not exercise the foregoing power in a way that violates the applicable rules against perpetuities or similar rules, and any attempt to do so shall be ineffectual.

Article 6.02(p) provides that the trustee has the power to divide any trust into two or more separate trusts with terms identical to those of the original trust. With respect to the separate trusts, the trustee may make tax elections differently, exercise discretionary powers differently, and invest the property comprising the trusts differently.

At the time Trust was executed, State A Statute 1 provided that when a nonvested property interest is created, the interest must vest or terminate no later than twenty-one years after the death of an individual then alive; or vest or terminate within ninety years after its creation.

On Date 2, the trustee of Trust entered into six new irrevocable trust agreements, creating six new trusts, Trusts 1 through 6. The provisions of the six new trusts are substantially the same as Trust, except that each separate trust agreement is for the benefit of one of the six children of Grantor (Child 1 through Child 6) and the child's descendants. On Date 2, the trustee exercised the power conferred upon him pursuant to Article 4.07 of Trust and distributed nearly all of the assets of Trust, in equal shares, to the respective trustees of Trusts 1 through 6. Trusts 1 through 6 are funded solely with assets from Trust and these trusts have not received any additional funding.

Article 2.11(h) of each new trust agreement grants Trust Protector the power to remove any trustee of any trust created under the trust agreement.

Article 2.11(k) of each new trust agreement grants Trust Protector the power to modify the trusts agreements to "[c]orrect ambiguities, including scrivener's errors, that might otherwise require court construction or reformation."

Article 3.04 provides that the trustee of each new trust, other than an Interested Trustee, may distribute to the Primary Beneficiary (one of the six children for whom the trust is created) and any one or more of the Primary Beneficiary's descendants, as

much of the net income and principal of his or her trust as the trustee may determine is advisable for any purpose.

Article 3.10 provides that each new trust will terminate at the time provided in Article 8.01. Upon termination, if directed by the exercise of a testamentary limited power of appointment, the trustee shall divide the trust into a charitable portion and noncharitable portion. The charitable portion shall be distributed to the charities named in the power of appointment in the proportions allocated. The trustee shall divide the remaining trust property into equal shares for the then living descendants of the Child, *per stirpes*. The share for any beneficiary that has attained the age of z shall be distributed outright to that beneficiary. The shares for all other beneficiaries shall be held in trust under the same terms and conditions of the new trust until the beneficiary attains the age of z, at which time the remaining principal and accumulated income shall be distributed outright to the beneficiary.

Article 5 of each new trust provides terms for administration of trusts for underage and incapacitated beneficiaries.

Article 8.01 of each new trust agreement provides that, notwithstanding any other provision of the trust agreement, unless terminated earlier under other provisions of the agreement, each trust created under the agreement will terminate upon the earlier of: (a) the latter of the date twelve months after the date a controlling interest of Bank or its successor is sold by the descendants of Grantor and Spouse or the date seventy-five years after the date of the death of Child, or (b) the expiration of the longest period that property may be held in trust under this agreement without violating the applicable rule against perpetuities. The trustee may also extend the period provided in subsection (a) by a period of twenty-five years if it determines that it is in the best interests of the beneficiaries to do so. If the applicable rule against perpetuities for trusts is determined by reference to the death of the last to die among a group of individuals living on the date of this agreement is signed, the group of individuals shall consist of the descendants of the paternal and maternal grandparents of the respective child and the descendants of Individual, who are living at the time the trust agreement is signed. At that time, the remaining trust property shall vest in and be distributed in accordance with the provisions of Article 3.06.

Article 8.04 provides that Trust Protector may, at any time, remove all or any part of the property or the situs of administration of the trust from one jurisdiction to another.

Article 8.06(d) provides that the new trust agreement shall be governed, construed and administered according to the laws of State A.

A few months prior to the execution of Trusts 1 through 6, State A modified State A Statute 1 to provide that interests must vest w years from the date of its creation. State A Statute 2.

Grantor died on Date 3, survived by all of his six children.

On Date 4, Trust Protector exercised his power to remove the trustee and replaced the trustee with the predecessor of the current trustee, Trustee, located in State B. Trust Protector also exercised his power to change the situs of administration of the trusts from State A to State B. However, State A law continued to govern the validity of the trusts, including the issue of whether the trusts violate a rule against perpetuities.

On the same date, Trust Protector also exercised his power to correct Article 8.01 of the new trusts. Article 8.01 specifically referenced death of the last to die among a group of individuals living on the “date of this agreement is signed” and identifies a class of individuals “who are living at the time this agreement is signed.” Trust was modified to provide that the rule against perpetuities for the trusts is determined by reference to the death of the last to die among a group of individuals living on a date an interest is created and the group of individuals consist of descendants of the respective child and Individual who were living on Date 1, the date Trust was created.

On Date 5, Trustee petitioned Court to reform Trusts 1 through 6 so that each new trust is consistent with Grantor’s intent in creating Trust and that each new trust is subject to State A Statute 1, which was in effect when Trust was created. Trustee expressed concern that if the “applicable rule against perpetuities” referenced in Article 8.01(a) is construed to mean the State A Statute 2, rather than State A Statute 1, the trusts would last longer than Grantor intended and the validity of the trusts could be brought into question. It is represented that Grantor intended that the interests of the beneficiaries vest no later than a period provided by State A Statute 1, which is comparable to the period allowed for extending the vesting of interests in a GST exempt trust under § 26.2601-1(b)(4)(i)(A). Trustee asserts that the scrivener made a mistake by not adding a phrase providing that the new trusts are subject to the rule against perpetuities in existence at the time that Trust was created.

Trustee also asserts that there is an ambiguity in Article 3.10, which requires the trusts to terminate according to the termination provisions of Article 8.01 of Trust. However, Article 3.10 includes conflicting language providing that any share for a beneficiary who is under age z is to be held in trust until he or she reaches that age. The conflicting language which extends the trusts for beneficiaries under age z is inconsistent with the intent of the Grantor and the draftsman that the interests of the beneficiaries vest no later than a period provided by the State A Statute 1 in effect when Trust was created. Accordingly, Trustee asserts that the continuation of property in trust for persons under age z in Article 3.10 was a scrivener’s error.

Finally, Trustee asserts that a scrivener’s error resulted in an incorrect cross reference at the end of Article 8.01 of each trust agreement. Article 8.01 states that upon the trust’s termination, the trust property shall vest in and be distributed in accordance with the provisions of Article 3.06. However, section 3.10, not Article 3.06,

is the provision pertaining to the distribution of trust property upon its termination. Article 3.10 appropriately cross references Article 8.01.

Under State B law, Court has the authority to reform a trust under common law if there is clear and convincing proof that there was a mistake in the drafting of the trust instrument and that the parties' actual agreement was not accurately reflected in their executed agreement. See Cases 1, 2, and 3.

On Date 6, Court ordered that Article 8.01 of Trusts 1 through 6 be reformed to provide that each trust, if not earlier terminated, must terminate upon the earlier of: (a) the latter of the date twelve months after the date a controlling interest of Bank or its successor is sold by the descendants of Grantor and Spouse, or the date seventy-five years after the death of Child, or (b) the date which is immediately prior to the expiration of 21 years after the death of the last to die among the descendants of the paternal and maternal grandparents of Child and the descendants of Individual, who were living on Date 1, which is the date Trust was created. At that time, the remaining trust property will vest in and be distributed in accordance with section 3.10. The last two sentences of Article 3, section 3.10 are removed and replaced with the following new sentence: The share for each individual shall be distributed outright to the beneficiary, subject only to Article 5.

You have requested the following rulings:

1. The reformation of Trusts 1 through 6 to correct scrivener's errors pursuant to Court order does not give rise to any taxable income or cause Child 1 through 6 or Trusts 1 through 6 to recognize gain or loss on the sale or disposition of any trust property.
2. The transfer of Trust assets to Trusts 1 through 6 and the reformation of Trusts 1 through 6 to correct scrivener's errors pursuant to Court order does not alter the inclusion ratio of Trust or Trusts 1 through 6.
3. The reformation of Trusts 1 through 6 will not result in Child 1 through 6 making a taxable gift.
4. The reformation of Trusts 1 through 6 to correct scrivener's errors pursuant to Court order will not cause any portion of Trusts 1 through 6 to be included in Child 1 through 6's gross estate prior to the termination of Trusts 1 through 6.

## Law and Analysis

### Ruling #1

Section 61(a)(3) of the Internal Revenue Code provides that gross income includes all income from whatever source derived, including gains derived from dealings in property and under § 61(a)(15), from an interest in a trust.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c) the entire amount of gain or loss on the sale or exchange of property shall be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

Accordingly, based on the information submitted and the representations made, we conclude that there will be no sale or other disposition because there will be no transfer of money or property. In accordance with Court's order, the changes to Trusts 1 through 6 clarify Grantor's original intent. If Court determines that a trust agreement contains ambiguities or mistakes and resolves those ambiguities or mistakes in a way that effectuates the testator's intentions, there is no disposition event for purposes of § 1001. Therefore, neither Trusts 1 through 6 nor Child 1 through 6 will recognize gain or loss under § 1001 upon reformation in accordance with Court's Order. The amendments to Trusts 1 through 6 will not cause Child 1 through 6 or Trusts 1 through 6 to recognize any gain or loss from sale or other disposition of property under §§ 61 and 1001.

### Ruling #2

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

Section 2631 provides that every individual is allowed a GST exemption amount which may be allocated by the individual or the individual's executor to any property with respect to which the individual is the transferor.

Section 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations provide that the GST tax is not applicable to any GST under a trust that was irrevocable on September 25, 1985, but

shall apply to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Trust and Trusts 1 through 6 became irrevocable after September 25, 1985. Grantor and Spouse each allocated his/her respective GST exemption to create an inclusion ratio of  $\underline{x}$  in Trust. No guidance has been issued concerning judicial modifications that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to create an inclusion ratio, as opposed to obtaining a GST exempt status under the Act and § 26.2601-1(b)(1). At a minimum, a modification that would not affect the GST status of a trust that was irrevocable on September 25, 1985, should similarly not affect the exempt status of such a trust. Accordingly, the following regulations are applied to determine whether the transfer of assets from Trust to Trusts 1 through 6 and the reformation of Trusts 1 through 6 pursuant to Court order will not cause a change in the inclusion ratio in Trust and Trusts 1 through 6.

Section 26.2601-1(b)(1)(v) provides, in relevant part, that where any portion of a trust remains in the trust after the post-September 25, 1985 release, exercise, or lapse of a power of appointment over the portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

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 GST tax under § 26.2601-1(b)(1), (b)(2), or (b)(3), will not cause the trust to lose its exempt status. The rules of § 26.2601-1(b)(4)(i) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus (unless specifically noted), 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 any beneficiary, or may result in the realization of gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(A) provides, in part, that the distribution of trust principal from an exempt trust to a new trust or retention of trust principal in a continuing trust will not cause the new trust or continuing trust to be subject to the provisions of chapter 13, if (1) the terms of the governing instrument of the exempt trust authorize distributions to the new trust or the retention of trust principal in a continuing trust, without the consent or approval of any beneficiary or court; and (2) the terms of the governing instrument of the new or continuing trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date the original trust became irrevocable, extending beyond



any life in being at the date the original trust became irrevocable plus a period of 21 years, plus if necessary, a reasonable period of gestation.

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 be subject to the provisions of chapter 13, 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 (b)(4)(i)(A), (B), or (C) of this section) 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.

In this case, pursuant to Article 4.07 of Trust, the trustee exercised its discretionary authority to transfer the assets of Trust to Trusts 1 through 6. This exercise satisfies the requirement of § 26.2601-1(b)(4)(i)(A)(1). The exercise of such authority must also satisfy § 26.2601-1(b)(4)(i)(A)(2) which requires Trusts 1 through 6 to retain the same perpetuities period as set forth in Trust. In this case, Article 8.01, Perpetuities Termination Provision, of Trusts 1 through 6 could be interpreted to extend the period for vesting of interests in the property of Trusts 1 through 6 for a period longer than allowed under § 26.2601-1(b)(4)(i)(A)(2). When Trust was executed, State A Statute 1 met the requirements of this subparagraph. However, immediately prior to the execution of Trusts 1 through 6, State A Statute 1 was modified and replaced with State A Statute 2, which is at odds with the requirements of subparagraph (2). The failure of Trusts 1 through 6 to expressly provide that State A Statute 1 continued to apply created ambiguities. As such the language in Trusts 1 through 6 could be interpreted to provide for a rule against perpetuities that extends beyond the requirements under § 26.2601-1(b)(4)(i)(A)(2). It is represented that Grantor and Spouse never intended Trusts 1 through 6 to extend the time for vesting beyond the period in Trust. It is represented that Grantor intended that the "applicable rule against perpetuities" of Article 8.01 of Trusts 1 through 6 would satisfy subparagraph (2). Court Order reforms Article 8.01 and Article 3.10 to conform to the requirements of § 26.2601-1(b)(4)(i)(A)(2). Accordingly, the reformation of Trusts 1 through 6 pursuant to Court order satisfies the requirements of subparagraph (2). Accordingly, based upon the facts submitted and representations made, we conclude that the transfer and subsequent reformation of Trusts 1 through 6 satisfy the requirements of § 26.2601-1(b)(4)(i)(A). Therefore, we conclude that the transfer of Trust assets to Trusts 1 through 6 and the reformation of Trusts 1 through 6 will not alter the inclusion ratio of the trusts.

### Ruling #3

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year 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 25.2511-1(c) provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

In this case, the reformation of Trusts 1 through 6 by Court order will not change the beneficial interests of Child 1 through Child 6 in Trusts 1 through 6, respectively. Accordingly, based upon the facts submitted and representations made, we conclude that the reformation of Trusts 1 through 6 pursuant to Court order will not cause Child 1 through 6 to make gifts for purposes of § 2501.

### Ruling #4

Section 2001 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 includes the value of all property to the extent of the interest therein of the decedent at the time of his or her death.

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 the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for life or for any period not ascertainable without reference to the decedent's death or for any period that does not in fact end before the death the possession or enjoyment of, or the right to the income from, the property, or the right,

either alone or in conjunction with any persons, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides, generally, 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 (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 3-year period ending on the date of the decedent's death.

Section 2038(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, 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.

For §§ 2036, 2037, or 2038 to apply, a decedent must have made a transfer of property of any interest therein (except in case of a bona fide sale for adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property.

In this case, the reformation of Trusts 1 through 6 pursuant to Court order does not constitute a transfer within the meaning of §§ 2036, 2037, or 2038. Accordingly, based upon the facts submitted and representations made, we conclude that the property of Trusts 1 through 6 will not be included in the respective gross estates of Child 1 through Child 6 by reason of the order.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter 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.

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,

Lorraine E. Gardner

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

Enclosure:

Copy for § 6110 purpose

cc: