

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09 / PLR-123590-02
Date:
December 4, 2002

Legend

- Trust 1 =
- Date 1 =
- Grantor =
- Date 2 =
- Daughter =
- Granddaughter =
- Grandson =
- Trust 2 =
- Court =
- Date 3 =
- State =

Dear :

This letter responds to your letter, dated April 25, 2002, submitted on behalf of Trust 1, requesting rulings under §§ 2501 and 2601 of the Internal Revenue Code.

On Date 1, Grantor created Trust 1 and executed a will. In her will, Grantor exercised a power of appointment under father's will creating Trust 2.

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Article VI, paragraph A, sub-paragraph 3 of Grantor's will states that upon the death of the survivor of my husband and Daughter, Trust 2 shall terminate and shall thereupon be distributed in equal shares, one share to each child of Daughter then living, and one share per stirpes to the then living issue of each child of Daughter not living at the termination of Trust 2.

Section 2.D.3.c. of Trust 1 provides that upon the death of Grantor's Daughter, the trustee shall divide and apportion the trust estate as then constituted into equal shares. One such equal share shall be set aside for each child of Grantor's Daughter, then living, and one such equal share shall be set aside "for the living issue of each grandchild of Grantor."

Section 2.D.3.c.i. provides that each share apportioned to the issue of a deceased grandchild shall forthwith be distributed per stirpes to such deceased grandchild's issue free of trust.

Section 8 of Trust 1 provides that Trust 1 shall be deemed a State trust and shall in all respects be governed and interpreted under the laws of State.

Section 9 of the Trust 1 agreement provides that from and after Grantor's death, the trust created herein shall be irrevocable.

Grantor died on Date 2. Grantor's Daughter is now living. Daughter has one child, Granddaughter, now living, and one child, Grandson, now deceased. Granddaughter has three children now living, and Grandson is survived by two children (collectively referred to as great-grandchildren).

The trustees of Trust 1 petitioned Court to correct a scrivener's error in Section 2.D.3.c. of Trust 1. They asserted that in preparing Grantor's Trust 1 the drafting attorney inadvertently omitted the word "deceased" between "each" and "grandchild" in the section describing the division of shares among Grantor's great-grandchildren on Daughter's death. They further asserted that the inclusion of Section 2.D.3.c.i. was evidence of the scrivener's error. In addition, the trustees submitted affidavits from the drafting attorney and one of the witnesses. The drafting attorney and the witness both expressed an opinion that the word "deceased" was inadvertently omitted from the distribution provision in Section 2.D.3.c. of Trust 1.

The adult beneficiaries, the natural guardians of a minor beneficiary and a contingent beneficiary entered into a consent agreement that generally provides the beneficiaries' agree that the omission of "deceased" in Section 2.D.3.c. of Trust 1 was a scrivener's error. Paragraphs 3-6 of the agreement describe the inconsistencies in the distribution provision between the Trust 1 agreement and the provisions for Trust 2 found in Grantor's will. Paragraph 7 references the affidavit of the drafting attorney concerning the Grantor's intent for distribution of the Trust 1 assets. Paragraph 8

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provides that the parties intended that the family agreement be submitted to the Court in support of a petition for interpretation and clarification of the Trust 1 agreement. The beneficiaries have represented that no consideration was paid or received by any party that signed the family agreement other than the mutual promises and covenants contained in the family agreement.

On Date 3, Court issued an order correcting the scrivener's error in order to effectuate Grantor's intent by adding the word "deceased" between "each" and "grandchild" in Section 2.D.3.c.

Section 2.D.3.c. of the Trust 1 agreement, as modified by the Date 3 court order, provides that upon the death of Grantor's Daughter, the trustee shall divide and apportion the trust estate as then constituted into equal shares. One such equal share shall be set aside for each child of Grantor's Daughter, then living, and one such equal share shall be set aside for the living issue of each deceased grandchild of Trustor.

The trustee of Trust 1 has requested the following rulings: (1) the proposed judicial reformation of Trust 1 adding the word "deceased" before the word "grandchild" in paragraph 2.D.3.c. to correct the scrivener's error will not affect Trust 1's status as exempt from the generation-skipping transfer tax under § 2601; and (2) the proposed judicial reformation with a family agreement among the interested parties agreeing to such reformation, will not result a taxable gift or transfer under § 2501.

The trustee represents that there have been no additions to Trust 1 since September 25, 1985.

Ruling Request 1

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term "generation-skipping transfer" to include a taxable distribution, taxable termination, and a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(ii)(A) provides that, except as provided in § 26.2601-1(b)(1)(ii)(B) or (C), any trust in existence on September 25, 1985, is considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042.

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In the present case, Trust 1 is considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(4) 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)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its 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)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if (1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

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 (1) the judicial action involves a bona fide issue; and (2) 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)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy § 26.2601-1(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 in the original trust. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

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State law provides that State courts have exclusive jurisdiction over proceedings concerning the internal affairs of trusts, including the administration and distribution of trusts, a declaration of rights and determination of other matters involving trustees and beneficiaries of trusts. These proceedings include, but are not limited to, proceedings to ascertain beneficiaries, determine any question arising in the administration or distribution of any trust including questions of construction of trust instruments, instruct trustees and determine the existence or nonexistence of any immunity, power, privilege, duty or right. State law further provides that a family may submit for court approval a family agreement which explains (1) the need for a family agreement and that (2) the agreement is fair and reasonable. The law further provides that if there are minors or unborn issue, this fact should be addressed within the agreement.

The judicial construction resolves an ambiguity in the Trust 1 agreement by correcting a scrivener's error. The judicial action involves a bona fide issue and the construction, including the contemporaneous family agreement, is consistent with applicable State law. Therefore, we conclude that the construction and correction of the scrivener's error will not affect the exempt status of Trust 1.

Ruling Request 2

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual, resident or nonresident.

Section 2511(a) provides that the tax imposed by § 2501 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.

The judicial construction clarifies the terms and beneficiaries of a previous transfer in accordance with the Grantor's intent. No money or other property was exchanged between the parties as a condition of execution of the family agreement. Therefore, the judicial construction and contemporaneous family agreement does not result in a taxable gift or transfer under § 2501.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal 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 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.

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Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the trustee of Trust 1.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Chief, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure

Copy of this letter for § 6110 purposes