



# WRNewswire

## An AALU Washington Report

Monday, 03 April 2017

WRN# 17.04.03

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### **TOPIC: Modifications to Correct Scrivener's Errors and Ambiguities to Pre-1985 Trusts Won't Effect GST Tax Exempt Status**

The IRS has privately ruled on how certain trust modifications impact the trust's GST tax exempt status. The facts in a series of PLRs involved trustees who had petitioned a court to resolve the drafting attorney's inadvertent omission of trust provisions that would have: (1) directed the distribution of assets if the primary beneficiary died without surviving descendants and (2) allocated shares to the descendants of a deceased child of the settlor's daughters. The PLRs ruled that, due to the administrative ambiguities caused by these omissions, trust modifications to correct these errors would not cause the trust to lose its GST exempt status. See PLR 201712003; PLR 201712004; PLR 201712005.

[View PLR 201712003](#)

[View PLR 201712004](#)

[View PLR 201712005](#)

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**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **201712003**  
Release Date: 3/24/2017  
Index Number: 2601.00-00

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Re:

Refer Reply To:  
CC:PSI:B04  
PLR-120963-16  
Date: November 29, 2016

Legend

- Trustor =
- Date 1 =
- Trust =
- Trust 1 =
- Trust 2 =
- Trust 3 =
- Daughter 1 =
- Daughter 2 =
- Daughter 3 =
- Date 2 =
- Trustees =
- Date 3 =
- Court =
  
- State =
- Statute =
- Cite 1 =
  
- Cite 2 =
- Cite 3 =

Dear \_\_\_\_\_:

This letter responds to your letter dated June 27, 2016, requesting a ruling regarding the generation-skipping transfer consequences to a court-ordered modification to a trust.

The facts and representations made are as follows.

On Date 1, Trustor created an irrevocable trust, Trust, to benefit his three daughters, Daughter 1, Daughter 2, and Daughter 3. Date 1 is a date prior to September 25, 1985. Pursuant to the terms of Trust, three separate trusts (Trust 1, Trust 2, and Trust 3) were established, one to benefit each daughter. Each daughter is the Primary Beneficiary of her trust. The three trusts are situated in State and are administered under the laws of State. This private letter ruling pertains to Trust 1 benefitting Daughter 1.

Article III, paragraph A. of Trust provides that during the Primary Beneficiary's lifetime, the Trustees may, from time to time, distribute to or for the benefit of each Primary Beneficiary so much of the corpus and income of her trust as the Trustees determine in their discretion. The income of a trust not so distributed shall be accumulated and added to the corpus of the trust.

Article III, paragraph B. provides that the Trustees may also, from time to time, distribute to or for the benefit of the issue of such Primary Beneficiary at such times and in such amounts as they in their sole discretion determine.

Article III, paragraph C. provides that upon the death of a Primary Beneficiary, the Trustees shall divide such deceased Primary Beneficiary's trust into as many equal shares as there are children of such deceased Primary Beneficiary surviving and deceased children thereof leaving issue surviving. Thereafter, one such share shall be allocated for the benefit of each surviving child of such deceased Primary Beneficiary, and one such share shall be allocated collectively for the benefit of the surviving issue of a deceased child of such Primary Beneficiary who leaves issue then surviving.

Article III, paragraph C.1. provides that the separate shares to a surviving child (Secondary Beneficiary) of a deceased Primary Beneficiary shall be held and managed as a separate trust. The Trustees may, from time to time, distribute to or for the benefit of each such Secondary Beneficiary so much of the corpus and income of his or her trust as the Trustees determine in their discretion. Under paragraph C.1., the Secondary Beneficiary may withdraw one-third of the principal of his or her trust at the age of 25; one-half of the principal of his or her trust at the age of 30; and the remaining balance of his or her trust at the age of 35.

Article III, paragraph C.2. provides that if a Secondary Beneficiary dies before receiving final distribution of his or her trust, then the balance shall be paid over and distributed equally to such Secondary Beneficiary's surviving issue by right of representation. But if such Secondary Beneficiary leaves no issue surviving, then all of his or her trust shall be paid over and distributed equally to the other Secondary Beneficiaries or their issue, such issue, however, taking by right of representation only the share which their parent would have received if living.

Paragraph C.4. provides that, if any amounts become distributable to persons who have not then attained the age of 21, then such distributee's share shall continue to be held in trust for his or her benefit and the Trustees shall pay to or for the benefit of such distributee so much of the net income and principal that the Trustees in their sole discretion deem necessary or advisable to provide for the proper care, support, and education of such distributee. When such distributee attains the age of 21, any balance held for his or her benefit shall be paid over and distributed to him or her outright. If such distributee dies before attaining age 21, then upon the death of such distributee, any remaining portion of such trust for his or her benefit shall be paid over and distributed to the surviving issue of the child of such deceased Secondary Beneficiary who was his or her parent, by right of representation. If no issue of his or her parent survives him, then to Trustor's heirs-of-law as determined at that time.

Article III, paragraph C.5. provides that if at any time before final distribution of the trust estate there shall not be in existence any one who is or might become entitled to receive benefits therefrom, any portion of the trust estate then remaining shall be paid over and distributed as follows: (a) one-half in equal shares to Trustor's two sisters or to their surviving issue by right of representation, and (b) one-half to Trustor's wife's parents, or the survivor of them.

Two omissions were made by the attorney in drafting the dispositive provisions of Trust. First, Trust fails to include a provision directing how assets are to be distributed if the Primary Beneficiary dies without surviving issue. Second, Trust contains no dispositive provisions for any share allocated to the issue of a deceased child of Trustor's daughters. When Trustor executed Trust, he was not aware that the terms of Trust did not contain these distributive provisions.

On Date 2, Trustor executed an affidavit to confirm that he intended to create separate trusts for each daughter. He assumed each daughter would die with surviving issue and he intended that the assets of each separate trust would be administered and distributed under Article III of Trust as follows:

1. To or for the benefit of Trustor's daughters for whom each separate trust was created for her lifetime.
2. In the case of a deceased daughter leaving surviving issue, to or for the benefit of the surviving issue of said daughter for whom the separate trust was initially created.
3. In the case of a deceased daughter leaving no surviving issue, to be divided equally between the separate trusts of Trustor's then-living daughters and the then-living issue of any deceased daughter by right of representation.

4. If all of Trustor's daughters and all of their issue are deceased, then, and only then, would the remaining trusts assets be distributed to Trustor's more remote family members named in Trust.

Trustees petitioned Court to modify the terms of Article III of Trust to resolve the ambiguities in conformance with Trustor's intentions. On Date 3, Court issued an order that modifies and restates Trust as follows:

Article III, paragraphs A. and B. are not modified.

Article III, paragraph C. is divided into two paragraphs, C. and D. Paragraph C. contains provisions for Trust 1 in the event a Primary Beneficiary dies leaving no surviving issue, and paragraph D. contains provisions for Trust 1 in the event a Primary Beneficiary dies leaving surviving issue.

Paragraph C. provides that upon the death of a Primary Beneficiary who leaves no surviving issue, the assets of such deceased Primary Beneficiary's trust will be divided into as many shares as there are: (i) Primary Beneficiaries who are then living and (ii) Primary Beneficiaries who are then deceased but are survived by issue. One share is to be allocated to each living Primary Beneficiary and one share is to be allocated to each deceased Primary Beneficiary with surviving issue. Thereafter, any share of a living Primary Beneficiary will be distributed to a separate trust of such Primary Beneficiary established under Trust. Any share of a deceased Primary Beneficiary with surviving issue will be distributed to the issue of such deceased Primary Beneficiary by right of representation; provided that if an issue of the deceased Primary Beneficiary is a beneficiary of a separate trust established under Trust, the property that is otherwise distributable to such person will not be distributed outright to such person, but is to be instead added to such separate trust to be held and distributed as provided therein.

Paragraph D. provides that upon the death of a Primary Beneficiary leaving surviving issue, the Trustees shall divide such deceased Primary Beneficiary's trust into as many equal shares as there are children of such deceased Primary Beneficiary surviving and deceased children thereof leaving issue surviving. Thereafter, one such share shall be allocated for the benefit of each surviving child of such deceased Primary Beneficiary, and one such share shall be allocated collectively for the benefit of the surviving issue of a deceased child of such Primary Beneficiary who leaves issue then surviving.

Subject to Article IV, after such allocation, such shares shall be held and distributed as follows, *i.e.*, pursuant to sections 1. through 4 of Article III. Sections 1. through 4. are substantively unchanged, except to incorporate new paragraph D. Section 5 and section 6 are unchanged and renamed paragraph E and paragraph F, respectively.

The modifications are contingent upon the trustees receiving a favorable private letter ruling from the Internal Revenue Service.

Trust was irrevocable prior to September 25, 1985. The Trustees represent that there have been no additions to Trust after September 25, 1985.

### Ruling Request

Trustees request a ruling that the Court-ordered modifications of Trust to correct the scrivener's errors and resolve ambiguities related to the administration and distribution of Trust 1 upon the death of Daughter 1 will not cause Trust 1 to lose its GST exempt status or cause the provisions of chapter 13 to apply to any generation-skipping transfers made under Trust 1.

### Law and Analysis

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST). Section 2611(a) provides that, for purposes of the GST tax, the term "generation-skipping transfer" means (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (the Act), the 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 § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Regulations, the tax does not apply to any generation-skipping transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died on September 25, 1985.

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 GST tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in this paragraph 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 a beneficiary, or may result in the realization of 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 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)(E), *Example 3*, considers a situation where, 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 GST tax.

State Statute provides that a court may reform the terms of a trust to conform to the trustor's intention if the failure to conform was due to a mistake of fact or law and the trustor's intent can be established. State Statute is a codification of the court's common law equitable power of courts to reform a trust upon a showing of factors, including mistake. See Cite 1. See also Cite 2, which quotes the rule that

[w]here an instrument is drawn or executed, which professes or is intended to carry into execution an agreement . . . previously entered into, but which, by mistake of the draftsman, either as to fact or law, does not fulfill that intention, or violates it, equity will correct that mistake so as to produce a conformity to the agreement.

If the language of the trust instrument is not clear, construction of an ambiguous trust instrument is a question of law to be decided by the court. See Cite 3. In interpreting a trust instrument, all words and provisions appearing in the trust are given effect as far as possible and none are cast aside as meaningless, but where the trust instrument is ambiguous, extrinsic evidence can be used to determine a trustor's intent. See *Id.*

In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the Supreme 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 rules 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 this case, the two omissions, described above, created ambiguities in Trust. Trustees petitioned Court to construe Trust in order to resolve the ambiguities. This judicial action involved bona fide issues. An examination of the relevant trust instruments and representations of the parties indicate that Trustor intended to create separate trusts to provide for his three daughters and their respective surviving issue. Further, Trustor assumed that each daughter would die with surviving issue and he intended that the assets of each separate trust would be administered and distributed under Article III of Trust to each daughter for that daughter's lifetime, and then for a deceased daughter's surviving issue. Trustor intended that in the event a deceased daughter left no surviving issue, then that daughter's trust would be divided equally between the separate trusts of the then-living daughters and the then-living issue of any deceased daughter by right of representation. Further, Trustor intended that if all of his daughters and all of their issue are deceased, then, and only then, would the remaining trust assets be distributed to Trustor's more remote family members. Accordingly, we conclude that the Court-ordered modifications to Trust are consistent with applicable State law that would be applied in the highest court of State.

Therefore, based upon the facts presented and the representations made, we conclude that the Court-ordered modifications of Trust to correct the scrivener's errors and resolve ambiguities related to the administration and distribution of Trust 1 upon the death of Daughter 1 will not cause Trust 1 to lose its GST exempt status or cause the provisions of chapter 13 to apply to any GST made under Trust 1.

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,

Leslie H. Finlow

Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for section 6110 purposes

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **201712004**  
Release Date: 3/24/2017  
Index Number: 2601.00-00

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Re:

Refer Reply To:  
CC:PSI:B04  
PLR-120964-16  
Date: November 29, 2016

Legend

- Trustor =
- Date 1 =
- Trust =
- Trust 1 =
- Trust 2 =
- Trust 3 =
- Daughter 1 =
- Daughter 2 =
- Daughter 3 =
- Date 2 =
- Trustees =
- Date 3 =
- Court =
  
- State =
- Statute =
- Cite 1 =
  
- Cite 2 =
- Cite 3 =

Dear \_\_\_\_\_ :

This letter responds to your letter dated June 27, 2016, requesting a ruling regarding the generation-skipping transfer consequences to a court-ordered modification to a trust.

The facts and representations made are as follows.

On Date 1, Trustor created an irrevocable trust, Trust, to benefit his three daughters, Daughter 1, Daughter 2, and Daughter 3. Date 1 is a date prior to September 25, 1985. Pursuant to the terms of Trust, three separate trusts (Trust 1, Trust 2, and Trust 3) were established, one to benefit each daughter. Each daughter is the Primary Beneficiary of her trust. The three trusts are situated in State and are administered under the laws of State. This private letter ruling pertains to Trust 2 benefitting Daughter 2.

Article III, paragraph A. of Trust provides that during the Primary Beneficiary's lifetime, the Trustees may, from time to time, distribute to or for the benefit of each Primary Beneficiary so much of the corpus and income of her trust as the Trustees determine in their discretion. The income of a trust not so distributed shall be accumulated and added to the corpus of the trust.

Article III, paragraph B. provides that the Trustees may also, from time to time, distribute to or for the benefit of the issue of such Primary Beneficiary at such times and in such amounts as they in their sole discretion determine.

Article III, paragraph C. provides that upon the death of a Primary Beneficiary, the Trustees shall divide such deceased Primary Beneficiary's trust into as many equal shares as there are children of such deceased Primary Beneficiary surviving and deceased children thereof leaving issue surviving. Thereafter, one such share shall be allocated for the benefit of each surviving child of such deceased Primary Beneficiary, and one such share shall be allocated collectively for the benefit of the surviving issue of a deceased child of such Primary Beneficiary who leaves issue then surviving.

Article III, paragraph C.1. provides that the separate shares to a surviving child (Secondary Beneficiary) of a deceased Primary Beneficiary shall be held and managed as a separate trust. The Trustees may, from time to time, distribute to or for the benefit of each such Secondary Beneficiary so much of the corpus and income of his or her trust as the Trustees determine in their discretion. Under paragraph C.1., the Secondary Beneficiary may withdraw one-third of the principal of his or her trust at the age of 25; one-half of the principal of his or her trust at the age of 30; and the remaining balance of his or her trust at the age of 35.

Article III, paragraph C.2. provides that if a Secondary Beneficiary dies before receiving final distribution of his or her trust, then the balance shall be paid over and distributed equally to such Secondary Beneficiary's surviving issue by right of representation. But if such Secondary Beneficiary leaves no issue surviving, then all of his or her trust shall be paid over and distributed equally to the other Secondary Beneficiaries or their issue, such issue, however, taking by right of representation only the share which their parent would have received if living.

Paragraph C.4. provides that, if any amounts become distributable to persons who have not then attained the age of 21, then such distributee's share shall continue to be held in trust for his or her benefit and the Trustees shall pay to or for the benefit of such distributee so much of the net income and principal that the Trustees in their sole discretion deem necessary or advisable to provide for the proper care, support, and education of such distributee. When such distributee attains the age of 21, any balance held for his or her benefit shall be paid over and distributed to him or her outright. If such distributee dies before attaining age 21, then upon the death of such distributee, any remaining portion of such trust for his or her benefit shall be paid over and distributed to the surviving issue of the child of such deceased Secondary Beneficiary who was his or her parent, by right of representation. If no issue of his or her parent survives him, then to Trustor's heirs-of-law as determined at that time.

Article III, paragraph C.5. provides that if at any time before final distribution of the trust estate there shall not be in existence any one who is or might become entitled to receive benefits therefrom, any portion of the trust estate then remaining shall be paid over and distributed as follows: (a) one-half in equal shares to Trustor's two sisters or to their surviving issue by right of representation, and (b) one-half to Trustor's wife's parents, or the survivor of them.

Two omissions were made by the attorney in drafting the dispositive provisions of Trust. First, Trust fails to include a provision directing how assets are to be distributed if the Primary Beneficiary dies without surviving issue. Second, Trust contains no dispositive provisions for any share allocated to the issue of a deceased child of Trustor's daughters. When Trustor executed Trust, he was not aware that the terms of Trust did not contain these distributive provisions.

On Date 2, Trustor executed an affidavit to confirm that he intended to create separate trusts for each daughter. He assumed each daughter would die with surviving issue and he intended that the assets of each separate trust would be administered and distributed under Article III of Trust as follows:

1. To or for the benefit of Trustor's daughters for whom each separate trust was created for her lifetime.
2. In the case of a deceased daughter leaving surviving issue, to or for the benefit of the surviving issue of said daughter for whom the separate trust was initially created.
3. In the case of a deceased daughter leaving no surviving issue, to be divided equally between the separate trusts of Trustor's then-living daughters and the then-living issue of any deceased daughter by right of representation.

4. If all of Trustor's daughters and all of their issue are deceased, then, and only then, would the remaining trusts assets be distributed to Trustor's more remote family members named in Trust.

Trustees petitioned Court to modify the terms of Article III of Trust to resolve the ambiguities in conformance with Trustor's intentions. On Date 3, Court issued an order that modifies and restates Trust as follows:

Article III, paragraphs A. and B. are not modified.

Article III, paragraph C. is divided into two paragraphs, C. and D. Paragraph C. contains provisions for Trust 1 in the event a Primary Beneficiary dies leaving no surviving issue, and paragraph D. contains provisions for Trust 1 in the event a Primary Beneficiary dies leaving surviving issue.

Paragraph C. provides that upon the death of a Primary Beneficiary who leaves no surviving issue, the assets of such deceased Primary Beneficiary's trust will be divided into as many shares as there are: (i) Primary Beneficiaries who are then living and (ii) Primary Beneficiaries who are then deceased but are survived by issue. One share is to be allocated to each living Primary Beneficiary and one share is to be allocated to each deceased Primary Beneficiary with surviving issue. Thereafter, any share of a living Primary Beneficiary will be distributed to a separate trust of such Primary Beneficiary established under Trust. Any share of a deceased Primary Beneficiary with surviving issue will be distributed to the issue of such deceased Primary Beneficiary by right of representation; provided that if an issue of the deceased Primary Beneficiary is a beneficiary of a separate trust established under Trust, the property that is otherwise distributable to such person will not be distributed outright to such person, but is to be instead added to such separate trust to be held and distributed as provided therein.

Paragraph D. provides that upon the death of a Primary Beneficiary leaving surviving issue, the Trustees shall divide such deceased Primary Beneficiary's trust into as many equal shares as there are children of such deceased Primary Beneficiary surviving and deceased children thereof leaving issue surviving. Thereafter, one such share shall be allocated for the benefit of each surviving child of such deceased Primary Beneficiary, and one such share shall be allocated collectively for the benefit of the surviving issue of a deceased child of such Primary Beneficiary who leaves issue then surviving.

Subject to Article IV, after such allocation, such shares shall be held and distributed as follows, *i.e.*, pursuant to sections 1. through 4 of Article III. Sections 1. through 4. are substantively unchanged, except to incorporate new paragraph D. Section 5 and section 6 are unchanged and renamed paragraph E and paragraph F, respectively.

The modifications are contingent upon the trustees receiving a favorable private letter ruling from the Internal Revenue Service.

Trust was irrevocable prior to September 25, 1985. The Trustees represent that there have been no additions to Trust after September 25, 1985.

### Ruling Request

Trustees request a ruling that the Court-ordered modifications of Trust to correct the scrivener's errors and resolve ambiguities related to the administration and distribution of Trust 2 upon the death of Daughter 2 will not cause Trust 2 to lose its GST exempt status or cause the provisions of chapter 13 to apply to any generation-skipping transfers made under Trust 2.

### Law and Analysis

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST). Section 2611(a) provides that, for purposes of the GST tax, the term "generation-skipping transfer" means (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (the Act), the 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 § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Regulations, the tax does not apply to any generation-skipping transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died on September 25, 1985.

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 GST tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in this paragraph 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 a beneficiary, or may result in the realization of 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 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)(E), *Example 3*, considers a situation where, 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 GST tax.

State Statute provides that a court may reform the terms of a trust to conform to the trustor's intention if the failure to conform was due to a mistake of fact or law and the trustor's intent can be established. State Statute is a codification of the court's common law equitable power of courts to reform a trust upon a showing of factors, including mistake. See Cite 1. See also Cite 2, which quotes the rule that

[w]here an instrument is drawn or executed, which professes or is intended to carry into execution an agreement . . . previously entered into, but which, by mistake of the draftsman, either as to fact or law, does not fulfill that intention, or violates it, equity will correct that mistake so as to produce a conformity to the agreement.

If the language of the trust instrument is not clear, construction of an ambiguous trust instrument is a question of law to be decided by the court. See Cite 3. In interpreting a trust instrument, all words and provisions appearing in the trust are given effect as far as possible and none are cast aside as meaningless, but where the trust instrument is ambiguous, extrinsic evidence can be used to determine a trustor's intent. See *Id.*

In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the Supreme 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 rules 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 this case, the two omissions, described above, created ambiguities in Trust. Trustees petitioned Court to construe Trust in order to resolve the ambiguities. This judicial action involved bona fide issues. An examination of the relevant trust instruments and representations of the parties indicate that Trustor intended to create separate trusts to provide for his three daughters and their respective surviving issue. Further, Trustor assumed that each daughter would die with surviving issue and he intended that the assets of each separate trust would be administered and distributed under Article III of Trust to each daughter for that daughter's lifetime, and then for a deceased daughter's surviving issue. Trustor intended that in the event a deceased daughter left no surviving issue, then that daughter's trust would be divided equally between the separate trusts of the then-living daughters and the then-living issue of any deceased daughter by right of representation. Further, Trustor intended that if all of his daughters and all of their issue are deceased, then, and only then, would the remaining trust assets be distributed to Trustor's more remote family members. Accordingly, we conclude that the Court-ordered modifications to Trust are consistent with applicable State law that would be applied in the highest court of State.

Therefore, based upon the facts presented and the representations made, we conclude that the Court-ordered modifications of Trust to correct the scrivener's errors and resolve ambiguities related to the administration and distribution of Trust 1 upon the death of Daughter 2 will not cause Trust 2 to lose its GST exempt status or cause the provisions of chapter 13 to apply to any GST made under Trust 2.

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,

Leslie H. Finlow

Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for section 6110 purposes

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **201712005**  
Release Date: 3/24/2017  
Index Number: 2601.00-00

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B04  
PLR-120965-16  
Date: November 29, 2016

Re:

Legend

- Trustor =
- Date 1 =
- Trust =
- Trust 1 =
- Trust 2 =
- Trust 3 =
- Daughter 1 =
- Daughter 2 =
- Daughter 3 =
- Date 2 =
- Trustees =
- Date 3 =
- Court =
  
- State =
- Statute =
- Cite 1 =
  
- Cite 2 =
- Cite 3 =

Dear \_\_\_\_\_ :

This letter responds to your letter dated June 27, 2016, requesting a ruling regarding the generation-skipping transfer consequences to a court-ordered modification to a trust.

The facts and representations made are as follows.

On Date 1, Trustor created an irrevocable trust, Trust, to benefit his three daughters, Daughter 1, Daughter 2, and Daughter 3. Date 1 is a date prior to September 25, 1985. Pursuant to the terms of Trust, three separate trusts (Trust 1, Trust 2, and Trust 3) were established, one to benefit each daughter. Each daughter is the Primary Beneficiary of her trust. The three trusts are situated in State and are administered under the laws of State. This private letter ruling pertains to Trust 3 benefitting Daughter 3.

Article III, paragraph A. of Trust provides that during the Primary Beneficiary's lifetime, the Trustees may, from time to time, distribute to or for the benefit of each Primary Beneficiary so much of the corpus and income of her trust as the Trustees determine in their discretion. The income of a trust not so distributed shall be accumulated and added to the corpus of the trust.

Article III, paragraph B. provides that the Trustees may also, from time to time, distribute to or for the benefit of the issue of such Primary Beneficiary at such times and in such amounts as they in their sole discretion determine.

Article III, paragraph C. provides that upon the death of a Primary Beneficiary, the Trustees shall divide such deceased Primary Beneficiary's trust into as many equal shares as there are children of such deceased Primary Beneficiary surviving and deceased children thereof leaving issue surviving. Thereafter, one such share shall be allocated for the benefit of each surviving child of such deceased Primary Beneficiary, and one such share shall be allocated collectively for the benefit of the surviving issue of a deceased child of such Primary Beneficiary who leaves issue then surviving.

Article III, paragraph C.1. provides that the separate shares to a surviving child (Secondary Beneficiary) of a deceased Primary Beneficiary shall be held and managed as a separate trust. The Trustees may, from time to time, distribute to or for the benefit of each such Secondary Beneficiary so much of the corpus and income of his or her trust as the Trustees determine in their discretion. Under paragraph C.1., the Secondary Beneficiary may withdraw one-third of the principal of his or her trust at the age of 25; one-half of the principal of his or her trust at the age of 30; and the remaining balance of his or her trust at the age of 35.

Article III, paragraph C.2. provides that if a Secondary Beneficiary dies before receiving final distribution of his or her trust, then the balance shall be paid over and distributed equally to such Secondary Beneficiary's surviving issue by right of representation. But if such Secondary Beneficiary leaves no issue surviving, then all of his or her trust shall be paid over and distributed equally to the other Secondary Beneficiaries or their issue, such issue, however, taking by right of representation only the share which their parent would have received if living.

Paragraph C.4. provides that, if any amounts become distributable to persons who have not then attained the age of 21, then such distributee's share shall continue to be held in trust for his or her benefit and the Trustees shall pay to or for the benefit of such distributee so much of the net income and principal that the Trustees in their sole discretion deem necessary or advisable to provide for the proper care, support, and education of such distributee. When such distributee attains the age of 21, any balance held for his or her benefit shall be paid over and distributed to him or her outright. If such distributee dies before attaining age 21, then upon the death of such distributee, any remaining portion of such trust for his or her benefit shall be paid over and distributed to the surviving issue of the child of such deceased Secondary Beneficiary who was his or her parent, by right of representation. If no issue of his or her parent survives him, then to Trustor's heirs-of-law as determined at that time.

Article III, paragraph C.5. provides that if at any time before final distribution of the trust estate there shall not be in existence any one who is or might become entitled to receive benefits therefrom, any portion of the trust estate then remaining shall be paid over and distributed as follows: (a) one-half in equal shares to Trustor's two sisters or to their surviving issue by right of representation, and (b) one-half to Trustor's wife's parents, or the survivor of them.

Two omissions were made by the attorney in drafting the dispositive provisions of Trust. First, Trust fails to include a provision directing how assets are to be distributed if the Primary Beneficiary dies without surviving issue. Second, Trust contains no dispositive provisions for any share allocated to the issue of a deceased child of Trustor's daughters. When Trustor executed Trust, he was not aware that the terms of Trust did not contain these distributive provisions.

On Date 2, Trustor executed an affidavit to confirm that he intended to create separate trusts for each daughter. He assumed each daughter would die with surviving issue and he intended that the assets of each separate trust would be administered and distributed under Article III of Trust as follows:

1. To or for the benefit of Trustor's daughters for whom each separate trust was created for her lifetime.
2. In the case of a deceased daughter leaving surviving issue, to or for the benefit of the surviving issue of said daughter for whom the separate trust was initially created.
3. In the case of a deceased daughter leaving no surviving issue, to be divided equally between the separate trusts of Trustor's then-living daughters and the then-living issue of any deceased daughter by right of representation.

4. If all of Trustor's daughters and all of their issue are deceased, then, and only then, would the remaining trusts assets be distributed to Trustor's more remote family members named in Trust.

Trustees petitioned Court to modify the terms of Article III of Trust to resolve the ambiguities in conformance with Trustor's intentions. On Date 3, Court issued an order that modifies and restates Trust as follows:

Article III, paragraphs A. and B. are not modified.

Article III, paragraph C. is divided into two paragraphs, C. and D. Paragraph C. contains provisions for Trust 1 in the event a Primary Beneficiary dies leaving no surviving issue, and paragraph D. contains provisions for Trust 1 in the event a Primary Beneficiary dies leaving surviving issue.

Paragraph C. provides that upon the death of a Primary Beneficiary who leaves no surviving issue, the assets of such deceased Primary Beneficiary's trust will be divided into as many shares as there are: (i) Primary Beneficiaries who are then living and (ii) Primary Beneficiaries who are then deceased but are survived by issue. One share is to be allocated to each living Primary Beneficiary and one share is to be allocated to each deceased Primary Beneficiary with surviving issue. Thereafter, any share of a living Primary Beneficiary will be distributed to a separate trust of such Primary Beneficiary established under Trust. Any share of a deceased Primary Beneficiary with surviving issue will be distributed to the issue of such deceased Primary Beneficiary by right of representation; provided that if an issue of the deceased Primary Beneficiary is a beneficiary of a separate trust established under Trust, the property that is otherwise distributable to such person will not be distributed outright to such person, but is to be instead added to such separate trust to be held and distributed as provided therein.

Paragraph D. provides that upon the death of a Primary Beneficiary leaving surviving issue, the Trustees shall divide such deceased Primary Beneficiary's trust into as many equal shares as there are children of such deceased Primary Beneficiary surviving and deceased children thereof leaving issue surviving. Thereafter, one such share shall be allocated for the benefit of each surviving child of such deceased Primary Beneficiary, and one such share shall be allocated collectively for the benefit of the surviving issue of a deceased child of such Primary Beneficiary who leaves issue then surviving.

Subject to Article IV, after such allocation, such shares shall be held and distributed as follows, *i.e.*, pursuant to sections 1. through 4 of Article III. Sections 1. through 4. are substantively unchanged, except to incorporate new paragraph D. Section 5 and section 6 are unchanged and renamed paragraph E and paragraph F, respectively.

The modifications are contingent upon the trustees receiving a favorable private letter ruling from the Internal Revenue Service.

Trust was irrevocable prior to September 25, 1985. The Trustees represent that there have been no additions to Trust after September 25, 1985.

### Ruling Request

Trustees request a ruling that the Court-ordered modifications of Trust to correct the scrivener's errors and resolve ambiguities related to the administration and distribution of Trust 3 upon the death of Daughter 3 will not cause Trust 3 to lose its GST exempt status or cause the provisions of chapter 13 to apply to any generation-skipping transfers made under Trust 3.

### Law and Analysis

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer (GST). Section 2611(a) provides that, for purposes of the GST tax, the term "generation-skipping transfer" means (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (the Act), the 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 § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Regulations, the tax does not apply to any generation-skipping transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died on September 25, 1985.

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 GST tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in this paragraph 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 a beneficiary, or may result in the realization of 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 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)(E), *Example 3*, considers a situation where, 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 GST tax.

State Statute provides that a court may reform the terms of a trust to conform to the trustor's intention if the failure to conform was due to a mistake of fact or law and the trustor's intent can be established. State Statute is a codification of the court's common law equitable power of courts to reform a trust upon a showing of factors, including mistake. See Cite 1. See also Cite 2, which quotes the rule that

[w]here an instrument is drawn or executed, which professes or is intended to carry into execution an agreement . . . previously entered into, but which, by mistake of the draftsman, either as to fact or law, does not fulfill that intention, or violates it, equity will correct that mistake so as to produce a conformity to the agreement.

If the language of the trust instrument is not clear, construction of an ambiguous trust instrument is a question of law to be decided by the court. See Cite 3. In interpreting a trust instrument, all words and provisions appearing in the trust are given effect as far as possible and none are cast aside as meaningless, but where the trust instrument is ambiguous, extrinsic evidence can be used to determine a trustor's intent. See *Id.*

In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the Supreme 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 rules 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 this case, the two omissions, described above, created ambiguities in Trust. Trustees petitioned Court to construe Trust in order to resolve the ambiguities. This judicial action involved bona fide issues. An examination of the relevant trust instruments and representations of the parties indicate that Trustor intended to create separate trusts to provide for his three daughters and their respective surviving issue. Further, Trustor assumed that each daughter would die with surviving issue and he intended that the assets of each separate trust would be administered and distributed under Article III of Trust to each daughter for that daughter's lifetime, and then for a deceased daughter's surviving issue. Trustor intended that in the event a deceased daughter left no surviving issue, then that daughter's trust would be divided equally between the separate trusts of the then-living daughters and the then-living issue of any deceased daughter by right of representation. Further, Trustor intended that if all of his daughters and all of their issue are deceased, then, and only then, would the remaining trust assets be distributed to Trustor's more remote family members. Accordingly, we conclude that the Court-ordered modifications to Trust are consistent with applicable State law that would be applied in the highest court of State.

Therefore, based upon the facts presented and the representations made, we conclude that the Court-ordered modifications of Trust to correct the scrivener's errors and resolve ambiguities related to the administration and distribution of Trust 3 upon the death of Daughter 3 will not cause Trust 3 to lose its GST exempt status or cause the provisions of chapter 13 to apply to any GST made under Trust 3.

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,

*Leslie H. Finlow*

Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

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