

Internal Revenue Service

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ATTN:

Re:

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:04

PLR-148687-13

Date:

May 28, 2014

LEGEND

Testator =

Year =

Date 1 =

Date 2 =

Grandson =

Trust =

Bank =

Real Property =

Academy =

Date 3 =

Superior Court =

Date 4 =

x =

y =

z =

Date 5 =

Issue 1 =

Issue 2 =

Issue 3 =

Issue 4 =

Issue 5 =

Issue 6 =

Issue 7 =

Issue 8 =

Probate Court =

State =

Statute 1 =
Statute 2 =
Case 1 =

Case 2 =

Case 3 =
Case 4 =

Dear :

This letter responds to your authorized representative's letter, dated November 21, 2013, in which you request rulings on the gift and generation-skipping transfer (GST) tax consequences of a judicial construction and modification of a trust.

FACTS

The facts submitted and representations made are as follows:

Testator died testate in Year, leaving a valid will with codicil, dated Date 1 and Date 2, respectively. Year, Date 1, and Date 2 are dates that precede September 25, 1985. Testator's will established several trusts at his death, including Trust for the benefit of Grandson and Grandson's "blood issue." The trustee of Trust is Bank.

Article FIFTEENTH of Testator's will provides, in relevant part, that after the disposition of other assets, the rest, residue and remainder of the trust estate passes to Trust. After specific disbursements of income to other beneficiaries, the remaining net annual income is to be paid to Grandson for life. Upon Grandson's death, the assets of Trust, including both principal and any undistributed income, is to be disposed of, "in cash or in kind," as the trustee deems, as follows: (1) Any and all lands and buildings located in Real Property is bequeathed and devised "to such of the blood issue of my grandson [Grandson] as shall survive him, by right of representation"; (2) One-third of the remaining trust estate is to be set apart and continued in trust for the benefit of Academy; and (3) The remaining two-thirds of the trust estate is "to be divided equally among [Grandson's "blood issue"], by right of representation."

Article SEVENTEENTH provides, in relevant part, that the trustee:

shall care for, manage and control the trust property, with full power to change the form thereof, to sell and convey in fee simple any real estate which may at any time become a part of the trust without license from any court and without obligation to furnish bond, and to invest and reinvest the trust estate from time to time and at any time as it in its judgment may deem expedient.

On Date 3, the trustee of Trust filed a civil complaint in Superior Court seeking construction of the will with respect to the trustee's authority to sell the Real Property under Article SEVENTEENTH. On Date 4, Superior Court granted summary judgment in favor of the trustee, holding that the trustee held an unrestricted power of sale over Real Property pursuant to Article SEVENTEENTH. Several years later, trustee sold a portion of Real Property (Sold Real Property) for approximately \$x, and segregated the proceeds from the sale in a separate account of Trust. The proceeds from the sale of Sold Real Property that remain in Trust are now valued at approximately \$y (Proceeds). The portion of Real Property that was not sold (Remaining Real Property) continues to be held by Trust. The remaining balance of Trust assets (including the Remaining Real Property) is approximately \$z.

Grandson died on Date 5. Grandson's "blood issue" consists of Issue 1 and her two adult children (Issue 2 and Issue 3) and Issue 4 and her four minor children (Issue 5, Issue 6, Issue 7, and Issue 8) (collectively, Grandson's Issue).

Bank, as trustee, proposes to file a petition in Probate Court for judicial construction and modification of Trust. In its petition, Bank states that while Article SEVENTEENTH provides for the sale of Real Property, the terms of Trust make no corresponding provision for retention and disposition of any proceeds of such sale in lieu of conveying the Real Property itself. The terms of Trust do not provide the trustee with terms for holding or administering Proceeds or conveying them upon Grandson's death. Further, Bank contends that it is "affirmatively directed to convey real property specifically in kind and [Trust] does not address the disposition of proceeds upon a sale of the real property." Consequently, Bank contends that ambiguities exist in the Trust's terms which present a bona fide trust management and distribution issue.

Accordingly, Bank will petition Probate Court to construe the specific devise of Real Property as directing a disposition of the Remaining Real Property and the Proceeds, and to modify the dispositive terms of Trust to direct that the remaining assets of Trust, including both principal and any undistributed income, be disposed of as follows:

- (1) The Remaining Real Property will be distributed outright to Grandson's Issue, by right of representation;
- (2) The Proceeds will be distributed outright to Grandson's Issue, by right of representation;
- (3) One-third of Trust assets remaining after distribution of the Proceeds will be held in trust for the benefit of Academy; and
- (4) Two-thirds of Trust assets remaining after distribution of the Proceeds will be distributed outright to Grandson's Issue, by right of representation.

Furthermore, inasmuch as the term “by right of representation” is not defined in the will or any State statute, Bank also requests that Probate Court construe “by right of representation” to mean *per stirpes* for distribution purposes under Trust. Accordingly, Issue 1 and Issue 4 are to receive the distributions to Grandson’s Issue as identified above.

Trust was irrevocable on September 25, 1985, and the trustee represents that there have been no additions to Trust after September 25, 1985.

You request the following rulings:

1. The proposed judicial construction and modification of Trust will not cause Trust to lose its status as exempt from GST tax within the meaning of § 2601 and § 26.2601-1(b)(4)(i) of the Generation-Skipping Transfer Tax Regulations.
2. The proposed distribution of the Proceeds to Grandson’s Issue by right of representation will not constitute a gratuitous transfer from any beneficiary of Trust that will be subject to federal gift tax under § 2501.
3. The proposed judicial construction of the phrase “by right of representation,” as used in Trust, to constitute distribution of Trust assets *per stirpes*, will not cause Trust to lose its status as exempt from GST tax within the meaning of § 2601 and § 26.2601-1(b)(4)(i).

LAW AND ANALYSIS

Rulings 1 and 3

Section 2601 of the Internal Revenue Code 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.

Under § 1433 of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, provided that no additions (actual or constructive) were made to the trust after that date.

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), (2), or (3) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the

trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the GST provisions 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 filed a construction suit with the appropriate local court to resolve the ambiguity. The court issued 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.

In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

Trust is governed by the laws of State. Under State law, a judicial proceeding involving a trust may relate to any matter involving the trust's administration, including a request for instructions and an action to declare rights. Statute 1. Further, State law provides that the court may modify the administrative or dispositive terms of a trust or terminate the trust if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust. Statute 2. See *Case 1*. To the extent practicable, the modification must be made in accordance with the settlor's probable intention. *Id.*

State does not have a statute that explicitly defines by right of representation. However, prior to the enactment of State Uniform Probate Code, *Case 2*, stated that “to inherit by right of representation is synonymous with inheritance *per stirpes*.”

In *Case 3*, testator devised the residue of his estate to his children and their heirs in equal shares. The testator’s will further authorized the executors to sell any or all of testator’s real estate at such time as they may see fit, and to invest the proceeds safely. The Supreme Court of State held that the testator expressly gave a naked power to his executors to “convey such real estate for the purposes of the conversion of the same into money, which should have the place of the real estate and go to the devisees in the place thereof.” See *also Case 4* (“A mere change of property from one form to another cannot, in itself, divest the owner, or those who have distance and immediate rights in the thing in its original shape, or their property in it.”).

In this case, Bank, as trustee of Trust, proposes to file a petition with Probate Court to resolve the ambiguity in Testator’s will regarding the distribution of the Proceeds from a partial sale of the Real Property. The Proceeds of the Sold Real Property have been and remain segregated, but the will is silent as to the retention and disposition of any proceeds of such sale in lieu of conveying the Real Property itself. Moreover, neither the will nor any State statute defines “by right of representation” for purposes of distributing the assets of Trust. Probate Court’s construction will resolve a bona fide issue regarding the proper management and distribution of assets in Trust. Accordingly, based on the facts presented and the representations made, and provided Probate Court approves the proposed petition for construction as described herein, we conclude that the judicial construction and modification of Trust to interpret the ambiguities in Testator’s will are consistent with applicable State law that would be applied in the highest court of State. Therefore, we conclude that the proposed construction and modification of Trust will not cause Trust to lose its status as exempt from the GST tax under § 2601 and § 26.2601-1(b)(4)(i).

Ruling 2

Section 2501(a) imposes a gift tax for each calendar year on the transfer of property by gift during the year by an individual.

Section 2511 provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 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 an adequate 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 a gift.

Article FIFTEENTH provides the disposition of the Real Property to Grandson's "blood issue...by right of representation." One-third of the remaining trust estate is to be held in trust for the benefit of Academy while two-thirds of the remaining trust estate is to be distributed outright to Grandson's "blood issue." The proposed judicial construction to resolve the ambiguity in Testator's will regarding the distribution of the Proceeds of the Sold Real Property will not result in any direct transfer between any of the beneficiaries of Trust. Because the beneficial interests, rights and expectancies of the beneficiaries are the same both before and after the proposed judicial construction and modification, no gratuitous transfer of property will be deemed to occur as a result of the distribution from Trust. Accordingly, based on the facts presented and the representations made, and provided Probate Court approves the proposed petition for construction as described herein, we conclude that the proposed distribution of the Proceeds to Grandson's Issue by right of representation will not constitute a gratuitous transfer from any beneficiary of Trust that will be subject to federal gift tax under § 2501.

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.

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

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.

Sincerely,

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

Enclosures (2)

cc: