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RE:

### Legend

Father	=
Decedent	=
Trust	=
Bank	=
Child 1	=
Child 2	=
Child 3	=
Child 4	=
Grandchild 1	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
Date 10	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Child 1 Trust	=
Child 2 Trust	=
Child 3 Trust	=

Child 4 Trust =

Attorney =

Court =

a =

b =

c =

County =

State =

Citation =

Statute 1 =

Statute 2 =

Statute 3 =

Dear :

This letter responds to your authorized representative's letter dated December 6, 2019, and subsequent correspondence, requesting rulings on the federal income, gift, estate, and generation-skipping transfer (GST) tax consequences of judicial modifications and constructions of Trust.

The facts and representations submitted are as follows.

Decedent died testate on Date 1, survived by Child 1, Child 2, Child 3, Child 4, and grandchildren, including Grandchild 1.

### Trust

Father, Decedent's father, died testate on Date 2, a date before September 25, 1985. Decedent, Child 1, Child 2, Child 3, Child 4, and Grandchild 1 were alive on Date 2.

Trust is a testamentary trust created under Article III, Paragraph B, of the Will of Father, dated Date 3, Codicil, dated Date 4, and Second Codicil, dated Date 5 (collectively, Father's Will). Trust was created for the benefit of Decedent and descendants of Father. It is represented that no actual or constructive additions were made to Trust. Bank is the Trustee of Trust.

Under Article III, Paragraph B(1) of Father's Will, the trustees shall pay and distribute first to Decedent, at regular intervals out of income or earnings of trust, as the trustees in their sole discretion may determine for his comfortable support and maintenance; second, to or for the account of, the issue of Decedent, any one or more of them, so much of the remainder of the income and earnings of Trust (in such proportions and in such amounts as between them as the trustees elect in their sole discretion for their education, support and maintenance. Any excess income shall be accumulated and added to the principal of Trust.

Under Article III, Paragraph B(2) of Father's Will, the trustees may pay over to Decedent so much or all of the principal of Trust, as the trustees may, in their absolute discretion, deem advisable.

Article III, Paragraph B(3) of Father's Will provides, in part, that Trust shall cease and terminate upon the death of Decedent, and all of the then assets and properties shall vest in, and become a part of, and be distributed to, or in trust for the benefit of, such person or persons or party or parties, upon such conditions and estates with such powers, in such manner, and at such time or times as Decedent, may effectively direct and appoint by his last Will and Testament (other than and excluding the estate of Decedent, and any of the creditors either of Decedent, or of his estate), among any child, grandchild or more remote issue of Decedent; any child, grandchild or more remote issue of Father; or any spouse of a child, grandchild or more remote issue of Father. In default of appointment, the assets of Trust shall vest to Decedent's then living issue, *per stirpes*.

Article III, Paragraph F of Father's Will provides that Trust shall terminate not later than twenty-one years after the decease of the last survivor of Father's wife, Father's sons, and any more remote issue who shall be living at the time of Father's decease.

Article III, Paragraph I of Father's Will provides that the then living adult beneficiaries of the trusts herein created acting through their unanimous decision shall have the right, power and authority at any time and from time to time to discharge the original corporate trustee (Bank) or any successor corporate trustee then serving as trustee of the trusts created pursuant to this Will; provided that such then living adult beneficiaries of the trusts created pursuant to this Will shall immediately designate and appoint a successor corporate trustee, who will accept and qualify as such, a bank or trust company domiciled in County, State, having a capital and surplus of not less than \$a dollars. Where any corporate trustee is so discharged by such adult beneficiaries acting herein pursuant to the authority hereinabove granted to them so to do, the successor corporate trustee appointed and designated by such adult beneficiaries shall succeed to all of the rights, duties, powers, authorities and discretions of the corporate trustee so removed and shall administer such trust created pursuant to this will, subject to all of the terms, conditions and provisions respectively applicable thereto.

Article V, Paragraph 23 of Father's Will provides that each trustee shall have the right, power and authority to determine what is principal and what is income of any trust and in their uncontrolled discretion, to allocate or apportion receipts and expenses as between principal and income. The trustees' allocation or apportionment shall be conclusive.

Article V, Paragraph 31 of Father's Will provides that Trust is governed by the law of State.

#### Prior Judicial Proceedings

Trust has been the subject of three prior judicial proceedings in Year 1, Year 2, and Year 3.

In Year 1, Court modified Article III, Paragraph I of Father's Will with respect to the power of the beneficiaries to discharge a corporate trustee and appoint a successor corporate trustee (Year 1 Modification).

In Year 2, Court further modified Article III, Paragraph I of Father's Will with respect to the power of the beneficiaries to appoint a successor corporate trustee that is a bank or trust with a capital surplus of not less than \$b (Year 2 Modification).

In Year 3, Court interpreted the term "earnings" as used in Section III, Paragraph B(1) of Father's Will, and determined that capital gains in the assets of the trust estate of the Trust constitute "earnings." Accordingly, Bank, as Trustee, may distribute "capital gains" to the issue of Decedent pursuant to the provisions of Trust (Year 3 Declaratory Judgment).

#### Decedent's Will

Decedent executed a Last Will, dated Date 6, a First Codicil, dated Date 7, and a Second Codicil, dated Date 8 (collectively Decedent's Will and Codicils).

Pursuant to Article Two of Decedent's Will, Decedent exercised the power of appointment over the Trust assets granted to him pursuant to Article III, Paragraph B(3) of Father's Will.

Article Two, Paragraph 1(a) of Decedent's Will provides the following:

I direct the trustees of the Decedent Exempt Trust distribute such one (1) share to the trustee of the trust under paragraph 2 of this Article for each child of mine who survives me; PROVIDED, HOWEVER, that to the extent any child of mine who survives me has received a distribution from the [Trust] during my lifetime such child's share shall be reduced by c percent (c%) of such distribution, which c percent (c%) shall be allocated equally among the other shares under subparagraphs 1(a) and 1(b) of this Article. [Emphasis added.]

Article Two, Paragraph 2(a) of Decedent's Will provides that the trustee shall pay to or apply for the benefit of the beneficiary all of the net income and principal of the trust as the trustee may determine is necessary and advisable for the health, education, support and maintenance of the beneficiary in accordance with the beneficiary's accustomed manner of living.

Article Two, Paragraph 2(b) of Decedent's Will provides that upon the beneficiary's death, the beneficiary may appoint the property of the trust to or for the benefit of such persons or entities other than the beneficiary, the beneficiary's creditors, the

beneficiary's estate, or creditors of the beneficiary's estate. Any unappointed balance of the trust is distributed to the then living descendants of the beneficiary, by right of representation, to be held in trust under Article Two of Decedent's Will. If the beneficiary has no living descendants, then the trust is distributed to the then living descendants of Decedent, by right of representation, to be held in trust under Article Two of Decedent's Will.

Article Two, Paragraph 3 of Decedent's Will provides as follows:

Notwithstanding any provision to the contrary contained in the foregoing paragraph 2, in no event shall any trust under this Article continue, by reason of the provisions of the foregoing paragraph 3 or otherwise, longer than the Maximum Duration for Trusts, as defined in this paragraph, and unless sooner terminated pursuant to the provisions of paragraph 3, each such trust shall altogether terminate at the end of Maximum Duration for Trusts. The principal and undistributed income of a terminated trust shall be distributed to the then income beneficiaries of that trust in the same proportion that the beneficiaries are entitled to receive income when the trust terminates. If at the time of such termination the rights to income are not fixed by the terms of the trust, distributions under this clause shall be made, by right of representation, to the persons who are entitled or authorized, in the trustee's discretion, to receive trust payments. The "Maximum Duration for Trusts" means the longest period that property may be held in trust under this will under the applicable rules governing perpetuities, vesting, accumulations, the suspension of alienation, and the like (including any applicable period in gross such as twenty-one (21) years or ninety (90) years). The Maximum Duration for Trusts also means the full period that the trust has beneficiaries, without external limitation, if applicable rules governing perpetuities, vesting, accumulations, the suspension of alienation, and the like, impose no limitation on the maximum period that property may be held in trust. If under those rules the Maximum Duration for Trusts shall be determined (or alternatively determined) with reference to the death of an individual, such individual shall be the last survivor of a group consisting of the descendants of His Late Majesty King George V of England living on the date of death of my father, [Father], who are living on the date that the trust in question was deemed to have commenced for purposes of the applicable rule limiting the duration of Trusts. The Maximum Duration for Trusts means the full period that the trust has beneficiaries, without external limitation, if applicable rules governing perpetuities, vesting, accumulations, the suspension of alienation, and the like impose no limitation on the maximum period that property may be held in trust. [Emphasis added.]

Article Three of Decedent's Will provides for the disposition of the residue of Decedent's estate, which is to be added and become part of the principal of Decedent's revocable trust.

Decedent's First Codicil

Article SECOND of Decedent's First Codicil provides, in relevant part, as follows:

SECOND: Article Two is deleted and the following is substituted in place thereof:

ARTICLE TWO

Disposi3tion of Residue

All of the rest, residue and remainder of my property and estate of every kind, character and description and wheresoever situated \* \* \* [Emphasis added.]

Decedent's Second Codicil

Article SECOND of Decedent's Second Codicil provides, in relevant part, as follows:

SECOND: Article Three is deleted and the following is substituted in place thereof:

ARTICLE THREE

Disposition of Residue

All of the rest, residue and remainder of my property and estate of every kind, character and description and wheresoever situated \* \* \* [Emphasis added.]

Scrivener's Errors and Ambiguities

As a result of the scrivener's errors in Decedent's Will and Codicils, ambiguities exist regarding how the assets of Trust should be transferred following Decedent's death, the definition of "Maximum Duration for Trusts," and other administration issues. Attorney declared under penalties of perjury that Decedent intended at all times to exercise, pursuant to Article Two of Decedent's Will (including Codicils) his power of appointment over Trust under Article III, Paragraph B of Father's Will, so that the principal and undistributed income of such trust continued in trust for each of Decedent's surviving children.

Accordingly, the following scrivener's errors and ambiguities were identified:

- (i) In Decedent's Will, Article Two, Paragraph 1(a) reference to the Decedent Exempt Trust. There is no Decedent Exempt Trust in existence. This

reference should be to Trust.

- (ii) In Decedent's Will, Article Two, Paragraph 3, there are references to "the foregoing paragraph 3" and "paragraph 3." These references are incorrect and should be to "the foregoing paragraph 2" and "paragraph 2."
- (iii) Article SECOND of Decedent's First Codicil states that "Article Two is deleted and the following is substituted in the place thereof: ARTICLE TWO Disposition of Residue." The reference to Article Two is incorrect as Article Three in Decedent's Will refers to the Disposition of Residue.
- (iv) Decedent's Second Codicil corrected the "Disposition" error and attempted to correct the references of "Article Two" to "Article Three." However, the Second Codicil did not expressly state that Article Two of Decedent's Will (exercise of the power of appointment granted from Father's Will) was to be reinstated. Thus, an ambiguity was created.
- (v) Article Two, Paragraph 3 of Decedent's Will provides that "Maximum Duration for Trusts" means the longest period that property may be held in trust under Decedent's Will under the applicable rules governing perpetuities, vesting, accumulations, the suspension of alienation, and the like (including any applicable period in gross such as twenty-one years or ninety years).
- (vi) Paragraph D of the Declaratory Judgment provides that references to the "applicable rules governing perpetuities" under the definition of "Maximum Duration for Trusts" under Article Two, Paragraph 3, of Decedent's Will shall be read to and include the rules under Article III, Paragraph F, of Father's Will; and, thus, all trusts under Article Two of Decedent's Will shall terminate on or before the date that is twenty-one years after the date of death of the last survivor of Child 1, Child 2, Child 3, Child 4, Grandchild 1, and any other issue of Father living on Date 2.

#### Year 4 Declaratory Judgment

On Date 9, Bank, as Trustee of Trust, filed a petition with Court to declare the rights and legal relations with respect to Trust, including construction and interpretation of Trust due to scrivener's errors, and discharge of Trustee. On Date 10, Court issued a declaratory judgment (Year 4 Declaratory Judgment), including the following:

1. Trust terminated on Decedent's date of death, Date 1.
2. References to Decedent's Exempt Trust shall be read as references to Trust.
3. References to "the foregoing paragraph 3" and "paragraph 3" under Article Two, Paragraph 3 of Decedent's Will shall be read as references to "the foregoing paragraph 2" and "paragraph 2," respectively.
4. References to the "applicable rules governing perpetuities" under the

definition of "Maximum Duration for Trusts" under Article Two, Paragraph 3 of Decedent's Will shall be read to and include the rules under Article III, Paragraph F, of Father's Will; and, thus, all trusts under Article Two of Decedent's Will shall terminate on or before the date that is twenty-one years after the date of death of the last survivor of Child 1, Child 2, Child 3, Child 4, Grandchild 1, and any other issue of Father living on Date 2.

5. The reference in Decedent's First Codicil to "Disposition of Residue" shall be read as "Disposition of Residue."
6. References in Decedent's First Codicil to "Article Two" shall be read as "Article Three."
7. The final account of the Trustee is approved.
8. The Trustee shall satisfy any and all outstanding liabilities and expenses of Trust and shall thereafter distribute each and all remaining assets and properties as follows: Twenty-five percent to each trust for the benefit of Child 1 (Child 1 Trust), Child 2 (Child 2 Trust), Child 3 (Child 3 Trust), and Child 4 (Child 4 Trust).
9. Effective as of the date the remaining assets are distributed from the reserve, the Trustee shall be relieved and discharged as trustee of Trust.

The Year 4 Declaratory Judgment is contingent upon the receipt of a private letter ruling from the Internal Revenue Service.

#### RULING REQUESTS

1. The Year 1 Modification, Year 2 Modification, and Year 3 Declaratory Judgment by Court did not cause Trust to lose its grandfathered exempt status for purposes of the GST tax.
2. Decedent's exercise of his testamentary power of appointment, as construed by the Year 4 Declaratory Judgment by Court, does not constitute the exercise of a general power of appointment under § 2041(b) over Trust property and Decedent's exercise of Decedent's power of appointment in Trust, as granted under Article III, Paragraph B(3) of Father's Will, in a manner that gives each of Decedent's children a power to appoint property at the child's death as construed in the Year 4 Declaratory Judgment, does not cause any of the assets of Trust to be includible in Decedent's estate for estate tax purposes under § 2041(a)(3).
3. The Year 4 Declaratory Judgment by Court will not cause Trust, Child 1 Trust, Child 2 Trust, Child 3 Trust, or Child 4 Trust to lose its grandfathered exempt status for purposes of the GST tax.
4. The Year 4 Declaratory Judgment by Court will not result in the realization of gain or loss for purposes of §§ 61 and 1001.
5. The Year 4 Declaratory Judgment by Court will not result in a gift by a beneficiary of Trust for purposes of § 2501.



6. The Year 4 Declaratory Judgment by Court will not cause Trust to be included in the gross estate of a beneficiary of Trust subject to estate tax under § 2001.

### LAW

Section 2001(a) 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 shall include the value of all property to the extent of the interest therein of the decedent at the time of the decedent's death.

Section 2035(a) provides that if (1) the decedent transferred an interest in property or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of the property (or interest therein) would have been included in the gross estate under § 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included. Under § 2035(b), the amount of the gross estate shall be increased by the amount of any gift tax paid by the decedent or his estate on any gift made by the decedent or his spouse during the 3-year period ending on the date of the decedent's 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 case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037(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 after September 7, 1916, 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, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) 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.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 through 2038, inclusive.

Section 2041(b)(1) defines the term "general power of appointment" as a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate.

Section 20.2041-1(c)(1) of the Estate Tax Regulations provides, in part, that a power of appointment is not a general power if by its terms it is either (a) exercisable only in favor of one or more designated persons or classes other than the decedent or his creditors, or the decedent's estate or the creditors of his estate, or (b) expressly not exercisable in favor of the decedent or his creditors, or the decedent's estate or the creditors of his estate.

Section 2041(a)(3) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent by will, or by a disposition which is of such nature that if it were a transfer of property owned by the decedent such property would be includible in the decedent's gross estate under § 2035, 2036, or 2037, exercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

Section 2501 imposes a tax on the transfer of property by gift.

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 2601 imposes a tax on every generation-skipping transfer (GST). A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, 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), the GST tax does not apply to a transfer under a trust 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)(v)(B) provides that the release, exercise, or lapse of a power of appointment (other than a general power) is not treated as an addition to a trust if (1) the power was created in an irrevocable trust that is not subject to the GST tax because it was irrevocable on September 25, 1985, and (2) in the case of an exercise, the power was not exercised in such a way 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 of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of twenty-one years plus, if necessary, a reasonable period of gestation (the perpetuities period). If a power is exercised by creating another power, it will be deemed to be exercised to whatever extent the second power may be exercised.

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) 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 generation-skipping transfer tax purposes. Thus, generally, 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 lose its exempt status 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)(E), *Example 3*, provides as follows: 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 provisions of chapter 13.

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)), 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.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. 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 to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), *Example 10*, provides as follows: In 1980, Grantor executed an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and 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. In addition, 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. Therefore, the trust will not be subject to the provisions of chapter 13.

Statute 1 provides that a statutory probate court has jurisdiction over all proceedings by or against a trustee and all proceedings concerning trusts, including proceedings to: construe a trust instrument; appoint or remove a trustee; determine the powers, responsibilities, duties, and liability of a trustee; ascertain beneficiaries; make determinations of fact affecting the administration, distribution, or duration of a trust; determine a question arising in the administration or distribution of a trust; relieve a trustee from any or all of the duties, limitations, and restrictions otherwise existing under the terms of the trust instrument or of this subtitle; require an accounting by a trustee, review trustee fees, and settle interim or final accounts.

In *Citation*, the Supreme Court of State stated that according to the authorities in State, and also according to the authorities generally, the rule against perpetuities, as contained in the State's constitution, is that no interest within its scope is good unless it must vest, if at all, not later than twenty-one years after some life in being at the time of the creation of the interest, and in some instances, the period of gestation will be added. In this connection, it is the settled law that if by any possible contingency a devise violates the rule, it cannot stand, and must be held void.

Statute 2 provides that the rule against perpetuities applies to trusts other than charitable trusts. Accordingly, an interest is not good unless it must vest, if at all, not later than twenty-one years after some life in being at the time of the creation of the interest, plus a period of gestation.

Statute 3 provides that a court may order that the terms of the trust be modified if, because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust; modification of administrative, nondispositive terms of the trust is necessary or appropriate to prevent waste or impairment of the trust's administration; the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's intentions; and the order is not inconsistent with a material purpose of the trust.

In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the United States 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 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 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.

## ANALYSIS

### Ruling 1

The Year 1 Modification and Year 2 Modification to Article III, Paragraph I of Father's Will affected the terms of Trust involving corporate trustee succession, as described above. These modifications are administrative in nature and under § 26.2601-1(b)(4)(i)(D)(2), will not be considered to shift a beneficial interest to a lower generation in the trust or extend the time for vesting of any beneficial interest in the trust beyond the period provided for in Father's Will. See *Example 10* of § 26.2601-1(b)(4)(i)(E). Therefore, based upon the facts submitted and the representations made, we conclude that the Year 1 Modification and Year 2 Modification will not adversely affect the exempt status of Trust for GST tax purposes.

In Year 3, Bank petitioned Court to interpret "earnings" as used in Section III, Paragraph B(1) of Father's Will. The terms of Trust presented a bona fide issue regarding whether "earnings" included capital gains in the assets of the trust estate. Court's Year 3 Declaratory Judgment construing the ambiguous term is consistent with applicable state law that would be applied by the highest court of the state. Accordingly, based on the facts submitted and the representations made, we conclude that under § 26.2601-1(b)(4)(i)(C), Court's Year 3 Declaratory Judgment construing Trust will not affect the exempt status of Trust for purposes of the GST tax.

### Ruling 2

In this case, under Article III, Paragraph B(3) of Father's Will, Decedent possessed a testamentary power of appointment. This power of appointment was a limited power of appointment because the power was expressly exercisable only in favor of one or more designated persons or classes and was not exercisable in favor of the decedent or his creditors, or the decedent's estate, or the creditors of his estate. Accordingly, under § 20.2041-1(c)(1), the power of appointment granted to Decedent under Article III, Paragraph B(3) of Father's Will was not a general power of appointment.

Pursuant to Article Two of Decedent's Will, Decedent exercised this power of appointment to appoint the property of Trust to trusts for the benefit of each child, Child 1 Trust, Child 2 Trust, Child 3 Trust, and Child 4 Trust. For each Child's Trust, Decedent created a testamentary power of appointment exercisable by the primary beneficiary of each Child's Trust to or for the benefit of such persons or entities other than the beneficiary, the beneficiary's creditors, the beneficiary's estate, or creditors of the beneficiary's estate. However, numerous scrivener's errors and ambiguities existed in Decedent's Codicils which called into question the effectiveness and scope of Decedent's exercise of this power. An examination of the relevant wills, codicils, declaration of Attorney and representations of the parties indicates that at all times Decedent intended to exercise, pursuant to Article Two of Decedent's Will (including Codicils), his power of appointment over Trust, under Article III, Paragraph B of Father's Will, so that the principal and undistributed income of such trust continued in trust for each of Decedent's surviving children.

Pursuant to the Year 4 Declaratory Judgment, references to the "applicable rules governing perpetuities" under the definition of "Maximum Duration for Trusts" under

Article Two, Paragraph 3 of Decedent's Will, shall be read to refer to and include the rules under Article III, Paragraph F, of Father's Will. Thus, all trusts under Article Two of Decedent's Will shall terminate on or before the date that is twenty-one years after the date of death of the last survivor of Child 1, Child 2, Child 3, Child 4, Grandchild 1, and any other issue of Father living on Date 2. The exercise of such power by Decedent as construed in the Year 4 Declaratory Judgment will not result in the creation of another power of appointment that can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspends the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of creation of the first power, in this case the power of appointment granted to Decedent under Article III, Paragraph B(3) of Father's Will.

Accordingly, after examination of the wills, codicils, declaration of Attorney and representations of the parties and based upon the facts submitted and the representations made, we conclude that Decedent's exercise of his testamentary power of appointment, as construed by the Year 4 Declaratory Judgment by Court, does not constitute the exercise of a general power of appointment under § 2041(b) over Trust property. Moreover, we conclude that Decedent's exercise of Decedent's power of appointment in Trust, as granted under Article III, Paragraph B(3) of Father's Will, in a manner that gives each of Decedent's children a power to appoint property at the child's death as construed in the Year 4 Declaratory Judgment, does not cause any of the assets of Trust to be includible in Decedent's estate for estate tax purposes under § 2041(a)(3).

### Ruling 3

In the present case, Trust was irrevocable on September 25, 1985.

As discussed above, Decedent exercised his power of appointment over Trust to direct the trustee to distribute the property of Trust to the trustees of new trusts created for Decedent's children under Article Two of Decedent's Will. Under § 26.2601-1(b)(1)(v)(B), Decedent's exercise of the power of appointment will be treated as an addition to Trust if the exercise of the power may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of Trust plus a period of twenty-one years plus, if necessary, a reasonable period of gestation.

Child 1 Trust, Child 2 Trust, Child 3 Trust, and Child 4 Trust are subject to a "Perpetuities Savings Provision" under Article Two, Paragraph 3, of Decedent's Will, which provides that in no event shall any trust under Article Two of Decedent's Will continue longer than the Maximum Duration for Trusts, and, unless sooner terminated, each such trust shall altogether terminate at the end of Maximum Duration for Trusts. At the time Trust was created, State law provides that no interest is good unless it must vest not later than twenty-one years after some life in being at the time of the creation of the interest, and in some instances, the period of gestation will be added. *Citation*. The

Year 4 Declaratory Judgment construes the reference to the “applicable rules governing perpetuities” under the definition of “Maximum Duration for Trusts” under Article Two, Paragraph 3, of Decedent’s Will to include the rules under Article III, Paragraph F, of Father’s Will and, thus, all trusts under Article Two of Decedent’s Will shall terminate on or before the date that is twenty-one years after the date of death of the last survivor of Child 1, Child 2, Child 3, Child 4, Grandchild 1, and any other issue of Father living on Date 2. Accordingly, Decedent’s exercise of the power of appointment over the Trust under Article Two of Decedent’s Will will not postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date of creation of Trust, extending beyond any life in being at the date of creation of Trust plus a period of twenty-one years. Thus, Decedent’s exercise of the power of appointment over Trust is not treated as an addition to Trust under § 26.2601-1(b)(1)(v)(B).

In addition to the definition of “Maximum Duration for Trusts,” other scrivener’s errors and ambiguities exist under Decedent’s Will and Codicils as set forth in the petition. These ambiguities present bona fide issues for the administration of Trust following Decedent’s death. The Year 4 Declaratory Judgment addresses the scrivener’s errors and clarifies the rights and legal relations of the beneficiaries of Trust, and is consistent with applicable State law that would be applied by the highest court of State. Accordingly, based upon the facts submitted and the representations made, we conclude that the Year 4 Declaratory Judgment by Court will not cause Trust, Child 1 Trust, Child 2 Trust, Child 3 Trust, or Child 4 Trust to lose its grandfathered exempt status for purposes of the GST tax.

#### Ruling 4

Section 61(a)(3) provides that gross income includes gains derived from dealings in property and, under § 61(a)(14), income 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), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

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



Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature and the partition of a joint tenancy in stock are not sales or exchanges. Similarly, divisions of trusts are also not sales or exchanges of trust interests where each asset is divided pro rata among the new trusts. See Rev. Rul. 69-486, 1969-2 C.B. 159 (pro rata distribution of trust assets not a sale or exchange).

In the present case, the assets of Trust will be distributed in kind on an equal basis among Child 1 Trust, Child 2 Trust, Child 3 Trust, and Child 4 Trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed division of Trust pursuant to the terms of the trust instrument will not result in the realization of gain or loss under § 61 and § 1001.

#### Ruling 5

In this case, the Year 4 Declaratory Judgment construes scrivener's errors and ambiguities in Decedent's Will and Codicils, as discussed above. As discussed, Court's construction of Trust is consistent with applicable state law that would be applied by the highest court of State. Therefore, based on the facts submitted and the representations made, we conclude that the Year 4 Declaratory Judgment by Court will not result in a gift by a beneficiary of Trust for purposes of § 2501.

#### Ruling 6

In order for §§ 2035 through 2038 to apply, a decedent must have made a transfer of property or any interest therein under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. As discussed above, Decedent's exercise of his power of appointment was not a general power of appointment. Moreover, the terms of the Year 4 Declaratory Judgment do not constitute transfers within the meaning of §§ 2035 through 2038. Accordingly, based on the facts submitted and the representations made, we conclude that the Year 4 Declaratory Judgment by Court will not cause Trust to be included in the gross estate of a beneficiary of Trust for purposes of § 2001.

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.

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

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

Sincerely,

*Lorraine E. Gardner*

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

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

cc: