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Department of the Treasury  
Washington, DC 20224

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### Legend

Settlor	=
Spouse	=
Son	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
Attorney 1	=
Attorney 2	=
Trust	=
Date 1	=
Date 2	=
Year 1	=
Year 2	=
Court	=
Court Order	=
State	=
State Statute 1	=
State Statute 2	=

Dear               :

This letter responds to your authorized representative's letter dated November 27, 2017, requesting rulings on the gift, estate and generation-skipping (GST) tax consequences of the reformation of an irrevocable trust.

The facts and representations submitted are summarized as follows:

Settlor executed an irrevocable trust (Trust) on Date 1 for the benefit of Settlor's grandchildren and their descendants. Trust was funded in Year 1 and Spouse made a second gift to Trust in Year 2. No additional gifts have been made to Trust. Trust is governed by the laws of State. The current beneficiaries of Trust are Grandchild 1, Grandchild 2, and Grandchild 3.

Article SECOND provides that the trustee will divide the trust property into three equal shares. Each share is to be named for one of Settlor's grandchildren. Each grandchild is a beneficiary of an independent share of Trust.

Article THIRD paragraph (B) provides that the trustee may from time to time pay to or for the benefit of such grandchild or his or her issue, such part of the net income and principal as the trustee deems advisable and in their respective best interests; provided, however, that in all but extraordinary emergency situations, distributions to the grandchild and his or her issue shall be limited to their medical and educational needs. Any net income not so paid may be added to principal.

Article THIRD paragraph (C) provides that upon the death of a grandchild, the trustee shall distribute the remaining principal and all accrued and accumulated income to or for such one or more appointees as the grandchild appoints by will (other than the grandchild, the grandchild's estate, the grandchild's creditors or creditors of the grandchild's estate).

Article THIRD paragraph (D) provides that any property not appointed by a grandchild shall be distributed to grandchild's then living issue by right of representation. Any distribution to an issue of grandchild under the age of 30 will be held in further trust. If there are no issue of grandchild the unappointed property shall be distributed to the Settlor's then living issue, if none, too Settlor's son, Son, if living, otherwise to Settlor's issue by right of representation.

Article THIRD paragraph (A) provides, generally, for withdrawal rights for the beneficiaries, specifically, that during the calendar year, the grandchild may make withdrawals from any additions to the principal of the share during such year. This right of withdrawal may be exercised from time to time by written request signed by the grandchild (or, during any period when the grandchild is legally incompetent, by his or her legal representative other than Settlor or Spouse) and delivered to the Trustee. For the purpose of this paragraph, any withdrawal right with respect to any addition extends to the property, if any, in which

such addition is invested. The trustee immediately shall notify the grandchild in writing as to any addition, the existence of such right and the property to which it pertains.

Notwithstanding the foregoing, if any addition is added to the share after December 1<sup>st</sup> of any given calendar year, the grandchild's withdrawal right with respect to such addition shall lapse on the thirty-first day after his or her receipt of the notice from the trustee. This withdrawal right is non-cumulative.

Attorney 1 drafted Trust. Settlor created and funded Trust in reliance on the advice of Attorney 1. Based on affidavits of Spouse and Attorney 1, Settlor created Trust to provide for his descendants of all generations, and to reduce the overall transfer taxes payable on Trust assets by ensuring that the assets held in Trust would not be includible in the grandchild's gross estate upon the grandchild's death, and to minimize the amount subject GST tax by utilizing Settlor's and Spouse's GST exemption.

The withdrawal provision in Article THIRD paragraph (A) contains two drafting errors. First, Trust grants each grandchild the right to withdraw the entire amount of any contribution to that grandchild's separate share of the trust and fails to limit the withdrawal right to the gift tax annual exclusion amount, causing the grandchild to possess general powers of appointment (within the meaning of §§ 2514 and 2041) over the entire amount of the contribution to that grandchild's separate share of Trust. Second, each grandchild's withdrawal right over the assets contributed to Trust in any given year is non-cumulative and lapses in its entirety on an annual basis. Since the lapse is not limited to the greater of \$5,000 or 5 percent of the value of the trust assets, any lapse of a grandchild's withdrawal right would be treated as a taxable transfer by that grandchild under § 2514 to the extent that the property that could have been withdrawn exceeds in value the greater of \$5,000 or 5 percent of the aggregate value of the assets subject to withdrawal.

Settlor and Spouse each timely filed a Year 1 Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return and elected to gift-split. Settlor and Spouse incorrectly reported the Year 1 gift to Trust as an indirect skip. However, Settlor and Spouse each allocated his or her GST exemption to Trust. Spouse timely filed a Form 709 for Year 2 and allocated her remaining GST exemption to Trust. No GST transfers have been made from Trust.

The errors were discovered when Son retained a new attorney, Attorney 2, to represent him in estate planning matters. Attorney 2 informed Son of the drafting errors that defeated the intent of the Settlor in establishing Trust. Trustee filed a petition in State Court requesting judicial reformation of the erroneous provision of Article THIRD, paragraph (A), effective as of the date Trust was originally created. On Date 2, Court allowed the petition and, in Court Order, reformed Trust to eliminate the scrivener's error retroactive to the date of Trust's creation.

As reformed, Trust limits the beneficiaries' withdrawal rights to the gift tax annual exclusion amount, and it limits the annual lapse of the withdrawal rights to the greater of \$5,000 or 5% of the value of the trust assets.

You have requested the following rulings:

1. As a result of the judicial reformation of Trust, Settlor's grandchildren, Grandchild 1, Grandchild 2, and Grandchild 3, do not possess general powers of appointment (within the meaning of §§ 2514 and 2041) over their respective shares of Trust, except to the extent of each grandchild's withdrawal rights under the reformed trust instrument.
2. The judicial reformation of Trust does not constitute, for federal gift and estate tax purposes, the exercise or release by any grandchild of Settlor of a general power of appointment.
3. The lapse of any grandchild's withdrawal right over Trust did not result in a gift for federal gift tax purposes.
4. No part of Trust property will be included in the gross estates of the Settlor's grandchildren for federal estate tax purposes, except to the extent of each grandchild's withdrawal rights under the reformed trust instrument exercisable at the grandchild's death.
5. Settlor and Spouse substantially complied with the requirements of § 2632(a) to allocate their available GST exemption to the Year 1 gift to Trust.

#### Rulings 1-4

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides, generally, that the value of the gross estate shall include the extent the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2041(a)(2) provides that the value of the gross estate includes the value of all property to the extent of any property with respect to which the decedent has at the time of his 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 to 2038, inclusive. For purposes of § 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or

before the date of the decedent's death notice has been given or the power has been exercised.

Section 2041(b)(1) provides that for purposes of § 2041(a), the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property, which could have been appointed by exercise of such lapsed powers, exceeded in value, at the time of such lapse, the greater of the following amounts: (A) \$5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied.

Section 2501(a)(1) provides, generally, that a tax is imposed for each calendar year on the transfer of property by gift by any individual, resident or nonresident. Section 2511(a) provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that for purposes of § 2514, the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

Section 2514(e) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. The rule of the preceding sentence shall apply with respect to the lapse of powers during any calendar year only to the extent that the property which could have been appointed by exercise of such lapsed powers exceeds in value the greater of the following amounts: (1) \$5,000, or (2) 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied.

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.

State Statute 1 provides, in part, that a proceeding to approve or disapprove a proposed modification of termination of a trust, may be commenced by a trustee or a beneficiary.

State Statute 2 provides, in part, that the court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor’s intention if it is proved by clear and convincing evidence that the settlor’s intent or the terms of the trust were affected by a mistake of fact or law.

In this case, an examination of the relevant trust instruments, affidavits, and representations of the parties indicate that the original terms of Article THIRD paragraph (A), resulting from scrivener’s error, are contrary to the intent of Settlor. The purpose of the reformation is to correct the scrivener’s error, not to alter or modify the trust instrument. Accordingly, based on the facts presented and the representations made, we conclude that as a result of the reformation of Trust, Settlor’s grandchildren do not possess general powers of appointment over the assets of Trust, except to the extent of each grandchild’s withdrawal rights under the reformed trust instrument. Further, we conclude that the judicial reformation of Trust does not constitute, for federal gift and estate tax purpose, the exercise or release by any grandchild of Settlor of a general power of appointment. We also conclude that the lapse of Grandchild 1, Grandchild 2, or Grandchild 3’s withdrawal rights did not result in a gift for federal gift tax purposes. Finally, we conclude that upon the death of Grandchild 1, Grandchild 2 or Grandchild 3, the assets of each Grandchild’s portion of Trust will not be includible in that grandchild’s gross estate under § 2041.

#### Ruling 5

Section 2513(a)(1) provides, generally, that a gift made by one spouse to any person other than the donor’s spouse is considered for purposes of the gift tax as made one-half by the donor and one-half by the donor’s spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States.

Section 25.2513-1(b)(4) of the Gift Tax Regulations provides that the consent is effective only if both spouses signify their consent to treat all gifts made to third parties during that calendar period by both spouses while married to each other as having been made one-half by each spouse. Such consent, if signified with respect to any calendar period, is effective with respect to all gifts made to third parties during such calendar period except, in part, if one spouse transferred property in part to his or her spouse and in part to third parties, the consent is effective with respect to the interest transferred to third parties only insofar as such interest is ascertainable at the time of the gift and severable from the interest transferred to his spouse.

Section 25.2513-1(b)(5) provides that the consent applies alike to gifts made by one spouse alone and to gifts made partly by each spouse, provided such gifts were to third parties and do not fall within any of the exceptions set forth in § 25.2513-1(b)(1) through (b)(4). The consent may not be applied only to a portion of the property interest constituting such gifts. If the consent is effectively signified on either the husband's return or the wife's return, all gifts made by the spouses to third parties (except as described in subparagraphs (1) through (4) of this paragraph), during the calendar period will be treated as having been made one-half by each spouse.

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

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means, with respect to any GST, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Section 2641(a) defines the applicable rate as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer.

Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the "applicable fraction." The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator of which is the value of the property transferred to the trust or involved in the direct skip.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption amount which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his or her GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Under § 2652(a)(1), for purposes of chapter 13, the term "transferor" means the decedent, in the case of any property subject to tax imposed by chapter 11 and, the donor, in the case of any property subject to tax imposed by chapter 12.

Section 26.2652-1(a)(1) of the Generation-Skipping Transfer Regulations provides that the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of that property for purposes of chapter 13.

In this case, Settlor and Spouse elected to gift-split on their timely filed Form 709 in Year 1. Thus, we conclude that Settlor and Spouse are each treated as the transferor of one-half of the assets gifted to Trust in Year 1. Spouse timely filed Form 709 for Year 2. For GST purposes, Spouse is the transferor of the assets gifted to Trust in Year 2.

Settlor and Spouse incorrectly reported the Year 1 gift to Trust as an indirect skip. However, Settlor and Spouse allocated their GST exemption to the Year 1 gift to Trust. Settlor and Spouse did not literally comply with the instructions to Form 709 to properly allocate their remaining GST exemption to the Year 1 gift to Trust. However, literal compliance with the procedural instructions to make an election is not always required. Elections may be treated as effective where the taxpayer complied with the essential requirements of a regulation (or the instructions to the applicable form) even though the taxpayer failed to comply with certain procedural directions therein. *See Hewlett-Packard Company v. Commissioner*, 67 T.C. 736, 748 (1977), *acq.* *In result*, 1979-1 C.B. 1. Thus, an allocation that does not strictly comply with the instructions on Form 709 or the applicable regulations, will be deemed valid if the information on the return is sufficient to indicate that the donor intended to make the allocation. Based upon the facts submitted and representations made, we conclude that Year 1 Forms 709 contain sufficient information and, therefore, we further conclude that Settlor and Spouse substantially complied with the requirements of § 2632(a) to allocate their respective GST exemption to the Year 1 gift to Trust. Spouse allocated her available GST exemption to the Year 2 gift to Trust on a timely filed Form 709.

A copy of this letter should be attached to any gift, estate, or generation-skipping transfer tax returns that you may file relating to these matters.

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.

Except as specifically rules herein, we do not express or imply any opinion concerning the federal tax consequences of any aspect of the transaction or subsequent transaction to Trust under the cited provisions or under any other provisions of the Code.



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.

Sincerely,

Associate Chief Counsel  
Passthroughs & Special Industries

*Lorraine E. Gardner*

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

Enclosures

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cc: