**Internal Revenue Service**

Department of the Treasury

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Refer Reply To:
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July 22, 1999

RE:

Legend:

Grantor =

Son =
Company =
Trust =

State =
Local Court =
Bank =
Daughter-in-law =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Grandchild 5 =
Grandchild 6 =
Date1 =

This letter is in response to a letter dated July 12, 1999, and prior correspondence from your authorized representative, requesting rulings on the gift, estate, and generation-skipping transfer tax consequences resulting from a court order construing and modifying a trust.

In 1960, Grantor, who was domiciled in State, executed a revocable trust agreement and transferred stock of Company and other assets to Trust. A bank in State was appointed trustee of Trust.

Paragraph 1 of the trust instrument directs the trustee to pay all of the net income to Grantor during his life. Paragraph 2 provides that, after Grantor's death, the trust's income shall be paid to Son during his life.

Paragraph 3 provides that, after the death of Son, the income shall be divided and paid one-half to Grantor's daughter-in-law (Daughter-in-law) and one-half to or for the benefit of Grantor's grandchildren (Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, Grandchild 5, and Grandchild 6) during their lives. In addition, Paragraph 3 provides that the share of any deceased grandchild shall be paid to that grandchild's issue.

Paragraph 7 provides that Trust, or any trust created pursuant to the trust agreement, shall terminate upon the death of the last survivor of Son's children who are alive at Grantor's death and certain named individuals. When the trust terminates, the trustee shall distribute the trust property among the beneficiaries who are receiving income. The property is to be distributed in the proportion in which the respective beneficiary is receiving income.

Paragraph 8 authorizes the trustee to pay corpus to or for the benefit of any beneficiary who at the time is entitled to receive income for "hospital, nursing, and medical expenses of any such beneficiary and also such amounts as may be considered advisable for the maintenance, support and welfare of any such beneficiary." The amount of any payment is to be determined by the trustee in its sole discretion.

Under Paragraph 9(k), the laws of State govern the administration of the Trust.

Paragraph 15 provides that if, at any time, the beneficiaries entitled to receive two-thirds of the income from the trust property shall become dissatisfied with any trustee, the beneficiaries may remove the trustee and appoint a successor trustee. If the trustee that has been removed is a corporate trustee, the successor shall be a corporate trustee. If the trustee removed is an individual, the successor shall be an individual.

Paragraph 16 provides that, if there is a vacancy in the office of one of the co-trustees, beneficiaries entitled to receive two-thirds of the income from the trust may fill the vacancy that exists.

In 1969, Grantor died and Trust became irrevocable. Son died on Date 1. Grandchild 1 and Bank are currently acting as co-trustees of the Trust.

On May 9, 1991, State enacted F.S.A. § 737.402(4), 1991 Fla. Laws ch. 91-61, § 3. Under F.S.A. § 737.402(4)(a)(1), any fiduciary power conferred upon a trustee to make discretionary distributions of either principal or income to or for the trustee's own benefit cannot be exercised by the trustee, except to provide for that trustee's health, education, maintenance, or support, as described under §§ 2041 and 2514 of the Internal Revenue Code.

The statute applies, inter alia, to any trust created under a document executed before July 1, 1991. However, with respect to irrevocable trusts that were executed before July 1, 1991, the statute does not apply if all parties in interest elect affirmatively not to be subject to the application of the statute. F.S.A. § 737.402(4)(b)(3). With respect to Trust, this election had to be made on or before July 1, 1994. This election was not made with respect to Trust. Further, the statute does not apply to any distribution made pursuant to the exercise of a power referred to in F.S.A. § 737.402(4)(a), if the power was exercised prior to July 1, 1991.

In letter ruling 9510065, the Internal Revenue Service addressed certain gift, estate, and generation-skipping transfer tax issues pertaining to the application of F.S.A. § 737.402(4) to Trust and the beneficiaries of Trust.

On April 13, 1999, the trustees filed a motion for summary judgement requesting that Local Court reform the instrument by removing the word “welfare” from Section 8 of the Trust, effective as of August 1, 1960. The trustee argued that the term “welfare” in Section 8 was a scrivener’s error because, at the time the instrument was executed, use of the term “welfare” as a standard for invasion could have caused the trust to be subject to inclusion in the gross estate of a trustee-beneficiary. The motion argued that it was Grantor’s intent that the Trust not be subject to estate tax with respect to succeeding generations. The motion contained more than 40 supporting affidavits, documents, and exhibits. These items included statements from a business associate of Grantor indicating that Grantor believed that Trust would operate to ensure the Company passed to his descendants and a statement of an attorney at the firm involved in drafting the instrument admitting that there was an error in drafting the instrument.

On April 19, 1999, the Local Court granted the trustee’s motion to reform the instrument. After examining the items put forth, the court determined that there was clear and convincing evidence that Grantor did not intend to include the term ”welfare” in Section 8 of the trust agreement.

The trustees of Trust, the executor of Son’s estate, Daughter-in-law, Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, Grandchild 5, and Grandchild 6 (hereinafter referred to as the Beneficiaries) have requested the following rulings:

1. The reformation will not cause the Trust or any distributions from the Trust to be subject to the generation-skipping transfer tax.

2. Neither Son nor the other Beneficiaries of the Trust made a taxable gift for Federal gift tax purposes as a result of the reformation.

3. The reformation will not cause any part of the value of any property of the Trust to be included in the gross estate of Son or any of the other Beneficiaries, for Federal estate tax purposes.

Issue 1

Section 2601 imposes a tax on each generation-skipping transfer. Section 2611(a) defines a generation-skipping transfer to mean (1) a taxable distribution, (2) a taxable termination, or (3) a direct skip.

Section 1433(a) of the Tax Reform Act of 1986 (TRA of 1986) provides that, except as provided in § 1433(b), the generation-skipping transfer tax applies to generation-skipping transfers made after October 22, 1986.

Section 1433(b)(2)(A) of the TRA of 1986 provides that the generation-skipping transfer tax does not apply to transfers under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations provides that a trust qualifies for transitional rule relief from the provisions of Chapter 13 of the Code, 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)(A), any trust in existence on September 25, 1985, will be considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C) (relating to property includible in a grantor's gross estate under §§ 2038 and 2042).

In general, any modification of a trust instrument that changes the quality, value or timing of any powers, beneficial interests, rights or expectancies originally provided for under the terms of the trust instrument will cause the trust to lose exempt status for generation-skipping transfer tax purposes.

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.

Generally, if, due to a mistake in drafting, the instrument does not contain the terms of the trust that the settlor and trustee intended, the settlor or other interested party may maintain a suit in equity to have the instrument reformed so that it will contain the terms that were actually agreed upon. Bogert & Bogert, The Law of Trusts and Trustees, § 991 (revised 2d ed. 1983). The law in State recognizes that instruments may be reformed if the written agreement does not express the intent of the parties. Jacobs v. Parodi, 50 Fla. 541, 544 (1903). The evidence of the mistake, however, must be clear and convincing. Ayers v. Thompson, 536 So. 2d 1352 (Fla 3rd DCA 1991).

In this case, the court determined that there was clear and convincing evidence that Grantor did not intend to include the term "welfare" in Section 8 of the trust agreement. Accordingly, Trust was reformed by removing the word "welfare" from Section 8, effective as of August 1, 1960.

Based on the facts submitted and the representations made, we conclude that the reformation of Trust is consistent with applicable state law as it would be applied by the highest court of State. Thus, the reformation based on scrivener's error does not change any powers, beneficial interests, rights or expectancies provided for under the terms of the trust instrument. Accordingly, the reformation will not cause the Trust or any distributions from the Trust to be subject to the generation-skipping transfer tax.

Issues 2 and 3

Section 2501 imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 2501 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(b) provides that, where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift.

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. Under § 2031, the decedent's gross estate includes the value of all property to the extent provided for in §§ 2033 through 2045. Section 2033 states that the value of a decedent's gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of his death.

As discussed above, we have concluded that the reformation based on scrivener's error was consistent with applicable state law and did not change any beneficial interest otherwise provided for under the trust instrument. Therefore, based on the facts submitted and the representations made, we conclude that neither Son nor any of the other Beneficiaries made a taxable gift as a result of the reformation and that the reformation will not cause any part of the value of the Trust to be included in the gross estate of Son or any of the other Beneficiaries.

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

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 yours,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____________
George Masnik
Chief, Branch 4