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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
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Person To Contact: \_\_\_\_\_, ID No. \_\_\_\_\_

Telephone Number:

Refer Reply To:  
CC:PSI:04  
PLR-115077-15

Date:  
October 13, 2015

RE:

## LEGEND

Date 1	=
Grantor	=
Trust Agreement	=
Child 1	=
Child 2	=
Child 3	=
Child 4	=
Child 5	=
Child 6	=
Trust	=

State 1 =  
Side Agreement =

Date 2	=
Corporate Trustee	=
State 2	=
Individual	=
State 2 Court	=
Date 3	=
Date 4	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
Child 2's Widow	=

Child 4's Widow =  
 Grandchild 4 =  
 Grandchild 5 =  
 Grandchild 6 =  
 Date 5 =  
 Date 6 =  
 X =  
 Y =  
 Date 7 =  
 Citation 1 =  
  
 Citation 2 =

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

This letter responds to your authorized representative's letter, dated April 10, 2015, requesting rulings concerning the generation-skipping transfer (GST) tax consequences of a court-approved settlement agreement.

### FACTS

The facts submitted and representations made are as follows:

On Date 1, a date prior to September 25, 1985, Grantor established an irrevocable Trust Agreement, creating separate trusts for the benefit of Grantor's children.

Section 3.01 of Trust Agreement provides that the trustees shall divide the trust property into separate trusts, equal in value, one for each of the following children and stepdaughter of Grantor: Child 1, Child 2, Child 3, Child 4, Child 5, and Child 6. Accordingly, upon execution of the Trust Agreement, the trust property was divided immediately into six separate trusts of equal value for the Grantor's children (individually, "Child Trust"). This ruling request pertains to the trust ("Trust") that was established for the benefit of Child 1.

Section 3.01 further defines "sons and daughters of the Grantor" as the above-named children together with any child hereinafter born to or adopted by Grantor. In determining whether any person is a child, grandchild or descendant for purposes of Trust Agreement, legal adoption, single or successive, shall be the equivalent of blood relationship.

Section 3.02(a) provides, in part, that after a son or daughter of the Grantor reaches the age of twenty-one, the trustees shall pay all the net income of his trust to him in convenient installments at least as often as quarter-annually. However, the

trustees may in their discretion withhold from any son or daughter of the Grantor so much of the income of his trust as the trustees determine not to be required for his support, comfort, education and welfare, or for any other purpose the trustees believe to be to his best interest. The trustees may in their discretion pay to one or more of the descendants of any son or daughter of the Grantor so much of any income withheld from such son or daughter as the trustees determine to be required or desirable for his or their support, comfort, education and welfare, or for any other purpose the trustees believe to be to his or their best interests. Whenever the trustees determine that the income of any son or daughter of the Grantor from all sources known to the trustees, together with any resources that might be made available by enforcement of any obligation of the Grantor to support and educate him, is not sufficient for his reasonable support, comfort and education and that of his immediate family, the trustees may pay to him or use for his benefit, so much of the principal of his trust as the trustees determine to be required for those purposes.

Section 3.02(b) provides that upon the death of any son or daughter of the Grantor, the trustees shall distribute his trust to, or in trust for the benefit of, such person or persons among the spouse of such son or daughter and the Grantor's descendants, as he appoints and directs by will. However, no greater interest may be appointed for the benefit of a spouse of such son or daughter than the net income from such trust until such spouse's death or remarriage. To the extent that he does not effectively exercise his power of appointment, the trustee shall divide, hold and distribute his trust as follows: the trustee shall first divide such trust into equal trusts, one for each then living child of such son or daughter of Grantor, "a grandchild of Grantor," and one for the then living descendants, collectively of each then deceased grandchild of Grantor. The share established for the descendants, collectively, of each then deceased grandchild of Grantor shall be divided and allocated into portions *per stirpes* for the benefit of such then living descendants of such deceased grandchild. Each share established for a grandchild of Grantor and each portion established for a descendant of a deceased grandchild of Grantor shall be held as a separate and independent trust designated by the name of such grandchild or descendant of a deceased grandchild (individually, "Descendant Trust").

Section 3.02(b) also provides terms of a Descendant Trust that are similar to the terms of a Child Trust. However, after any grandchild or descendant of a grandchild of Grantor has attained the age of thirty years, the trustees shall distribute to him the balance of his trust. Upon the death of any grandchild or descendant of a grandchild of Grantor prior to becoming entitled to receive full distribution of his trust, the trustees shall distribute his trust to or for the benefit of such person or persons among the spouse of such grandchild or descendant of a grandchild of Grantor and Grantor's descendants, as he appoints and directs by will. However, no greater interest may be appointed for the benefit of a spouse of such grandchild or descendant of a grandchild of Grantor than the net income from such trust until such spouse's death or remarriage. To the extent that he does not effectively exercise his power of appointment, the trustee

shall distribute his trust, subject to the provisions of Section 4.01 of Trust Agreement, to his then living descendants, if any *per stirpes*, and, if none, to his then living brothers and sisters, if any, in equal shares, the then living descendants of any deceased brother or sister to take such deceased brother's or sister's share *per stirpes*, and if there are no then living brothers or sisters or descendants of a deceased brother or sister of said decedent, then in equal shares among the living grandchildren of Grantor, the then living descendants of any deceased grandchild to take such deceased grandchild's share, *per stirpes*.

Section 4.07 provides that no trust created hereunder or by any power of appointment hereunder shall continue for more than twenty-one years after the death of the last survivor of the Grantor and the Grantor's descendants and their spouses living on Date 1. At that time, the trustees are to distribute each remaining portion of the trust property to the beneficiary or beneficiaries, the current income, and if there is more than one beneficiary, in the proportions in which they are beneficiaries, and if their interests are indefinite, the trustees shall distribute the trust *per stirpes* to those beneficiaries as are descendants of the Grantor, or if no beneficiary is a descendant of the Grantor, to those beneficiaries in equal shares.

Trust Agreement does not include a provision regarding which state's law will govern the validity, construction or administration of Trust. Trust Agreement was executed and initially administered in State 1. Section 8.09 provides whenever the trustees consider it advantageous to the beneficiaries of any trust, the trustees may transfer the situs of any trust and in so doing may appoint, as a successor trustee, any person or corporation authorized under the laws of the United States or of any state to administer trusts by a written instrument delivered to the successor.

A Side Agreement executed on or before Date 2, by Child 1, as the income beneficiary and individual co-trustee of Trust, and Corporate Trustee provided, among other things, that the situs of Trust is State 2 and the laws governing the administration of Trust shall be of State 2. The current trustees of Trust are Individual and Corporate Trust (collectively, "Trustees"). By order of State 2 Court dated Date 3, State 2 governs the administration of Trust and State 1 continues to govern matters pertaining to the validity and construction of Trust Agreement and Trust.

Child 1 died on Date 4, without a surviving spouse or living descendants. Child 1's will provides that all of Child 1's assets are to be used for animal welfare and makes no specific bequest or devise of her assets to any individual or trust. Child 1 did not exercise her testamentary power of appointment over the assets of Trust in her will.

Child 2 and Child 4 predeceased Child 1. Child 2 was survived by one biological child, Grandchild 1, and two adopted children, Grandchild 2 and Grandchild 3. Accordingly, under the terms of Trust Agreement, Grandchild 2 and Grandchild 3 are descendants of Child 2. It is represented that the terms of the adoptions qualify

Grandchild 2 and Grandchild 3 as descendants of Child. In his will, Child 2 exercised his testamentary power of appointment to distribute the assets of Child 2's Child Trust to a trust ("Family Trust") for the benefit of Grandchild 1 and Child 2's Widow. Counsel to the trustees of the Family Trust represent that the Family Trust complies with the requirements of Trust Agreement, including the limitations with respect to the interest of Child 2's Widow in the Family Trust. Grandchild 1 and Grandchild 2 have living children.

Child 4 was survived by Child 4's Widow, Grandchild 4, Grandchild 5, and Grandchild 6. The terms of Child 4's will exercised his testamentary power of appointment to distribute the assets of Child 4's Child Trust to separate trusts for the benefit of Child 4's Widow, Grandchild 4, Grandchild 5, and Grandchild 6. Grandchild 4 and Grandchild 6 have living children.

Child 1 failed to exercise her testamentary power of appointment over the assets of Trust in her will. Trust Agreement is silent as to the distribution provisions of Trust upon the death of Child 1 with no surviving spouse or descendants. Consequently, the proper distribution of Trust assets under Trust Agreement is in issue. Trustees of Trust 1 communicated with the representatives of the living descendants of Grantor and trustees of the trusts that are potential beneficiaries under Trust regarding distributions of the assets of Trust. The Trustees entered into arm's length negotiations with the potential beneficiaries. As part of the negotiations, the parties considered alternative constructions of Trust Agreement. A Distribution Alternatives Schedule containing several possible distribution alternatives was circulated among the parties. To date, there are twenty-nine individuals representing the possible descendants of Grantor.

On Date 5, the Trustees filed a petition with State 2 Court in order to preserve claims concerning the proper distribution of Trust and to delineate the various issues and the possible distribution schemes that may result from the resolution of the issues. All interested parties, including the Attorneys General of State 1 and State 2, received notice and service of process regarding the petition.

Over the next two years, the parties entered into extensive negotiations, a settlement was consummated, and the parties executed a Settlement Agreement and Mutual Release, dated Date 6 ("Settlement Agreement").

The Settlement Agreement provides in relevant part: (1) the Settlement Agreement is contingent upon approval by State 2 Court; (2) the Settlement Agreement is contingent upon Trustees receiving a favorable private letter ruling from the Internal Revenue Service that the termination of Trust and the distribution of the assets of Trust pursuant to the terms of Settlement Agreement will not result in tax under the provisions of chapter 13; (3) Grandchild 2 and Grandchild 3 will each receive outright distributions from Trust equal to \$x (\$y in the aggregate); (4) the assets of Trust, after payment to Grandchild 2 and Grandchild 3 and net of costs, will be distributed in five

equal shares to the following: (i) Family Trust; (ii) Child 3's Child Trust; (iii) Child 4's children, Grandchild 4, Grandchild 5, and Grandchild 6, further divided among them in equal shares; (iv) Child 5's Child Trust; and (v) Child 6's Child Trust; and (5) neither Child 2's Widow nor Child 3's Widow shall have any right or interest in any asset distributed from Trust. On Date 7, State 2 Court entered an Order approving the Settlement Agreement.

It is represented that no additions (actual or constructive) have been made to Trust since September 25, 1985.

You have requested a ruling that termination of Trust and distributions of the assets of Trust pursuant to the terms of the Settlement Agreement will not result in GST tax under the provisions of Chapter 13 of the Code.

## LAW AND ANALYSIS

Section 2601 imposes a tax on every generation-skipping transfer. Section 2611(a) defines the term "generation-skipping transfer" as a taxable distribution, a taxable termination, and a direct skip.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985. However, this exemption does not apply if additions (actual or constructive) are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(ii)(A) provides that 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), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042.

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Unless specifically noted, the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of § 1001.

Section 26.2601-1(b)(4)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if (1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

The trustees represent that Trust was irrevocable on September 25, 1985 and that there were no additions to Trust after September 25, 1985. Accordingly, Trust is exempt from GST tax.

Under State 1 law, the construction of a will or trust is based on the intent of the testator or settlor. See *Citation 1*. Where a trust is silent on a particular question in the sense that it contains no express answer to the question, then a construction of the trust is necessary. *Citation 2*.

The parties were represented by separate counsel and the Settlement Agreement was signed by the individual party or on behalf of his or her minor and unborn descendants. Accordingly, the Settlement Agreement is a product of arm's length negotiations.

In this case, the fact that Trust did not contain a distribution provision in the event Child 1 died with no surviving spouse or descendants created a bona fide issue regarding the construction of Trust. The parties considered various constructions of Trust in order to reach a compromise regarding the distribution of the terminating distributions of Trust. The terms of the Settlement Agreement are a compromise of the parties' respective adverse economic interests in Trust. State 2 Court approved the Settlement Agreement. We conclude that the Settlement Agreement and State 2 Court Order represent a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions and therefore is within the range of reasonable outcomes.

Accordingly, based upon the facts provided and representations made, we conclude that the requirements of § 26.2601-1(b)(4)(i)(B) are satisfied and rule that termination of Trust and distributions of the assets of Trust pursuant to the terms of the Settlement Agreement will not result in GST tax under the provisions of Chapter 13 of the Code.

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,

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

Enclosures (2)

Copy for section 6110 purposes  
Copy of this letter

cc: