Internal Revenue Service

Number: **202635009**
Release Date: 8/28/2026

Index Number: 2501.00-00, 2601.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-120120-25

Date:
June 02, 2026

Re:

<u>Legend</u>

Grantor 1	=
Grantor 2	=
Child 1	=
Child 2	=
Child 3	=
Trust	=
Grandchildren’s Trust	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
Individual	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Year	=
State	=
State Court	=
Statute 1	=
Statute 2	=

Statute 3 =
Statute 4 =
Citation =

Dear :

This letter responds to your authorized representative's letter dated December 1, 2025, and subsequent correspondence, requesting rulings with respect to the federal gift and generation-skipping transfer (GST) tax consequences of a court approved settlement agreement and division of trust.

The facts and representations submitted are summarized as follows:

On Date 1, a date before September 25,1985, Grantor 1 and Grantor 2 (Grantors) created an irrevocable trust, Trust, for the benefit of their children and grandchildren. Trust is governed by the laws of State. Grantors are deceased, survived by their three adult children, Child 1, Child 2, and Child 3 (individually Child, collectively Children), and three grandchildren, Grandchild 1, Grandchild 2, and Grandchild 3 (individually Grandchild, collectively Grandchildren). Child 1's two adult children are Grandchild 1 and Grandchild 2. Grandchild 1 has two minor children. Child 2's adult child is Grandchild 3. Child 3 does not have children.

Clause Eighth of Trust established four trusts, one trust for the benefit of each Child and a separate trust for the benefit of Grantors' grandchildren (Grandchildren's Trust). This letter pertains to Grandchildren's Trust only. The current Trustees of Grandchildren's Trust are Child 1, Child 2, and Individual.

Clause Tenth of Trust provides the dispositive provisions of the Grandchildren's Trust. Until the death of the survivor of Child 1, Child 2, and Child 3, Grandchildren's Trust is to be held as a single trust. Clause Tenth, Paragraph A, provides that the trustees, other than Grantors' Children, may distribute all or any part of the net income to or for the benefit of the grandchildren, or any of them, and shall add to the principal the net income remaining undistributed at the end of each calendar year. Clause Tenth, Paragraph B, provides that the trustees shall also distribute to the grandchildren, or any of them, or apply for their benefit, so much of the principal as the trustees, other than Grantors' Children, may from time to time consider advisable for the maintenance, education, and emergency needs of the grandchildren.

Clause Tenth, Paragraph C, provides for the division of the Grandchildren's Trust at the death of the survivor of the Grantors' Children as follows:

> When there is no [child] of the grantors then living, the trustee shall divide the principal and any undistributed income then remaining <u>into per stirpital shares attributable to the grantors' then living issue</u>. The trustee shall hold the share attributable to each such issue of the grantors in a separate trust

> for him or her (hereinafter called "the beneficiary"), and shall dispose of the net income and principal of each such trust as follows: .... [Emphasis added].

Clause Tenth, Paragraph C of Trust further provides the following dispositive provisions upon division of the Grandchildren's Trust. Under Paragraph C.(1), the trustee may distribute all or any part of the net income to or for the benefit of the beneficiary and his or her issue, or any of them, as the trustee may from time to time consider advisable. Any income not so distributed shall be added to principal. Clause Tenth, Paragraph C.(3), provides the trustee shall distribute to the beneficiary or apply for his or her benefit, such portions of the principal as the trustee may from time to time consider advisable for the beneficiary's maintenance, education, wedding gift, home purchase, business investment, and emergency needs.

Under Clause Twelfth, Grandchildren's Trust must terminate twenty-one years after the death of the last to die of the Grantors and those of their issue who were living on Date 1 (the Termination Date) and any remaining assets will be distributed to the beneficiary who is then entitled or eligible to receive the trust income. If two or more beneficiaries are then entitled or eligible to receive the trust income, the trust assets shall be distributed either to one of them entirely or to more than one of them in whatever proportions the trustees may consider advisable.

At the time Grantors established Grandchildren's Trust on Date 1, Grantors had no living grandchildren. Since Year, Grandchildren have discussed and negotiated the interpretation of Clause Tenth C, including a potential action in State Court to resolve a dispute as to whether Grantors intended to divide Grandchildren's Trust at the level of Grantors' Children or at the level of the Grantors' Grandchildren. On Date 2, to avoid the possibility of protracted legal proceedings to resolve the interpretation of Clause Tenth C, the Grandchildren entered into a Settlement Agreement, as supplemented on Date 3. The Settlement Agreement provides percentages (Settlement Percentages) to apply upon division of the Grandchildren's Trust into separate trusts for each grandchild at the death of the survivor of Children. The negotiated Settlement Percentages fall between the two percentages that would result from the conflicting interpretations of the per stirpes division described above. Under the Settlement Agreement, no beneficiary receives more than what his or her best-case litigation outcome would have been, and all beneficiaries have settled for something less than their best-case litigation outcome. All parties to the Settlement Agreement were represented by separate legal counsel.

The Settlement Agreement also proposes to divide Grandchildren's Trust into three separate trusts, in accordance with the Settlement Percentages (individually Divided Trust, collectively Divided Trusts) rather than at the death of the survivor of Children.

The dispositive provisions of each Divided Trust are the same in all material respects as the dispositive provisions of Grandchildren's Trust, except each Divided Trust will be for the benefit of a current Grandchild only. If a Grandchild dies (Deceased Grandchild) before the Termination Date, the trustees may distribute income from the Deceased Grandchild's Divided Trust to or for the benefit of the living grandchildren of the Grantors (but not the issue of the Deceased Grandchild or the issue of any other grandchild). If the Deceased Grandchild leaves no issue, the Deceased Grandchild's Divided Trust will terminate and that Divided Trust will be distributed to the remaining Divided Trusts with living members.

If a Child has further children (a Later Grandchild), the trustees of each Divided Trust as then administered will distribute to a new Divided Trust for the benefit of the Later Grandchild, a fraction of each Divided Trust based on the cumulative Divided Trusts' value on the business day immediately preceding the birth or adoption of the Later Grandchild.

State Court issued an Order, as amended on Date 4, approving the Settlement Percentages and division of Grandchildren's Trust as described in the Settlement Agreement, contingent upon the receipt of a favorable private letter ruling by the Internal Revenue Service.

It is represented that there have been no additions, constructive or actual, to Trust or Grandchildren's Trust after September 25, 1985.

You have requested the following rulings:

1. The Settlement Agreement, including the proposed modification to divide Grandchildren's Trust, will not affect the exempt status of Grandchildren's Trust for purposes of the GST tax under § 2601.

2. The Settlement Agreement, including the proposed modification to divide Grandchildren's Trust, will not cause any of the beneficiaries of Grandchildren's Trust to be treated as having made a transfer subject to the gift tax.

LAW AND ANALYSIS

Ruling 1

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

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations provide that the GST tax shall not apply to any GST under a trust that was irrevocable on September 25, 1985, but shall apply to the extent that the 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)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b)(1), (2), or (3) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of a 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.

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.

Section 26.2601-1(b)(4)(i)(D) 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. 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. However, 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 a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), *Example 5*, illustrates a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The division of the trust into two trusts does not shift any 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 division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

Trust is governed by the laws of State. Statute 1 provides that the court may determine the administration and distribution of the real and personal property of inter vivos trusts. Statute 2 provides that a trustee may, without court approval, divide a trust into separate trusts. The beneficiaries of the separate trusts may be different so long as their rights are not impaired.

Statute 3 provides, in relevant part, that beneficiaries, all trustees and other persons, if any, who have an interest in a matter relating to a trust may enter into a binding nonjudicial settlement agreement with respect to the matter including the interpretation or construction of the terms of a trust, the modification of a trust, and any other matter concerning the administration of the trust. Any beneficiary or trustee of a trust may request court approval of a nonjudicial settlement agreement to determine whether the agreement contains terms and conditions the court could have properly approved. Statute 4.

The State Supreme Court stated that "[i]t is now hornbook law (1) that the testator's intent is the polestar and must prevail; and (2) that his intent must be gathered from a consideration of (a) all language contained in the four corners of his will and (b) his scheme of distribution and (c) the circumstances surrounding him at the time he made his will and (d) the existing facts." Citation.

In the present case, Grandchildren's Trust was created and was irrevocable before September 25, 1985. It is represented that no additions, constructive or actual, have been made to Grandchildren's Trust on or after September 25, 1985. Consequently, Grandchildren's Trust is currently exempt from GST tax.

The terms of Grandchildren's Trust present a bona fide issue regarding the meaning of "per stirpes" as used in Clause Tenth C, causing uncertainty at which generation level the per stirpes distribution is to be determined upon the death of the survivor of Grantors' children. To avoid the possibility of protracted litigation to resolve the interpretation of the ambiguous text, Grandchildren engaged in arm's length negotiations, each represented by separate counsel. Settlement Agreement is a compromise between the positions of the beneficiaries and reflects their assessments of the relative strengths of their positions. Thus, Settlement Agreement is within the range of reasonable outcomes under the language of Grandchildren's Trust and applicable State law.

Accordingly, based on the facts submitted and the representations made, we conclude that Settlement Agreement will not affect the exempt status of Grandchildren's Trust for purposes of the GST tax under § 2601.

Further, the proposed modification to divide Grandchildren's Trust into Divided Trusts will not result in a shift of any beneficial interest to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification and division. The proposed modification to divide Grandchildren's Trust will not extend the time for vesting of any beneficial interest beyond the period provided for in Trust. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed modification to divide Grandchildren's Trust will not affect the exempt status of Grandchildren's Trust for purposes of the GST tax under § 2601.

Ruling 2

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Whether an agreement settling a dispute is effective for gift tax purposes, depends on whether the settlement is based on a valid enforceable claim asserted by the parties and, to the extent feasible, produces an economically fair result. *See Ahmanson Foundation v. U.S.*, 674 F.2d 761, 774-75 (9th Cir. 1981), citing *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967). Thus, state law must be examined to ascertain the legitimacy of each party's claim. A settlement that fairly reflects the relative merits and economic values of the various claims asserted by the parties and reaches a settlement that is within a range of reasonable settlements will not result in a transfer for gift tax purposes.

As discussed above, the Settlement Agreement resolves a bona fide issue among the Grandchildren as beneficiaries of Grandchildren's Trust. All interested parties have been represented in the proceedings that culminated in the Court Order approving Settlement Agreement. The highest court in State has not ruled directly on point in any case that would address a similar ambiguity with any degree of certainty. Each Grandchild has a legitimate claim, and it is uncertain what distribution a Grandchild would receive if the question were litigated. The Settlement Agreement reflects the rights of the parties under the applicable State law that would be applied by the highest court of State.

Accordingly, based upon the facts submitted and the representations made, the Settlement Agreement, including the proposed modification to divide Grandchildren's Trust into Divided Trusts, will not cause any of the beneficiaries of Grandchildren's Trust to be treated as having made a transfer subject to the gift tax.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers accompanied by penalty of perjury statements executed by the appropriate parties. While this office has not verified 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 6100(k)(3) provides that it may not be used as precedent.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Passthroughs, Trusts, and Estates)

Enclosure
Copy for § 6110 purposes

cc:

cc:

cc: