Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-124603-14

Date:
December 15, 2014

Legend

Grantor	=
Trust	=
Trust 1	=
Trust 2	=
Grandchild 1	=
Grandchild 2	=
Corporate Trustee	=
Spouse	=
Plaintiffs	=
Defendants	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
Date 10	=
Date 11	=
Date 12	=
Date 13	=
Date 14	=
Corporation	=

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Settlement Agreement =

Court 1 =

Court 2 =

State Statutes =
X =

Dear :

This letter responds to your authorized representative's letter dated June 21, 2014, requesting a ruling on the generation-skipping transfer (GST) tax consequences of a proposed settlement agreement.

The facts and representations submitted are summarized as follows:

On Date 1, Grantor established a revocable inter vivos trust (Trust) for the benefit of Grantor, Grantor's grandchildren, Grandchild 1 and Grandchild 2, and their issue. Trust was amended on Date 2, Date 3, Date 4, Date 5, and Date 6. Grandchild 1 and Corporate Trustee are trustees of Trust. Grantor died on Date 7.

The terms of Trust are as follows:

Article Three, Section B, provides that upon the death of Grantor, Trust will be divided into two irrevocable trusts, Trust 1 for the benefit of Grandchild 1 and Trust 2 for the benefit of Grandchild 2. This private letter ruling pertains to Trust 1.

Article Three, Section B, Subsection 2, of Trust 1, provides that during the lifetime of the beneficiary, the trustees will pay to her, free from trust, all of the net income for her benefit, in monthly or more convenient installments, but not less frequently than annually. Trustees may also distribute principal at any time, if in their sole and absolute discretion, they deem that there is a need. The need may be occasioned by sickness, accident, misfortune or any other emergency or by the fact that income from the trust is insufficient to provide for the maintenance, comfort, education and support of said beneficiary in the manner to which she has been accustomed, or by any other factor which, in the sole and absolute judgment of the trustees, constitutes good and sufficient reason for such encroachment, it being Grantor's intent that the said trustees be free to exercise their discretion in this respect liberally so as to provide adequately for the welfare of the beneficiary of such trust.

Article Three, Section B, Subsection 3, provides that the beneficiary shall have the right to appoint by will, making specific reference hereto, all or any part of the assets of her trust directly to, or in trust for the benefit of any of her descendants and/or in trust for the

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benefit of a surviving spouse. If a beneficiary exercises the power to appoint in trust to her surviving spouse, any such trust will by its terms preclude the distribution of the corpus of trust to such spouse, except that the corporate trustee may be given a power to encroach on corpus for the spouse's benefit if the net income of the trust is insufficient to provide for the spouse's maintenance, comfort and support in the manner to which he may have been accustomed during the lifetime of the beneficiary. Said trust may provide that all or any part of the net income thereof may be paid to said spouse for any term that the beneficiary shall specify in establishing such a trust and such trust shall at all times have a corporate trustee as a co-trustee or sole trustee of the trust.

Article Three, Section B, Subsection 4, provides that if the beneficiary fails to exercise her power of appointment in whole or in part, the trustees will divide the unappointed property into separate shares, *per stirpes,* among the deceased beneficiary's descendants living at the time of the beneficiary's death. If no such descendant is then living, the unappointed property will be added to Trust 2 for the benefit of Grandchild 2 if he is then living, but if Grandchild 2 is not then living, the unappointed property will be distributed to Grandchild 2's then living descendants*, per stirpes*. If there are no living descendants of Grandchild 2, the unappointed property will be distributed to Corporation.

Article Three, Section D, Subsection 4(d), provides that any trust created for a descendant of a beneficiary will terminate when that descendant reaches the age of 35.

Trust became irrevocable upon Grantor's death, on Date 7, a date prior to September 25, 1985. At such time, Trust, pursuant to its terms, was divided into two irrevocable trusts, Trust 1 for the benefit of Grandchild 1 and Trust 2 for the benefit of Grandchild 2.

Grandchild 1 is married to Spouse and they have no living descendants. Pursuant to Trust 1, Grandchild 1 exercised her power to provide that upon her death, Spouse will become the income beneficiary of Trust 1 for the remainder of his life. Any property remaining in Trust 1 at the death of the survivor of Grandchild 1 and Spouse will be added to Trust 2 for the benefit of Grandchild 2, if he is then living.

During the term of Trust 1, the trustees distributed all of the net income to Grandchild 1 and distributed some principal to Grandchild 1.

On Date 8, Grandchild 2 filed a Petition against Corporate Trustee and Grandchild 1, as trustees of Trust 1, in Court 1. On Date 9, Corporate Trustee with the consent of Grandchild 1, moved the Petition to Court 2.

The Petition alleged that Corporate Trustee and Grandchild 1, as trustees of Trust 1, breached their fiduciary duties of loyalty, impartiality, prudent management and good faith, by failing to provide statements concerning Trust 1 to Grandchild 2 and by encroaching on the principal of Trust 1 for the benefit of Grandchild 1. Grandchild 2

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sought to obtain an accounting, recover damages from Corporate Trustee and Grandchild 1 in the amount of the encroachments, obtain an order that no further encroachments be made for Grandchild 1, remove Corporate Trustee and Grandchild 1 as trustees, and appoint another corporate trustee for Trust 1.

Corporate Trustee and Grandchild 1 filed a Motion to Dismiss the Petition for failure to state a claim upon which relief can be granted, or in the alternative, to add Grandchild 2's three children and Corporation as necessary parties. Court 2 entered an order denying the Motion to Dismiss but granted the motion to add necessary parties. Subsequently, Corporation filed a notice waiving any claims it may have in the case.

On Date 10, Grandchild 2 and his three children (Plaintiffs) filed a Second Amended Complaint naming Corporate Trustee and Grandchild 1 as Defendants.

On Date 11, Corporate Trustee and Grandchild 1 filed their answers to the Petition and Second Amended Complaint denying the allegations and asserting defenses. Thereafter, Plaintiffs and Defendants entered into extensive discovery. During the scheduling conference, the judge encouraged the Plaintiffs and the Defendants to agree to mediate the issues raised in the second complaint. Mediation was held on Date 12.

After a full day of mediation, Plaintiffs and Defendants agreed to enter into Settlement Agreement. Settlement Agreement was executed on Date 13.

Paragraph 2 of Settlement Agreement provides that Grandchild 2's three children represent his or her unborn children by representation according to State Statutes.

Paragraph 6 of Settlement Agreement provides that the encroachment authority of the trustees of Trust 1 will be construed and administered in such a manner hereafter that for any calendar year the total principal distributions from Trust 1 to Grandchild 1, when added to net income to which Grandchild 1 is absolutely entitled, will not exceed X percent of the fair market value of the corpus of Trust 1 as of the beginning of said year; provided, however, that the trustees shall have the authority to encroach on the principal for emergencies due to health and maintenance even if the encroachment causes the total distributions to exceed X percent, and further that Grandchild 1 will always be entitled to receive the net income of Trust 1 without limitation of any kind. Because the exact amount of net income for any given calendar year of Trust 1 will not be certain until the end of the year, the trustees may use an estimate of the year's net income determined at the beginning of the year when determining the available principal amount pursuant to the X percent limit. Corporate Trustee will provide statements concerning the administration of Trust 1 no less frequently than quarterly to Grandchild 2 and any of Grandchild 2's children who request statements, and Grandchild 1 and Corporate Trustee will continue to act as trustees of Trust.

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Paragraph 7 of Settlement Agreement provides that, in the event Spouse survives Grandchild 1, and Trust 1 is held for Spouse's benefit pursuant to the terms of Trust instrument and the exercise of the power of appointment granted to Grandchild 1, the encroachment authority of the trustees of Trust 1 shall be construed and administered in the same manner as during the lifetime of Grandchild 1.

Paragraph 24 of Settlement Agreement further provides that Corporate Trustee will request a private letter ruling that the terms of Settlement Agreement will not affect the GST status of Trust 1. Settlement Agreement is contingent on obtaining a favorable private letter ruling from the Internal Revenue Service. On Date 14, Court 2 approved Settlement Agreement.

You have requested the following ruling:

Settlement Agreement will not affect the GST exempt status of Trust 1 or cause Trust 1, or the resulting distributions made from Trust 1 to become subject to chapter 13.

Ruling

Section 2601 of the Internal Revenue code imposes a tax on every generation-skipping transfer made after October 22, 1986.

Section 2611(a) provides that the term "generation-skipping transfer" means a tax distribution, a taxable termination, and a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), 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) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

Section 26.2601-1(b)(4)(i) of the Generation-Skipping Tax Regulations 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) will not cause the trust to lose its exempt status. These rules 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 the trust or the construction of terms of the

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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.

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 of an exempt trust that does not satisfy paragraph (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 a 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. Furthermore, 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.

Since Trust 1 was irrevocable prior to September 25, 1985, and it is represented that no additions have been made to Trust 1 since that date, Trust 1 is currently exempt from the generation-skipping transfer tax pursuant to § 1433(b)(2)(A) of the Tax Reform Act of 1986.

The facts provided and representations made indicate that the proposed Settlement Agreement represents a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions. These facts and representations indicate that the settlement is the product of arm's length negotiations and is within the range of reasonable outcomes under Trust 1's terms and applicable State law.

Accordingly, based upon the facts submitted and the representations made, we conclude that Settlement Agreement will not affect the present GST exempt status of Trust 1, or cause the resulting distributions made from Trust 1 to become subject to chapter 13 of the Code.

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

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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 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.

Sincerely,

_____

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

Enclosures
Copy for § 6110 purposes
Copy of this letter

cc:

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