

## Internal Revenue Service

Number: **201527011**

Release Date: 7/2/2015

Index Number: 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-134574-14

Date:

March 12, 2015

RE:

### LEGEND:

Trust	=
Grantor	=
Son	=
A	=
B	=
Bank	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Year	=
Grandchild	=
Great-Grandchild A	=
Great-Grandchild B	=
Great-Grandchild C	=
Great-Grandchild D	=
Great-Grandchild E	=
Great-Great-Grandchild A	=
Great-Great-Grandchild B	=
Great-Great-Grandchild C	=
State	=
Court	=
<u>X</u>	=

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

This letter responds to your letter, dated August 29, 2014, submitted by your authorized representative, requesting generation-skipping transfer (GST) tax rulings with respect to a court-approved settlement agreement.

The facts provided and representations are as follows. Grantor created and funded an irrevocable trust, Trust, on Date 1. Trust was established for the primary benefit of Grantor's Son, Son's spouse, Son's widow, and his lineal descendants. The current beneficiaries of Trust include Grandchild, Grandchild's children (Great-Grandchildren A through E) and Great-Grandchild B's children (Great-Great-Grandchildren A through C). Article 1.01 of Trust provides that the trustees may, in their sole discretion, pay or expend income or corpus of the trust for the benefit of the trust beneficiaries for their maintenance, support, care and education. Income not distributed is to be added to corpus. In determining the amount of income of principal to be distributed among the various beneficiaries, the trustees shall consider also the income available to them, respectively, from other known available sources.

Trust terminates upon the death of the last-to-die of Son, A, and Grandchild. Upon termination, the trustees are to distribute the trust estate to the then living lineal descendants of Son, *per stirpes*, or if there are none, to the then living descendants of B, *per stirpes*. Trust does not contain any provision governing the management of distributions to minor beneficiaries. Bank is currently the sole corporate trustee of Trust.

In Year, Bank notified the beneficiaries that Bank proposed to make distributions based on a Distribution Plan in which Bank would distribute a certain percentage of Trust to the current beneficiaries, excluding Great-Great-Grandchildren A and B. Further, the plan did not include a requirement that Bank inquire into the respective needs of the beneficiaries for maintenance, support, care, and education and did not require Bank to take into account existing income available to the current beneficiaries.

On Date 2, Great-Grandchild B, Great-Great-Grandchild A, and Great-Great-Grandchild B brought suit in Court against Bank, as corporate trustee, and Grandchild, Great-Grandchild A, Great-Grandchild C, Great-Grandchild D, and Great-Grandchild E seeking an order from Court to compel Bank to comply with the terms of Trust and not carry out the Distribution Plan. Further, the plaintiffs alleged that Bank has made distributions to some of the other defendants which were not for maintenance, support, care, and education, while Bank denied a distribution request to cover Great-Grandchild B's medical expenses. Plaintiffs also alleged that Bank made distributions to some of the defendants without considering the income available to the beneficiary from other sources, in violation of Trust. Plaintiffs claimed that these actions constitute a breach of fiduciary duty. Plaintiffs also requested to have Bank removed as trustee.

In Court, the minor Great-Grandchildren C through E were represented by a Guardian ad litem and the three Great-Great-Grandchildren A through C were represented by their natural guardian. All of the parties, other than the Guardian ad litem, who is an attorney, were represented by counsel in Court.

On Date 4, Bank and the trust beneficiaries, including the Guardian ad litem, and the natural guardian of the Great-Great-Grandchildren, entered into a Settlement Agreement. The Settlement Agreement provides for: (a) specific accounting rules for trust distributions; (b) mandatory annual distributions of x percent of the value of specific assets to be divided into six equal shares and distributed as follows: one for Grandchild and one for each of Grandchild's five children (Great-Grandchildren A through E) and their descendants, valued annually; (c) clarified rules governing additional discretionary distributions, including documentation beneficiaries must provide in support of any application for such distributions; (d) the requirement that any distributions to minor beneficiaries be made to a Uniform Transfer to Minors Act (UTMA) Account for the minor beneficiary's benefit; (e) mandatory quarterly meetings between the trustee and Grandchild and any Eligible Beneficiary; and (f) various mutual releases.

Specifically, the specific accounting rules require that upon termination of Trust, any distribution of trust assets to an Eligible Beneficiary shall be charged against the Eligible Beneficiary's share of Trust and if the Eligible Beneficiary has no share, against the shares of Trust, if any, of the Eligible Beneficiary's lineal descendants. No chargeback applies to any distributions made to any beneficiary pursuant to paragraph 2 providing for mandatory Trust distributions, any beneficiary prior to Date 5, Grandchild, and any currently living or afterborn child of Grandchild who is deceased and has no living lineal descendants at the time of termination of Trust. Eligible Beneficiaries is defined in Trust to include the beneficiaries named in Article 1.01.

The mandatory trust distributions are to be paid on a prorated monthly basis. If a beneficiary predeceases Grandchild, the distribution to which the deceased beneficiary would have been entitled will be paid to the deceased beneficiary's then living lineal descendants, *per stirpes*. The Settlement Agreement did not modify or limit the trustee's discretionary authority to distribute corpus to a beneficiary as provided under Trust.

The Settlement Agreement is made contingent upon Bank receiving a favorable private letter ruling from the Internal Revenue Service with regard to the requested GST tax rulings. On Date 5, Court approved the Settlement Agreement.

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

You have requested rulings that the execution and implementation of the Settlement Agreement will not cause: (a) Trust to lose its status as exempt from the GST tax and (b) any GST tax to be imposed against Trust or its beneficiaries.

### 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.

The parties were represented by separate counsel and the minors were represented by their natural guardian or a Guardian ad litem. Accordingly, the Settlement Agreement is a product of arm's length negotiations.

The Settlement Agreement requires specific accounting for mandatory distributions and mandatory regular meetings between Bank and the beneficiaries. The Settlement Agreement also provides that any distributions to a minor shall be made to a UTMA Account and requires mandatory annual distributions of x percent of the value of specific assets of Trust to be divided equally into six shares, one each for Grandchild and Grandchildren A through E, and their descendants. The Settlement Agreement provides for mutual releases. Lastly, the Settlement Agreement provides that Bank continues to have the discretionary authority to distribute principal to the beneficiaries, subject to the chargeback provisions. Court approved the settlement. We conclude that the Settlement Agreement and 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 Settlement Agreement will not cause: (a) Trust to lose its status as exempt from the GST tax and (b) any GST tax to be imposed against Trust or its beneficiaries.

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(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representatives.

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