

Internal Revenue Service

Department of the Treasury

Number: **200132016**
Release Date: 8/10/2001
Index Number: 2601.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-117338-00
Date:

May 09, 2001

Re:

Legend:

- Settlor =
- Son 1 =
- Son 2 =
- Son 3 =
- Spouse 1 =
- Spouse 2 =
- Daughter =
- Trust =

- Trustee =
- Date 1 =
- Date 2 =
- Court =
- Year 1 =

Dear :

This is in response to your letter of February 2, 2001, and prior correspondence, in which you request a ruling on the application of the generation-skipping transfer (GST) tax provisions of Chapter 13 of the Internal Revenue Code to the proposed modification to Trust.

Decedent died testate on Date 1, survived by Son 1, Son 2, and Son 3.

Article III of Decedent's will provides that all the residue of Decedent's estate is bequeathed to Trustee, as trustee of a testamentary trust (Trust). Article III, paragraph 1 provides that Trustee is to pay all the net income of Trust to Decedent's descendants, per stripes. Article III, paragraph 2 provides that if a male descendant dies leaving a surviving widow, a portion of the net income may be paid to the widow until her death, or until the termination of Trust, whichever occurs first. Trustee may in its sole discretion, distribute up to one-half of the income to a widow. The term widow does not

PLR-117338-00

include a divorced wife of any beneficiary.

Article III, paragraph 4 provides that as to any beneficiary of Trust (other than Son 1, Son 2, or Son 3, or the widows of Decedent's descendants) who has attained forty-five years of age, Trustee may pay over at any time after the death of his or her predecessor in interest all or a part of a beneficiary's share of trust principal together with any undistributed or accumulated net income held for the benefit of such beneficiary. If a withdrawal of principal occurs, Trustee must make adjustments in the proportion of the net income thereafter accruing to such beneficiary. No Trustee who is a beneficiary under Trust may participate in any action taken by Trustees with respect to any distribution in favor of such beneficiary.

Article III, paragraph 5, provides that unless sooner terminated, Trust shall cease and terminate upon the expiration of a period of twenty years after the death of the last to survive of Son 1, Son 2, and Son 3, and their children living at the time of Settlor's death. On termination, Trustee will divide and distribute the entire principal of Trust to the beneficiaries who are then entitled to the current net income, in the same proportions to which they are entitled to such current income, provided that should any widow of a descendant be surviving, the principal that would otherwise be distributed to any such widow will be distributed to the persons who would be entitled to the principal had the widow been deceased at the time of termination of Trust. Trustee is further directed to distribute any undistributed or accumulated net income to the beneficiary for whom such undistributed net income is then held.

Article III, paragraph 6, provides that until any beneficiary attains the age of twenty-one, or in the event that Trustee deems any beneficiary unable to apply to his or her best interest any payments under Trust, Trustee may withhold such portion of the net income and either accumulate it for the beneficiary, or expend it for the proper care, support, maintenance and education of a beneficiary.

Article III, paragraph 7, provides that upon the death of a beneficiary all unpaid net income which has accrued or been accumulated for the benefit of a beneficiary shall be administered for the benefit of his or her successors and shall not be considered part of the estate of the deceased beneficiary.

Article III, paragraph 8 provides that if the income of Trust is insufficient to provide the beneficiary with suitable support, education and maintenance, then Trustee may expend such part of the principal as is proportionate to the share of the current income that beneficiary is entitled to receive. Upon any encroachment on the principal, Trustee will make an adjustment to that beneficiary's share of income so that no other beneficiary's interest will be prejudiced. No trustee who is a beneficiary may participate in any action taken by Trustee with respect to encroachment on principal.

Son 1 died in Year 1, survived by Spouse 2 and four children. After Son 1's

PLR-117338-00

death, a dispute arose regarding whether one of these children, Daughter, was a descendant of Son 1. Son 1 had been married twice during his life; first to Spouse 1 and subsequently to Spouse 2. Daughter claimed to be a descendant of Son 1 through his marriage to Spouse 1. Spouse 2 and other descendants of Son 1 claimed that she is not a descendant or issue of Son 1 and is not entitled to a share of Trust. Litigation ensued. The parties then entered into settlement negotiations.

With the assistance of a mediator, the parties entered into a settlement agreement. Under the agreement, Daughter and her descendants will be declared beneficiaries of Trust, and will be entitled to receive income and principal distributions from Trust under the terms of Trust. However, Daughter and her descendant's right to receive trust income and principal distributions will be limited to 75 percent of the share in Trust they would have been entitled to as Son 1's daughter and descendants.

Daughter's and Daughter's descendant's share of Trust will be partitioned and held in a separate trust. Daughter will be entitled to choose her own trustees to manage the partitioned trust. The partitioned trust will be administered under the identical terms of Trust, except that Daughter and her descendants will be the only beneficiaries of the share. None of Daughter's share will be diverted to other beneficiaries (Spouse 2 and the other descendants of Son 1). The partitioned trust will terminate at the same time as Trust. On Date 2, Court approved the settlement agreement.

It is represented that Trust was created and irrevocable before September 25, 1985 and that no additions have been made to Trust since September 25, 1985.

You have requested the following rulings:

1. Trust is exempt from application of the generation-skipping transfer tax.
2. The partition of Trust will not result in a generation-skipping transfer under Chapter 13.
3. Following the partition contemplated by the settlement agreement, Trust and the partitioned trust will be exempt from Chapter 13.
4. No distributions from, or termination of, Trust or the partitioned trust will be subject to Chapter 13.

Section 2601 imposes a tax on every generation-skipping transfer.

Section 1433(b)(2)(A) of the 1986 Act and § 26.2601-1(b)(1)(i) of the generation-skipping transfer tax regulations provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on

PLR-117338-00

September 25, 1985, but only to the extent that such 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)(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)(1)(ii) (B) or (C) (relating to property includible in the grantor's gross estate under §§ 2038 and 2042).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust, which is excluded from the application of Chapter 13 by § 1433(b)(2)(A) of the 1986 Act, a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of Chapter 13.

Section 26.2601-1(b)(4) provides rules for determining under what circumstances a modification, judicial construction, settlement agreement or trustee action with respect to a trust that is otherwise exempt from GST tax under § 26.2601-1(b)(1), (2) and (3) will not cause the trust to lose its exempt status.

Under § 26.2601-1(b)(4)(i)(B), 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 issues resolved in 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 this case, Trust was created and irrevocable before September 25, 1985. Also, it is represented that no additions have been made to Trust since September 25, 1985. Consequently, Trust is currently exempt from GST tax.

Further, after reviewing the facts presented and applicable law, we believe the settlement satisfies the requirements of § 26.2601-1(b)(4)(i)(B).

Accordingly, based on the representations made, we conclude as follows:

1. Trust is currently exempt from application of the generation-skipping transfer tax.

PLR-117338-00

2. The partition of Trust pursuant to the settlement agreement will not result in a generation-skipping transfer under chapter 13.
3. The partition of Trust pursuant to the settlement agreement will not cause Trust or the partitioned trust to lose exempt status for generation-skipping transfer tax purposes.
4. No distribution from, or termination of, Trust or the partitioned trust will be subject to Chapter 13.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
George Masnik
Chief, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for 6110 purposes