

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-117337-00
Date:

May 09, 2001

Re:

Legend:

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

On Date 1, Settlor created Trust, an irrevocable inter vivos trust for the benefit of her three sons, Son 1, Son 2 and Son 3. The trust agreement provides a separate trust fund for each son, labeled Trust A, Trust B, and Trust C. Trust B was established for the benefit of Son 1.

Article I provides that Son 1 is to receive the net income from Trust B for life. At his death, Trust B is to be held for the benefit of his widow, if any, and for the benefit of his surviving issue, if any. Trust B provides for discretionary income distributions to his surviving widow to provide for her in a suitable manner. In addition, payments may be made, in the trustee's discretion, to his surviving issue, per stirpes (unless there are special needs) until the termination of Trust B. At the death of widow, or Son 1, if no spouse survives Son 1, the trustees are to pay the entire net income to Son 1's issue, per stirpes. If Son 1 dies and leaves a widow and no issue, the trustees are to pay the entire net income to the widow as long as she lives or until Trust B terminates. Trust B will terminate upon the expiration of a period of twentieth years and eleven months after

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the last to survive of Son 1, Son 2, and Son 3 and their children living at the time of execution of Trust B. On termination, Trust B assets will be paid one-third to Son 1's surviving widow and two-thirds to his surviving issue per stirpes, or all the assets will be paid to the surviving issue if the surviving spouse is not living. If the spouse survives, but no issue survive, Trust B assets will be distributed one-third to the widow and two-thirds will be divided equally between the trusts established for Son 2 and Son 3. At any time if the widow and no issue are living, Trust B assets will be distributed to trusts established for Son 2 and Son 3 in equal shares.

Article IV provides that the trustees may accumulate income payable for the benefit of any beneficiary as they deem to be in the best interests of the beneficiary, or expend the income to provide for the proper care, support, maintenance and education of a beneficiary. If the income from any trust created under Trust B is insufficient to provide the beneficiary with reasonable support, care and comfort, or is insufficient to meet the expenses of education, illness, death or other emergency, the trustees may expend such part of the principal as is proportionate to the share of the current income that the beneficiary is entitled to receive.

Son 1 died in Year 1 survived by Spouse 2 and four children. After Son 1's death, a dispute arose regarding whether one of these children, Daughter, was a descendant of Son 1. Son 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 B. 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 B, and will be entitled to receive income and principal distributions from Trust B as provided under the terms of Trust. However, Daughter and her descendants right to receive trust income and principal distributions will be limited to 75 percent of the share in Trust B they would have been entitled to as Son 1's daughter and descendants.

Daughter's and Daughter's descendants' share of Trust B 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 B, except that Daughter and her descendants will be the only beneficiaries. None of Daughter's share will be diverted to other beneficiaries (Spouse 2 and other descendant's of Son 1). The partitioned trust will terminate at the same time as Trust B. 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, 1975.

You have requested the following rulings:

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1. Trust B is exempt from the application of the generation-skipping transfer tax.
2. The partition of Trust B will not result in a generation-skipping transfer under Chapter 13.
3. Following the partition contemplated by the settlement agreement, Trust B and the partitioned trust will be exempt from Chapter 13.
4. No distributions from, or termination of, Trust B 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 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 negotiation's; 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 and of their positions is a settlement that is within the range of reasonable outcomes.

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In this case, Trust B was created and irrevocable before September 25, 1985. Also, it is represented that no additions have been made to Trust B since September 25, 1985. Consequently, Trust B 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 B is currently exempt from application of the generation-skipping transfer tax.
2. The partition of Trust B pursuant to the settlement agreement will not result in a generation-skipping transfer under chapter 13.
3. The partition of Trust B pursuant to the settlement agreement will not cause Trust B or the partitioned trust to lose exempt status for generation-skipping transfer tax purposes.
4. No distribution from, or termination of, Trust B 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