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Department of the Treasury

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CC:DOM:P&SI:4 - PLR-104529-99

Date: September 3, 1999

Re:

LEGEND:

Decedent =
Son =
Grandson =
Son #2 =
Bank =

E =
F =
Court =
County =
State =
Trust =
Year 1 =
Year 2 =
Year 3 =

This is in response to your authorized representative's letter dated February 23, 1999, in which a ruling was requested that the implementation of a proposed settlement agreement will not cause Trust or any distributions from Trust to be subject to the Generation-Skipping Transfer Tax under § 2601 of the Internal Revenue Code.

The facts submitted are as follows:

Decedent, a resident of County, State, died testate in Year 1. Decedent was survived by two sons, Son and Son #2. Son has one child, Grandson, who is an adult. At the present time, Grandson has no issue.

Under the terms of Decedent's will, Decedent's residuary estate was divided into two separate trusts (sometimes referred

to as the Residuary Trusts), one for the benefit of Son and his issue (Trust) and one for the benefit of Son #2 and his issue. This ruling relates solely to issues concerning Trust.

Paragraph 2 of Decedent's will provides that Trust will terminate upon the death of Son, and the Trust estate will be distributed to the issue of Son.

Distributions from Trust are provided for in Paragraph 3 of Decedent's will as follows:

In the case of a Residuary Trust created for a son of mine who survives me, the Trustees may first distribute to the son for whom such Trust was created such amounts of such Trust Estate as are sufficient to provide for his support and maintenance in the standard of living to which he was accustomed at my death, taking into consideration his other sources of support and maintenance to the knowledge of the Trustees. After any distribution to be made to such son at any given time has been made, the income of such Trust Estate may be accumulated and retained, in whole or in part, or the Trustees, from time to time, may distribute to any one or more of a group composed of such son's issue such amounts of such Trust Estate as, in the discretion of the Trustees, are in the best interests of such distributees.

In making distributions in the "best interests" of a distributee, the Trustees may take into consideration the age of a distributee, the costs of a distributee's comfort, support, maintenance and education, any income the distributee may have from other sources to the knowledge of the Trustees, and any other factors deemed relevant by the Trustees.

Distributions under this Paragraph 3 may be made without regard to any requirement of equality among distributees or to the fact that any ancestor of a distributee is then living or receiving distributions hereunder, and no deduction shall be made from a distributee's share upon termination of the Residuary Trust on account of any prior distributions from such Trust.

With respect to termination and distributions from Trust, Paragraph 8 of Decedent's will provides, in part:

Regardless of any other provision of this Will and notwithstanding the rights of any beneficiary, the Trustees may, at any time, terminate any one or more of the Residuary Trusts and the Contingent Trusts created hereunder, in whole or in part, if, in the discretion of the Trustees, such

early termination is in the best interests of the current beneficiaries of such Trust. The part of such Trust Estate as to which such Trust is terminated shall be distributed, outright, to the person for whom such Trust was created.

Several provisions of Decedent's will pertain to the Trustees of Trust. In Paragraph 5, Decedent appointed Son, Son #2, and Bank as Trustees and provided that, should either son cease to serve, the other son shall continue to act as a co-trustee with Bank. If both sons should cease to serve, Bank shall act as sole Trustee. If at any time there is no Trustee serving, a majority of the beneficiaries who might then be entitled to a distribution from the Trust shall appoint any individual, bank, or trust company as a successor Trustee.

Paragraph 6 pertains to distributions to trustee-beneficiaries. It states, in relevant part, as follows:

Any discretionary distribution to be made from any Trust to or for the benefit of any individual who is then acting as Trustee (including distributions to such individual's spouse and distributions in discharge of any legal obligation of such individual) shall be made solely in the discretion of the Trustees to or for whom distributions may not be made, and if no such Trustee is then acting, such distribution shall not be made. The preceding sentence shall not apply to distributions to an individual for his support and maintenance in his accustomed standard of living. Further, any power to dispose of the Trust Estate of any Trust to any distributee who is one of my issue shall not be exercisable by any Trustee who is an individual assigned for federal generation-skipping tax purposes to a generation which is younger than my generation and the same as or younger than the generation assignment of such distributee....

Paragraph 9 provides that any Trustee may resign without the necessity of any court procedure by giving at least thirty (30) days' written notice to each beneficiary who might then be entitled to receive a distribution from Trust, and by accounting to such resigning Trustee's successor Trustee for the administration of the Trust estate as required by the successor Trustee. Any Trustee's right to resign may be exercised with or without cause and regardless of any common law duty of the trustee not to resign.

Paragraph 10 provides that any Trustee (including any substitute or successor Trustee) shall have the right, at any time after qualifying as Trustee, to appoint a successor Trustee to act in the place of the appointing Trustee, either immediately or in the future upon any stated contingency. If any initial

Trustee or any such successor, for any reason, fails or ceases to act without having appointed a trustee who succeeds the former Trustee, the remaining Trustee or Trustees (if there be any) may appoint another Trustee to act in the former Trustee's place. A successor Trustee appointed under Paragraph 10 may be an individual, bank, or trust company.

Paragraph 22 provides that any fiduciary power granted a Trustee may be released, in whole or in part, temporarily or permanently and, except as provided in Paragraph 6, any such power may be delegated to any other Trustee then acting, in whole or in part, temporarily or permanently.

In Year 2, Son #2 resigned as Trustee of Trust and designated an individual, E, as his successor. In Year 3, Son resigned as Trustee of Trust and designated an individual, F, as his successor. At the present time, Bank, E, and F are serving as Trustees.

In Year 2, more than 10 years after the inception of the Trust, controversies arose between Son and Grandson regarding the meaning of the distribution standards set forth in Paragraph 3 of Decedent's will and their respective entitlements to Trust distributions pursuant to such standards. Son has objected to distribution requests made by Grandson, claiming that the Trust does not grant Grandson any right to distributions. Similarly, Grandson has opposed the requests for distribution made by Son, claiming that Son does not currently qualify for distributions under the "support and maintenance" standard.

In Year 3, Son initiated court proceedings against Grandson and the Trustees, requesting the Court to declare that it is within the discretion of the Trustees to terminate the Trust and distribute the assets to him. Grandson responded to the petition by requesting that the Court dismiss the petition, deny all relief sought thereunder, and exercise its equitable supervision over the Trust and instruct the Cotrustees regarding the distribution standards contained in the Trust. E and F filed an answer to the petition in which they requested a declaratory judgment from the Court concerning the "meaning of the Trust."

Court ordered the parties to settle the pending litigation and other controversies among Son, Grandson, the trustees, and other parties through mediation. As a result of the mediation process, the parties have executed a settlement agreement. In order for the settlement agreement to come into effect: 1) Court must approve the agreement, and (2) a favorable private letter ruling must be obtained from the Internal Revenue Service.

The proposed settlement agreement contains the following provisions:

1. Son will receive a distribution of 40% of each asset of Trust. This distribution will be made pursuant to the power under Paragraph 8 of the will that permits the trustees to terminate Trust, "in whole or in part, if, in the discretion of the Trustees, such early termination is in the best interests of the current beneficiaries of such Trust. The part of such Trust estate as to which such Trust is terminated shall be distributed, outright, to the person for whom such Trust was created..."

2. The remaining 60% of each asset of Trust will continue to be held under the terms of Trust.

3. E and F will resign as trustees and will irrevocably refuse in writing to appoint successors. Bank will resign as trustee unless it receives a written request from Grandson to continue to serve as the single successor corporate trustee of Trust. Trust will be modified to permit Grandson to appoint a single successor corporate trustee, that may not be related or subordinate as that term is defined in section 672(c) of the Internal Revenue Code. Grandson will also have the power to remove a corporate trustee and appoint a successor corporate trustee that is not a related or subordinate party under section 672(c).

4. An Order will be submitted to Court requesting that the Court, in construing the terms of the Decedent's will, make the following findings with respect to the future administration of Trust:

a. In making distributions from Trust to Son, the trustees must strictly apply the distribution standard applicable to Son: "support and maintenance in the standard of living to which [Son] was accustomed at [Decedent's] death, taking into consideration [Son's] other sources of support and maintenance to the knowledge of the trustees."

b. After taking into consideration the 40% settlement distribution to Son, Son currently has sufficient sources of support and maintenance to more than adequately provide for Son's support and maintenance in the standard of living to which Son was accustomed at the time of Decedent's death.

c. Because of other sources of support and maintenance available to Son at the present time, including the settlement distribution, Son is not currently entitled to receive any support and maintenance distributions from Trust.

d. In making distributions from Trust to Grandson, the trustees must strictly apply the "best interests" standard set forth in Paragraph 3 of Decedent's will.

e. Grandson is presently entitled to distributions from Trust as are in his "best interests," and the trustee(s) may consider his age, the cost of his comfort, support, maintenance and education, his income from other sources, and any other factors deemed relevant by the trustee(s).

f. In light of the agreement that Son currently has sufficient income from other sources to more than provide for his comfort, support, maintenance, and education, there is no current requirement that the trustee(s) inquire into Son's standard of living, lifestyle, health, and financial situation; and the trustee(s) are expressly released of any duty, statutory or at common law, to currently so inquire.

The settlement agreement also provides that the parties to the agreement will make application to the Court seeking a construction of Paragraph 8 of Decedent's will, which provides that the Trustees may, at any time (emphasis added), terminate any one or more of the Residuary Trusts, in whole or in part if, in the discretion of the Trustees, such early termination is in the best interests of the current beneficiaries of such Trust. The parties will ask the Court to construe this provision as meaning that a current beneficiary of Trust may receive only one termination distribution from Trust.

The settlement agreement also provides that upon satisfaction of the conditions of the settlement agreement, Son will not at any time, directly or indirectly, request or accept any further distributions from Trust. Son agrees that if he breaches this promise, he will indemnify and hold harmless the co-trustees or trustee of Trust for any damages, attorney's fees, expenses and court costs arising from such breach.

A ruling is requested on behalf of Trust, Son, Grandson, and all other beneficiaries of Trust, including future beneficiaries and beneficiaries whose interests are now contingent, that the implementation of the proposed settlement agreement will not cause Trust or any distributions from Trust to be subject to the generation-skipping transfer tax imposed by section 2601 of the Code.

Section 2601 provides that a tax is imposed on every generation-skipping transfer. Section 2611 defines the term "generation-skipping transfer" to mean (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(b) defines the term "taxable distribution" to mean any distributions from a trust to a skip person (other than a taxable termination or a direct skip). Section 2612(a)(1)(A)

provides, in essence, that a taxable termination occurs when an interest in a trust terminates, such as by death and, thereafter, only skip persons have an interest in the trust property.

Section 2613(a)(1) defines the term "skip person" as including a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor.

In this case, Trust is a generation-skipping trust because it provides for distributions to persons that are two or more generations below the Decedent's generation. Thus, unless Trust is excepted from the generation-skipping transfer tax provisions by reason of § 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, Trust would be subject to the generation-skipping transfer tax.

Section 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) 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).

A modification of a generation-skipping trust that is otherwise exempt under the Act and the GSTT regulations will generally result in a loss of its exempt or "grandfathered" status if the modification changes the quality, value, or timing of any powers, beneficial interests, rights, or expectancies originally provided for under the terms of the trusts.

The implementation of the proposed settlement agreement will be the end result of court-ordered mediation among the parties who have conflicting views as to the proper administration of the Trust under its terms as written. The settlement agreement, upon implementation, will resolve a bona fide controversy among the parties. The implementation of the proposed settlement agreement, upon approval by the Court, including the requested construction of the meaning of Paragraph 8 under Decedent's will, will not confer additional powers or beneficial interests upon any current or new trustee or upon any of the trust beneficiaries.

We believe that the proposed settlement agreement fairly reflects the relative merits of the claims made by the parties to the dispute and provides an allocation of Trust assets that is within the range of the reasonable outcomes which could result from a court determination of the issues. Specifically, if Son prevailed in his petition to the court, 100 percent of the Trust

would be distributed outright to Son. On the other hand, if Grandson prevailed in his request for strict construction of the "support and maintenance" standard applicable to distributions to Son, it is likely that no further distributions from Trust would be made to Son. Thus, the proposed settlement agreement is consistent with the relative merits of the parties' contentions regarding the proper administration of the Trust.

Based on the facts submitted and the representations made, we conclude that upon implementation of the proposed settlement agreement, Trust will continue to be exempt from the generation-skipping transfer tax. Provided there are no additions to the Trust, constructive or otherwise, neither distributions from the Trust (including the terminating distribution to Son), nor the termination of Trust will be subject to the generation-skipping transfer tax under §2601.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provisions of the Code.

In accordance with a 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) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
Katherine A. Mellody
Senior Technician Reviewer
Branch 4

Enclosure

Copy for section 6110 purposes