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April 27, 2009

LEGEND:

Settlor =
Trust =
Company =
Business =

Settlement =
Agreement =
Addendum =

Court =
State =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Year 1 =
Year 2 =
Year 3 =
Year 4 =

X =
Y =
Z =
Son 1 =
Grandson =
Son 2 =
Family 1 =
Family 2 =

Cousin's Son	=
Beneficiary 1	=
Beneficiary 2	=
Beneficiary 3	=
Beneficiary 4	=
Beneficiary 5	=
Beneficiary 6	=
Beneficiary 7	=
Beneficiary 8	=
Beneficiary 9	=
Beneficiary 10	=
Beneficiary 11	=
Beneficiary 12	=
Beneficiary 13	=
Beneficiary 14	=
Beneficiary 15	=
Beneficiary 16	=
Beneficiary 17	=
Beneficiary 18	=

Dear _____ :

This is in response to a letter dated June 12, 2008, and other correspondence, requesting rulings on behalf of Trust and the beneficiaries of Trust, regarding the gift and generation-skipping transfer (GST) tax consequences of a proposed termination of Trust and distribution of the Trust assets under a Settlement Agreement, as modified by Addendum.

Facts

The facts submitted and representations made are as follows. In Year 1, Settlor, the sole owner of Business, transferred x% of his stock in Business to Company in exchange for Company Stock. Subsequently, on Date 1, prior to September 25, 1985, Settlor created an irrevocable trust (Trust) and transferred to Trust all of his stock in Company, which was the principal asset of Trust. Settlor died in Year 2. Under the terms of his testamentary instruments, minor interests in real estate and tangible property passed to Trust. It is represented that other than those additions, no further additions have been made to Trust. In Year 3, a testamentary trust created under Settlor's will redeemed stock in Business owned by that trust (the remaining y%), and Company became the sole owner of Business. Years 2 and 3 were also prior to September 25, 1985.

Under the terms of Trust, Settlor directs the trustees to retain ownership and voting control of all shares of Company common stock held by Trust. Further, in general, the trustees are limited to investing only in Company. Settlor requests the trustees to cause Company to appoint Son 1 as an officer of Company, but if he does not attend to duties, to replace him, giving preference first to Grandson (the child of Son 1), then to Cousin's Son, and then to Son 2. Settlor also expresses his hope that Grandson, Cousin's Son, and Son 2, and their male children or more remote male issue will be employed by Company.

Under Article II, Section 1, sub-divisions (b) and (i), the trustees are to make specified payments to Son 1 for his life. On Son 1's death, annuities are to be paid to his issue per stirpes. Under Article II, Section 1, sub-divisions (c) and (h), the trustees are to make specified payments to Grandson and Son 2, respectively, for life. On the death of each individual, annuities are to be paid to the individual's issue per stirpes. In addition, after the death of Son 1 and Grandson, respectively, an annuity is to be paid to the decedent's surviving spouse, unless the spouse remarries.

In addition, under Article II, Section 1, sub-division (j), as construed by several court orders, "annual profits from operations" of Company are to be paid annually as follows. Under sub-division (j)(I), 1/3 of the profits but not to exceed z, are to be divided into 3 equal shares (a failed share to be added to other shares), and each share is to be paid "per stirpes to and among the female children and more remote female issue" then living of Grandson, Cousin's Son, and Son 2. Under sub-division (j)(II), the balance of the profits are to be divided into 3 equal shares (a failed share added to other shares). One share is to be paid per capita to Grandson and "his male children and more remote male issue, as shall then be serving [Company]." One share is to be paid per capita to Cousin's Son and "his male children and more remote male issue, as shall then be serving [Company]." Finally, one share is to be paid per capita to Son 2 and "his male children and more remote male issue, as shall then be serving [Company]."

Trust is to terminate 21 years after the death of the last to die of certain specified individuals. Under Article II, Section 3, upon the termination of Trust, 50 percent of the Trust corpus (the Discretionary Half) is to be distributed, in the trustees' absolute discretion, as follows:

Upon the termination of the trust period, the trustees shall pay over, transfer and convey free from trust and in such proportions as the trustees shall, in their absolute discretion, deem best, fifty per cent. (50%) of the capital of the trust estate (a) to and among the male children and/or more remote male issue of myself and of [Settlor's cousin] who are then serving [Company] as directors, officers, or employees and (b) if there be no such male children or more remote male issue of my said cousin or myself then so serving [Company], to and among

the children and /or more remote male issue of [two distant relatives of Settlor] who are then living and are so serving [Company], it being my hope that they will continue [Company] under the same principles that have caused me to create this trust.

Also under Article II, Section 3, the other 50 percent share (the Non-Discretionary Half) is to be distributed as follows. Seventy-five percent of the Non-Discretionary Half is to be distributed among the persons then entitled to the net income under Article II, Section 1, sub-divisions (b), (c), (g) and (h) in the proportions to which they are then entitled to such net income. The remaining 25 percent of the Non-Discretionary Half will pass to a fund to be held and administered for charitable purposes.

In Year 4, Business was terminated and Company assets were reinvested in a portfolio of businesses and assets. Cousin's Son, who along with his issue, was to receive payments under Article II, Section 1, sub-division (g) and (j)(II), died without issue. Accordingly, current distributions from Trust are being made to certain living members of two family lines: the family of Son 1 (Family 1); and the family of Son 2 (Family 2).

On Date 2, the last surviving individual specified as a measuring life died. Consequently, the Trust is scheduled to terminate on Date 3, which is 21 years from Date 2. The impending termination of the Trust on Date 3 raised concerns among current and potential Trust beneficiaries of the importance of employment with Company, because under the terms of the Trust, the Discretionary Half could only be distributed to those beneficiaries employed by Company. Litigation and disputes arose among the beneficiaries (and between the beneficiaries and the trustees). Issues that were raised included: whether, in general, Trust has fulfilled Settlor's purpose of making meaningful employment opportunities available to Settlor's family; whether the Trust provisions for the benefit of males serving Company violate modern public policy, anti-discrimination law, and State and federal employment discrimination laws; whether the trustees have an irreconcilable conflict of interest, because as male beneficiaries and Company executives they would benefit from gender discrimination and from preventing the employment advancement of others; and whether the modern business and legal environment made carrying out Settlor's intent impossible. The parties ultimately raised questions about the continuing operation of Trust. The parties agreed in principle to early termination of Trust.

On Date 4, the trustees, Company executives, Company, and those of Beneficiaries 1-18 who were then adults (Adult Beneficiaries), executed a settlement agreement (Settlement Agreement). Settlement Agreement provides for the early termination and distribution of Trust on Termination Date. In general, Termination Date

is the earliest date upon which the parties have received both judicial approval of the Settlement Agreement and a favorable letter ruling from the Internal Revenue Service.

Settlement Agreement contains specific provisions governing the distribution of the Trust corpus among Beneficiaries on Termination Date. Settlement Agreement accounts for the Trust distributions that would have been payable prior to Date 3 under Article II, Section 1, sub-divisions (b), (c), (h), (i) and (j), if Trust had continued. Under Settlement Agreement, the trustees will distribute to Trust beneficiaries the actuarial present value on Termination Date of the distributions the beneficiary would have received, or would have the potential right to receive, under Article II, Section 1, sub-divisions (b), (c), (h), (i) and (j) after Termination Date up to and including Date 3, if Trust did not terminate under Settlement Agreement.

The Settlement Agreement also accounts for the terminating distributions that would have been made under Article II Section 3 on Date 3, if Trust had continued until Date 3 and then terminated. The balance of Trust corpus (after providing for other payment under the Settlement agreement) is to be divided into a Non-Discretionary Half and a Discretionary Half. The Non-Discretionary Half is to be divided into a Charitable Portion and a Non-Discretionary Portion. The Charitable Portion will be administered and distributed in accordance with terms specified in the Settlement Agreement for the benefit of charity. In general, the Non-Discretionary Portion will be distributed to beneficiaries based on the actuarial present value of the interest each beneficiary potentially could be entitled to receive if living on Date 3, taking into account several factors, including the beneficiary's age. Specific adjustments are provided regarding the distribution to Grandson's surviving spouse (Beneficiary 1) and a related distribution to Grandson's son, Beneficiary 2.

Regarding the Discretionary Half, every Adult Beneficiary (or that beneficiary's estate), except Beneficiary 3 and Beneficiary 6, will receive a specified percentage of the Discretionary Half that was negotiated taking into account several factors, including the beneficiary's age, gender, and actual or potential employment with the Company. The distribution of the Discretionary Half is made first along family lines, then between the members of the higher and middle generations in the respective families.

Settlement Agreement provides that the agreement can be amended, with the consent of all the parties, to reflect the results of pending discussions with guardians ad litem for the minor, unborn, and unascertained beneficiaries (GALs).

On Date 5, the trustees petitioned Court, requesting approval of Settlement Agreement. Subsequently, on Date 6, an Addendum to Settlement Agreement (Addendum) was executed. Addendum states that one of the primary purposes of Addendum is to resolve all disputes regarding the relative merits of a claim by some

GALs regarding the Trust beneficiaries who were minors when Settlement Agreement was executed (Minor Beneficiaries). The GALs claimed that Minor Beneficiaries who would reach legal working age by Date 3 could have been employed by Company if Trust continued until that date and, thus, these “potentially employable beneficiaries” should be given a share of the Discretionary Half. Before executing Addendum, Adult Beneficiaries had offered several counter arguments in opposition to this claim. Under paragraph 1 of Addendum, specified Adult Beneficiaries’ Discretionary Half distributions will be reduced by a very small percentage to provide distributions to “potentially employable beneficiaries.” The amounts distributed to each beneficiary are determined based on the potential that the beneficiary might have been employed by Company by Date 3, in view of the respective beneficiary’s age and gender. The aggregate amount to be distributed to these potentially employable Minor Beneficiaries constitutes a very small percentage of the total Discretionary Half.

In addition, the GALs required that Addendum provide for unborn and unascertained beneficiaries who might become entitled to a portion of Trust in the future, and paragraph 4 of Addendum provided for such beneficiaries. Finally under paragraph 5 of Addendum, Settlement Agreement is modified regarding distributions with respect to payments that were otherwise to be made under Article II, Section 1, sub-division (j)(l) of the Trust agreement. Under paragraph 5 of Addendum, instead of making distributions on Termination Date based on actuarial present values, the trustees will purchase an annuity that will make payments from Termination Date through Date 3. The annuity contract will be owned by a trust that will receive the annuity payments and make annual distributions to existing and future beneficiaries who would, or could potentially, receive distributions under this provision. The annuity will provide for a total annual payment of \$z (the total annual amount payable under sub-division (j)(l))

On Date 7, Court issued an order approving Settlement Agreement and Addendum, authorizing the termination of Trust pursuant to Settlement Agreement and Addendum, authorizing the full implementation of Settlement Agreement and Addendum, and incorporating the findings in Court’s decision issued two days earlier. In that decision, among other things, Court discussed the legal basis for termination of Trust and found that termination pursuant to Settlement Agreement and Addendum, by consent of the Adult Beneficiaries with the recommendation of all GALs, is authorized.

The taxpayers have requested the following rulings:

1. The implementation of the proposed transaction will not cause Trust, any part of Trust, or any distributions from Trust (including distributions from the continuing trust under paragraph 5 of the Addendum with respect to sub-division (j)(I) of Trust) to be subject to the GST tax.

2. The implementation of the proposed transaction will not cause Beneficiaries 1-18 to make a taxable gift for gift tax purposes.

Ruling Request # 1:

Section 2601 imposes a tax on each generation-skipping transfer made by a transferor to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i), the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date. Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under §§ 2038 or 2042, if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(4)(i) 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 will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are generally applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Unless noted otherwise, 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 a trust or the construction of the 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.

In this case, Trust was created and irrevocable before September 25, 1985. It is represented that no additions have been made to Trust after that date.

We conclude that the Settlement Agreement and Addendum constitute a settlement of bona fide issues regarding the administration of Trust and regarding the construction of the terms of Trust. We also conclude, based on the facts as presented including statements executed by certain Adult Beneficiaries, that the terms of Settlement Agreement and Addendum are the product of arm's length negotiations and represent a compromise that reflects the parties' assessments of the relative strengths of their positions. Further, the terms of the Settlement Agreement and Addendum are within the range of reasonable outcomes under the governing instrument and the applicable state and federal law addressing the issues resolved by Settlement Agreement and Addendum.

Accordingly, based on the facts submitted and the representations made, we rule that the implementation of the proposed transaction will not cause Trust, any part of Trust, or any distributions from Trust (including distributions from the continuing trust under paragraph 5 of Addendum with respect to sub-division (j)(I) of Trust) to be subject to the GST tax.

Ruling 2

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year.

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(b) of the Gift Tax Regulations provides that, as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him or her no power to change its disposition, whether for his or her own benefit or for the benefit of another, the gift is complete. But, if upon a transfer, a donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the fact in the particular case.

Section 25.2511-1(c)(1) provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Whether an agreement settling a dispute is effective for gift tax purposes depends on whether the settlement is based on a valid enforceable claim asserted by the parties and, to the extent feasible produces an economically fair result. See *Ahmanson Foundation v. U.S.*, 674 F.2d 761, 774-75 (9th Cir. 1981), citing *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967). Thus, state law must be examined to ascertain the legitimacy of each party's claim. If it is determined that each party has a valid claim, the Service must determine that the distribution under the settlement reflects the result that would apply under state law. If there is a difference, it is necessary to consider whether the difference may be justified because of the uncertainty of the result if the question were litigated.

As discussed above, Settlement Agreement and Addendum represent the resolution of bona fide controversies among the parties. All interested parties who hold or may hold an interest in Trust, including any minors and unborn heirs, have been represented in the proceedings that culminated in the Date 7 order approving the Agreement. Further, based on the facts as presented including statements executed by certain Adult Beneficiaries, the terms of the Settlement Agreement and Addendum are the product of arm's length negotiations among all the interested parties. We conclude that Settlement Agreement and Addendum reflect the rights of the parties under the applicable law of State that would be applied by the highest court of State and under federal law. Accordingly, based on the facts submitted and representations made, we rule that the implementation of the proposed transaction will not cause Beneficiaries 1-18 to make a taxable gift for gift tax purposes.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the proposed transaction under the cited provisions or under any other provisions of the Code.

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,
Branch Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special
Industries)

Enclosure

Copy for section 6110 purposes