Internal Revenue Service

Number: **201013018**
Release Date: 4/2/2010

Index Number: 2501.00-00, 2601.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-129548-09
Date: November 30, 2009

LEGEND:

Husband	=
Wife	=
Son 1	=
Son 2	=
Grandchild 1	=
Grandchild 2	=
Grandchild 3	=
Grandchild 4	=
Grandchild 5	=
Grandchild 6	=
Grandchild 7	=
Grandchild 8	=
Company	=

Company 1 =

Bank =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Foundation =

Court =

Son 1's Will =

Settlement Agreement 1 =

Settlement Agreement 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Year 1 =

d =

e =

w =

x =

m =

y =

z =

n =

s =

t =

State =

State Statute 1 =

State Statute 2 =

State Statute 3 =

Dear :

This responds to a letter dated June 11, 2009, and other correspondence, requesting rulings on behalf of Trust 1 and Trust 2 and Son 2, regarding the gift and

generation-skipping transfer (GST) tax consequences of Settlement Agreement 1 which provides for the division of Trust 1 and Trust 2 and for an Equitable Adjustment of the trusts' State Tax Savings.

Facts

The facts submitted and representations made are as follows. Husband was one of the founders of Company. Before September 25, 1985, Husband created Trust 1 and Wife created Trust 2, irrevocable and substantially identical trusts. Husband also created Trust 3 and Trust 4, irrevocable and substantially identical trusts. All four trusts (Trusts) were funded with Company stock (Stock). Husband and Wife created Foundation, an organization described in §§ 501(c)(3) and 509(a) of the Internal Revenue Code. Husband and Wife both died and were survived by their two children, Son 1 and Son 2, and their then living descendants. All of these events occurred before September 25, 1985, and no additions have been made to Trusts since that date.

Article Third of Trust 1 and of Trust 2 directs the trustees to hold one-half of the principal for Son 1 and pay the net income to him quarterly for life. Son 1 has a testamentary power to appoint the net income of his one-half share among the grantor's descendants (other than the powerholder), their spouses, and charities, for the period beginning with Son 1's death and ending when the trust terminates. Any income he fails to appoint will be distributed per stirpes to his issue, or, if none, to issue of the grantor or other family members then entitled to receive income under Article Fourth, or, if none, to charities selected by trustees other than the grantor's spouse. Son 1 also has a testamentary power to appoint his one-half share of principal among family members (other than the powerholder) and charities, to be distributed upon termination of the trust. Any principal he fails to appoint will be distributed per stirpes to his issue, or, if none, to issue of the grantor or other family members then entitled to receive principal under Article Fourth, or, if none, to charities selected by the trustees other than the grantor's spouse. Article Fourth contains substantially identical provisions for Son 2.

Trust 1 and Trust 2 terminate 21 years after the death of the last survivor of Wife, Son 1, Son 2 and each person living at the trust's inception who shall become the widow of either Son 1 or Son 2.

Article First of Trust 3 and of Trust 4 directs the trustees to pay all of the trust's net income to charities (selected by a committee of trustees and public members provided for under Article Second) until 21 years after the death of the survivor of Son 1 and Son 2. From that point until the trust terminates, under Article Fifth(A), one-half of the net income will be paid to such persons as Son 1 appoints in his will; and under Article Fifth(B) one-half of the net income will be paid to such persons as Son 2 appoints in his will. Upon termination of the trust, under Article Sixth(A) one-half of the principal will be paid to such persons as Son 1 appoints in his will; and under Article Sixth(B) one-half of the principal will be paid to such persons as Son 2 appoints in his

will. To the extent Son 1 or Son 2 does not exercise his power over income or over principal, his issue have the respective power to appoint their respective shares. The donee of a power cannot appoint income or principal to the donee, the donee's creditors, the donee's estate, or the creditors of the donee's estate. Any income or principal not appointed under Articles Fifth and Sixth, respectively, will be distributed among the descendants of Husband, per stirpes, or if none, to Foundation, or if it is not then in existence, to charities selected by the trustees.

Trust 3 and Trust 4 terminate 21 years after the death of the last survivor of Son 1, Son 2, five named grandchildren of Husband, and each person living at the trust's inception who shall become the widow or widower of such individuals.

Son 1 died on Date 1, survived by his three children, Grandchild 1, Grandchild 2, and Grandchild 3, and their then living children.

In Article VIII of his Will, Son 1 appointed his one-half share of net income of Trust 1 and Trust 2, respectively. As appointed, Son 1's share of net income is to be divided into three equal shares, one share for each of his three sons and the son's respective family ("Family Share"), payable from Son 1's death until the respective termination of Trust 1 and Trust 2. Each Family Share of income is to be distributed under a detailed formula among the named son (or the son's surviving spouse) and the son's descendants. Under Article VIII.A.5 of Son 1's Will, any income payable to a beneficiary who is under age 30 is to be held in trust for that beneficiary (Article VIII.A.5 Trusts). Son 1 appointed his one-half share of principal of Trust 1 and Trust 2, respectively, to Foundation to be paid upon the termination of Trusts 1 and 2.

In Article IX of his Will, Son 1 appointed his one-half share of income of Trust 3 and Trust 4, respectively, to Foundation. As appointed, the income from each trust will be paid for a period commencing 21 years after Son 2's death and ending on the termination of Trusts 1 and 2. He also appointed his share of net income from Trust 3 and Trust 4 for the period that commences upon the termination of Trust 1 and Trust 2 and ends on the termination of Trusts 3 and 4. The income will be distributed in three equal shares, one share for each of his three sons and the son's respective family ("Family Share"), payable from the termination of Trusts 1 and 2 until Trusts 3 and 4 terminate. Each Family Share of income is to be distributed under a detailed formula among the named son (or the son's surviving spouse) and the son's descendants. Under Article IX.A.6 of Son 1's Will, any income payable to a beneficiary who is under age 30 is to be held in trust for that beneficiary. Son 1 appointed his one-half share of principal of Trust 3 and Trust 4, respectively, to be paid to Foundation at the termination of Trust 3 and Trust 4.

The current trustees of all four Trusts are Grandchild 1, Grandchild 2, Grandchild 3, Son 2, and Bank.

The trustees of Trusts have sold portions of Stock on a few occasions to pay expenses. On Date 2 in Year 1, Company 1 purchased all of the outstanding stock of Company (Date 2 Sale). Before the Date 2 Sale, Trusts held only Stock and relatively small amounts of cash. In the Date 2 Sale, Trusts sold all of their Stock.

Trust 1 and Trust 2's gross proceeds from the Date 2 Sale were approximately $w and $x, respectively. For State income tax purposes, Trust 1 and Trust 2 realized net capital gains from the Date 2 Sale of approximately $m in the aggregate. Trust 3 and Trust 4's gross proceeds from the Date 2 Sale were approximately $y and $z, respectively. For State income tax purposes, Trust 3 and Trust 4 realized net capital gains from the Date 2 Sale of approximately $n in the aggregate.

State income tax law provides a charitable set-aside deduction from income tax for the taxable income of a trust required to be set aside for ultimate distribution to charity. Since Son 1's death, one-half of the principal remainder of each Trust has been irrevocably set aside for charity pursuant to Son 1's exercise of his powers of appointment over the principal of Trusts. The trustees of Trusts have claimed the State charitable set-aside income tax deduction for one-half of the capital gains recognized by Trusts in the aggregate in some past years for a total State tax saving of $d for the years since Son 1's death. The trustees of Trusts have not claimed a federal charitable set-aside deduction under § 642(c)(2) for any capital gains recognized, and they will not claim one for the Date 2 Sale. The trustees of Trusts will claim the State charitable set-aside deduction for one-half of the capital gains recognized by each trust in the Date 2 Sale for a total State tax savings in Year 1 of approximately $e for all four Trusts in the aggregate.

Son 2, his spouse, and his children, Grandchild 4, Grandchild 5, Grandchild 6, Grandchild 7, and Grandchild 8, and numerous grandchildren of Son 2 are currently living.

After Stock was sold, differing investment preferences emerged between the families of Son 1 and Son 2, and differences in charitable preferences gained importance. Further, the capital gains Trusts realized between Son 1's death and the Date 2 Sale were nominal in comparison to the very substantial capital gains the trusts realized in the Date 2 Sale. In light of these substantial capital gains realized in the Date 2 Sale, a controversy arose among the families of Son 1 and Son 2 and the trustees over the tax benefit attributable to the State charitable set-aside deduction resulting for Year 1 from Son 1's exercise of his powers of appointment (the Year 1 State Tax Savings) and whether it should be allocated equally between both halves of each trust or should be allocated solely to the half of each trust subject to Son 1's exercise of his powers of appointment.

Between Date 3 and Date 4, pursuant to State Statute 1, Settlement Agreement 1 was executed regarding Trusts 1 and 2 and Settlement Agreement 2 was executed regarding Trusts 3 and 4.

Under Settlement Agreement 1, the trustees of Trusts 1 and 2, with the approval of Court, will exercise their power under State Statute 3 to divide each trust into two trusts. Each of Trusts 1 and 2 will be divided into A Trusts (Trust 1A and Trust 2A) consisting of that portion of each trust previously administered under Article Third of the respective trust for the benefit of the appointees of Son 1. Each of Trusts 1 and 2 will be divided into B Trusts (Trust 1B and Trust 2B) consisting of that portion of each trust previously administered under Article Fourth of the respective trust for the benefit of Son 2 and his family, Son 2's future potential appointees, and charity.

Subject to the Equitable Adjustment, every asset and every liability, other than tax liabilities, of each of Trusts 1 and 2 will be divided into equal fractional shares. One fractional share will be allocated to the respective A Trust, and one fractional share will be allocated to the respective B Trust. Federal tax liabilities, deductions and credits of each of Trusts 1 and 2 will be allocated equally between the respective A and B Trusts.

Settlement Agreement 1 also provides for the Equitable Adjustment of the Year 1 State Tax Savings. In conjunction with the division of Trusts 1 and 2, the trustees will implement this Equitable Adjustment as follows: (1) by allocating s percent of the Trust 1 Year 1 State Tax Savings to Trust 1A and t percent of the Trust 1 Year 1 State Tax Savings to Trust 1B; and (2) by allocating s percent of the Trust 2 Year 1 State Tax Savings to Trust 2A and t percent of the Trust 2 Year 1 State Tax Savings to Trust 2B. All other State tax liabilities, deductions, and credits of each of Trusts 1 and 2 will be allocated equally between the respective A and B Trusts.

All of the principal of Trusts 1A and 2A will be administered and distributed under the terms of Article Third of Trusts 1 and 2, respectively, as modified by Son 1's exercise of his powers of appointment. All of the principal of Trusts 1B and 2B will be administered and distributed under the terms of Article Fourth of Trusts 1 and 2, respectively, subject to any later modification by Son 2's exercise of his powers of appointment.

State Statute 1 provides for a binding nonjudicial procedure to resolve matters pertaining to trusts through a written agreement. The following parties executed Settlement Agreement 1: Grandchild 1- 3, individually, as trustee of Trusts 1 and 2 and as trustee of Trusts 1A and 2A and of the Article VIII.A.5 Trust for his children; the spouses of Grandchild 1 and 2, individually and as trustee of the Article VIII.A.5 Trust for each spouse's respective children; the former spouse of Grandchild 3 as trustee of the Article VIII.A.5 Trust for her son; the adult children of Grandchild 1 and 2, individually, and one such adult child and her spouse, each as trustee of the Article VIII.A.5 Trust for their children; Son 2, individually, as trustee of Trusts 1 and 2, and as

trustee of Trusts 1B and 2B; Grandchild 4-8, individually; Grandchild 5-8 as trustee of Trusts 1B and 2B; the adult children of Grandchild 4 and 6, individually; Bank as trustee of Trusts 1 and 2, and as trustee of Trusts 1A,1B, 2A, and 2B; and Foundation. Individual parties also executed Settlement Agreement 1 as virtual representatives of minor, unborn, or unascertained beneficiaries as permitted by State Statute 2. On Date 5, the Attorney General of State issued a statement that he does not object to Settlement Agreement 1.

Settlement Agreement 1 is subject to the approval of Court and to the receipt of a favorable ruling from the Internal Revenue Service. Settlement Agreement 1 will become effective upon a date that is agreed upon by the trustees and is within a reasonable time after the Court has approved the agreement (Effective Date). The parties to Settlement Agreement 1 and the current trustees of Trusts 1 and 2 petitioned the Court for an order approving Settlement Agreement 1 and dividing each of Trusts 1 and 2 as of Effective Date in the manner described in the agreement. The Office of the Attorney General of State filed a statement that the Attorney General did not object to Court's granting relief. On Date 6, Court issued an order approving Settlement Agreement 1 in all respects and ordering that each of Trusts 1 and 2 is to be divided on Effective Date in the manner described in the agreement.

The taxpayers have requested the following rulings:

1. The implementation of Settlement Agreement 1, under which an equitable adjustment would be made for State Tax Savings in Year 1, will not be treated as a modification that would cause either Trust 1 or Trust 2 to lose its exemption from the GST tax.

2. The division of Trust 1 and of Trust 2 in a manner consistent with Settlement Agreement 1 will not cause either Trust 1 or Trust 2 to lose its exemption from the GST tax.

3. The implementation of Settlement Agreement 1 will not subject Son 2 to federal gift tax.

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, Trusts 1 and 2 were created and irrevocable before September 25, 1985. It is represented that no additions have been made to Trusts 1 and 2 after that date.

We conclude that Settlement Agreement 1 constitutes a settlement of bona fide issues regarding the administration of Trusts 1 and 2 and regarding the construction of the terms of Trusts 1 and 2. We also conclude that the terms of Settlement Agreement 1 are the product of arm's length negotiations and represent a compromise that reflects the parties' assessments of the relative strengths of the positions of the families of Sons 1 and 2. Further, the terms of Settlement Agreement 1 are within the range of reasonable outcomes under the governing instrument and the applicable state law addressing the issues resolved by Settlement Agreement 1.

Accordingly, based on the facts submitted and the representations made, we rule as follows:

1. The implementation of Settlement Agreement 1, under which an equitable adjustment would be made for State Tax Savings in Year 1, will not be treated as a

modification that would cause either Trust 1 or Trust 2 to lose its exemption from the GST tax.

2. The division of Trust 1 and of Trust 2 in a manner consistent with Settlement Agreement 1 will not cause either Trust 1 or Trust 2 to lose its exemption from 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 1 represents the resolution of a bona fide controversy between the families of Sons 1 and 2. All interested parties who hold or may hold an interest in Trusts 1 and 2, including any minors and unborn heirs, have been represented in the proceedings that culminated in the Date 6 order approving the

Agreement. Further, based on the facts as presented, the terms of Settlement Agreement 1 are the product of arm's length negotiations among all the interested parties. We conclude that Settlement Agreement 1 reflects the rights of the parties under the applicable law of State that would be applied by the highest court of State. Accordingly, based on the facts submitted and representations made, we rule that implementation of Settlement Agreement 1 will not subject Son 2 to federal gift tax.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the proposed modifications of Trusts 1 and 2 under Settlement Agreement 1 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,

_____

James Hogan
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes