

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B4
PLR-116033-22

Date:
February 01, 2023

Legend

Decedent =
Daughter =
Trust =
Individual =
Date 1 =
Date 2 =
Date 3 =
u =
v =
w =
x =
y =
z =
State =
Statute 1 =
Statute 2 =
Statute 3 =
Cite =

Settlement Agreement =

Court =

Order =

Dear :

This letter responds to the letter from your authorized representative dated August 5, 2022, requesting rulings with respect to the federal income, gift, and generation-skipping transfer (GST) tax consequences of a court approved settlement agreement. The facts submitted and the representations made are as follows:

Decedent died on Date 1, a date before September 25, 1985. Decedent's last will and testament (Will) established Trust.

Article Eighth of Decedent's Will provides that upon the death of the last survivor of u named persons, the trustees shall divide the corpus of Trust "among the descendants in equal shares per stipes and not per capita, at that time surviving my [Daughter]."

State Statute 1 provides:

If a governing instrument requires property to be distributed "per stirpes," the property is divided into as many equal shares as there are: (1) surviving children of the designated ancestor; and (2) deceased children who left surviving descendants. Each surviving child is allocated one share. The share of each deceased child with surviving descendants is divided in the same manner, with subdivision repeating at each succeeding generation until the property is fully allocated among surviving descendants.

State Statute 2 provides: The term "Descendant" of an individual means all of his progeny of all generations with a relationship of parent and child at each generation being determined by the definition of child and parent.

Daughter, who is deceased, had y children, including Individual. Daughter had w grandchildren, of which x are living and y are deceased with surviving children (collectively, the "Presumptive Remainder Beneficiaries"). Individual, who is the sole survivor of Daughter's children and is z years old, is also the sole survivor of those u persons named in Article Eighth of Decedent's Will. Thus, pursuant to Article Eighth and State Statute 1, upon Individual's death, the trustees are required to make a per stirpital distribution to each of the Presumptive Remainder Beneficiaries.

Article Eighth of the Will, however, is ambiguous as to whether under State law, the per stirpital division of Trust should be made at the generation of descendants who are the children of Daughter, or at the generation of descendants who are the grandchildren of

Daughter. The phrase “among the descendants in equal shares per stirpes and not per capita,” presents a conflict between the phrases “descendants in equal share,” which connotes an intention of equal treatment of all of a grantor’s descendants, and the Latin term “per stirpes,” which connotes an intention of unequal treatment among a grantor’s descendants. See Cite. The highest court in State has not ruled directly in any case that would resolve this ambiguity with any degree of certainty.

State Statute 3 provides, in relevant part:

[I]nterested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust. . . . only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court [and] [a]ny interested person may request the court to approve a nonjudicial settlement agreement.

On Date 2, to avoid the possibility of lengthy and protracted legal proceedings to resolve the interpretation of the ambiguous text of Article Eighth, the Presumptive Remainder Beneficiaries entered into Settlement Agreement to set forth their agreement regarding the division of Trust. As such, Settlement Agreement falls between the two per stirpes divisions described above. Settlement Agreement is subject to the condition precedent that there continues to be a specific number of per stirpital shares at Individual’s death. Under Settlement Agreement, no Presumptive Remainder Beneficiary receives more than what his or her best-case litigation outcome would have been, and all Presumptive Remainder Beneficiaries have settled for something less than their best-case litigation outcome. Further, the Settlement Agreement is the product of arm’s length negotiations among the Presumptive Remainder Beneficiaries and is within the range of reasonable outcomes under the governing trust instrument in light of the governing State law. The trustees do not object to the manner in which the Settlement Agreement resolved the ambiguity.

On Date 3, upon a finding that all interested persons were given notice, Court issued Order approving Settlement Agreement. Order is conditioned upon the receipt of a favorable private letter ruling by the Internal Revenue Service.

It is represented that there have been no additions, constructive or actual, to Trust after September 25, 1985.

Rulings Requested

1. Neither Settlement Agreement, nor Order, nor the implementation of Settlement Agreement and distributions made in accordance with Order upon termination of Trust will cause Trust to lose its exempt status for GST purposes, and these events will not cause Trust, the trustees of Trust, or the beneficiaries of Trust to become subject to GST tax under §§ 2601 and 2603.

2. Neither Settlement Agreement, nor Order, nor the implementation of Settlement Agreement and distributions made in accordance with Order upon termination of Trust will cause any beneficiary of Trust to be treated as having made a taxable gift to another beneficiary, and these events will not cause any beneficiary of Trust to become subject to gift tax under § 2501.

3. Neither Settlement Agreement, nor Order, nor the implementation of Settlement Agreement and distributions made in accordance with Order upon termination of Trust will result in the recognition of gain or loss to Trust or any beneficiary of Trust or otherwise be treated as a taxable sale, exchange or other disposition of property between or among any of them under § 1001.

4. The implementation of Settlement Agreement in accordance with Order upon termination of Trust will not result in the receipt of gross income under § 61 by any beneficiary to the extent terminating distributions from Trust are in excess of Trust distributable net income as defined in § 643.

Law and Analysis

Ruling Request 1

Section 2601 imposes a tax on every GST made after October 26, 1986. Section 2611(a) defines a GST as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2603(a) provides that (1) in the case of taxable distribution, the tax imposed by § 2601 shall be paid by the transferee; (2) in the case of a taxable termination or direct skip from a trust, the tax shall be paid by the trustee; (3) in the case of a direct skip (other than a direct skip from a trust), the tax shall be paid by the transferor. Section 2603 (b) provides that unless otherwise directed pursuant to the governing instrument by specific reference to the tax imposed by chapter 13 of the Code, the tax imposed by chapter 13 on a GST transfer shall be charged to the property constituting such transfer.

Section 2611(a) defines the term “generation-skipping transfer” as a taxable distribution, a taxable termination, and a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the GST Tax Regulations, the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the tax does not apply to a transfer under a trust (as defined in § 2652(b)) 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)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b)(1), (b)(2), or (b)(3) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules of § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. They 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 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 the present case, Trust was created and was irrevocable before September 25, 1985. It is represented that no additions, constructive or actual, have been made to Trust on or after September 25, 1985. Consequently, Trust is currently exempt from GST tax.

Settlement Agreement addresses a bona fide issue as to how Trust assets are to be distributed upon termination of Trust. To avoid the possibility of protracted litigation to resolve the interpretation of the ambiguous text, the Presumptive Remainder Beneficiaries engaged in arm's length negotiations. Settlement Agreement is a compromise between the positions of the beneficiaries and reflects their assessments of the relative strengths of their positions. Thus, Settlement Agreement is within the range of reasonable outcomes under the language of Trust and applicable State law addressing the issue.

Accordingly, based upon the facts submitted and the representations made, neither Settlement Agreement, nor Order, nor the implementation of Settlement Agreement and distributions made in accordance with Order upon termination of Trust will cause Trust to lose its exempt status for GST tax purposes, and these events will not cause Trust, the trustees of Trust, or the beneficiaries of Trust to become subject to GST tax under §§ 2601 and 2603.

Ruling Request 2

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations 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 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.

In the present case, the ambiguity created by the language of Trust, when read in conjunction with State Statutes 1 and 2, presents a bona fide issue as to how the trust assets are to be distributed upon termination of Trust. The highest court in State has not ruled directly on point in any case that would address the ambiguity in this case with any degree of certainty. Thus, each Presumptive Remainder Beneficiary has a legitimate claim, and it is uncertain what distribution he or she would receive if the question were litigated. Settlement Agreement reflects the result that would apply under State law based on the language of Trust and State Statutes 1 and 2, after considering the uncertainty of the results if the question were litigated.

Accordingly, based upon the facts submitted and the representations made, neither Settlement Agreement, nor Order, nor the implementation of Settlement Agreement and distributions made in accordance with Order upon termination of Trust will cause any beneficiary of Trust to be treated as having made a taxable gift to another beneficiary, and these events will not cause any beneficiary of Trust to become subject to gift tax under § 2501.

Ruling Request 3

Section 61(a)(3) and (14) provides that gross income includes gains derived from dealings in property and income from an interest in an estate or trust.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

An exchange of property results in the realization of gain or loss under § 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). A material difference exists when the exchanged properties embody legal entitlements different in kind or extent or if they confer different rights and powers. Id. at 565.

In the present case, State Statutes 1 and 2, the language of Trust, and the remaining Trust beneficiaries create ambiguity as to how the Trust assets are to be distributed upon termination. Settlement Agreement provides for a distribution within reasonable outcomes based on the language of Trust. Further, Settlement Agreement does not extend beyond resolving the ambiguity.

Accordingly, based upon the facts submitted and the representations made, neither Settlement Agreement, nor Order, nor the implementation of Settlement Agreement in accordance with Order upon termination of Trust will result in the recognition of gain or loss to Trust or any beneficiary of Trust or otherwise be treated as a taxable sale, exchange, or other disposition of property between or among any of them under § 1001.

Ruling Request 4

As the implementation of Settlement Agreement in accordance with Order is not a taxable exchange under § 1001, implementation of Settlement Agreement upon termination of Trust will not result in the receipt of gross income under § 61 by any beneficiary to the extent terminating distributions from Trust are in excess of Trust distributable net income as defined in § 643.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure (1)

Copy for § 6110 purposes

cc: