

Number: **200634004**  
Release Date: 8/25/2006  
**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Index Number: 2601.00-00

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No. 50-00529

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Refer Reply To:  
CC:PSI:B04  
PLR-115482-05  
Date: MAY 03, 2006

Re:

LEGEND:

Decedent	-
Trust	-
Date 1	-
Date 2	-
Child A	-
Child B	-
Child C	-
Date 3	-
Court	-
State	-
State Statute	-
Year	-

Dear :

This is in response to a letter dated March 17, 2005, submitted by your authorized representative requesting a ruling under section 2601 of the Internal Revenue Code.

Decedent died Date 1. Under a will dated Date 2, Decedent bequeathed his residuary estate to his spouse, in trust (Trust), for the lifetime benefit of his spouse and three children (Child A, Child B, and Child C). Article Fourth of the will provides that the trustee is to sell and convert into cash all the stocks, bonds, and other personal estate and securities as soon after Decedent's death in the trustee's judgment "will be to the best interest of my estate." The trustee shall also sell and convey all the real estate

after Decedent's death and whenever in the trustee's judgment it will be to the best interest of the estate. The proceeds from the sale or conversions of the personal and

real estate shall be reinvested or loaned out at the highest possible rate of interest and the income derived from such property shall be paid to Decedent's spouse during her lifetime and then to Decedent's children, or issue of a deceased child per stirpes, for their lifetime. Upon the death of the last survivor of Decedent's children, Trust is to be distributed in equal shares to such issue of Decedent's children, per stirpes.

Trust further provides that the successor trustee, to be appointed by Court, shall continue to loan out the funds belonging to the estate and carry out the provisions of trust, and for that purpose the successor trustee shall have the same powers and authority as Decedent's spouse.

After the death of Decedent's spouse, Date 3, Child B was appointed successor trustee of Trust. In Year a dispute arose among certain trust beneficiaries regarding Child B's actions as trustee, including whether the will should be construed to require the investment of the proceeds of the sale of real estate be solely in bonds or whether the will and applicable local law permitted the trustee to invest trust assets in broadly diversified investments in accordance with the State prudent investor rule. The parties settled the dispute and by Court order a corporate trustee was appointed and Trust was modified to permit the trustee to invest 35 percent of the trust's assets in stocks and 65 percent in bonds. Additional administrative provisions regarding removing and replacing trustees, procedures for administering and selling real estate, and clarifying standards for reinvestment of proceeds were added as part of the order. As part of the settlement, Child B resigned as trustee.

State Statute provides, in part, that a trustee has a duty to invest and manage trust assets as a prudent investor would considering the purposes, terms, distribution requirements, and other circumstances of the trust. Also, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, the trustee reasonably believes it is in the interest of the beneficiaries and furthers the purposes of the trust not to diversify. Further, the trustee has a duty to pursue an investment strategy that considers both the reasonable production of income and safety of capital, consistent with the trustee's duty of impartiality and the purposes of the trust.

Trust became irrevocable on Decedent's death, prior to September 25, 1985, and it is represented that no additions have been made to Trust after said date.

The trustee has asked for a ruling that the court-approved settlement will not have any effect on the Trust's status as exempt from generation-skipping transfer (GST) tax under section 2601.

Section 2601 imposes a tax on every generation-skipping transfer, which is defined under section 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under section 1433 of the Tax Reform Act of 1986 (the Act), GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after 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 under section 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains exempt status for generation-skipping transfer tax purposes. 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 section 1001.

Section 26.2601-1(b)(4)(i)(B), provides that a court-approved settlement of a bona fide issue regarding the administration of the 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 this case, the court-approved settlement which provides for the trustee to invest 35 percent of the trust's assets in stocks and 65 percent in bonds is the product of arm's length negotiations and is within the range of reasonable outcomes under the governing instrument and applicable State law. Accordingly, based on the facts submitted and the representations made, we conclude that the court-approved settlement will not have any effect on the Trust's status as exempt from GST tax under section 2601.

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

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. We are specifically not ruling on the gift tax and income tax consequences of the transaction.

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.

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.

Sincerely yours,

Lorraine E. Gardner  
Senior Counsel, Branch 4  
(Passthroughs and Special  
Industries)

Enclosure:  
Copy of letter for section 6110