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Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Refer Reply To:  
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Date:  
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Legend

Patriarch =

Trust =  
Company

State =

Corporation =

A =

B =

C =

D =

E =

Family =

Matriarch =

F =

Child 1 =

Child 2 =

Child 3 =

Child 4 =  
Date 1 =  
Trust 1 =

Grandchild 1 =  
Trust 2 =

Grandchild 2 =  
Date 2 =  
Trust 3 =

Grandchild 3 =  
Trust 4 =

Grandchild 4 =  
Date 3 =  
Trust 5 =

Grandchild 5 =  
Trust 6 =

Grandchild 6 =  
Trustee 1 =  
Trustee 2 =  
Trustee 3 =  
Trustee 4 =  
Fund 1 =  
Fund 2 =  
Date 4 =  
Trust 7 =

Trust 8 =

Trustee 5 =  
Trustee 12 =  
Date 5 =

Trust 9 =

Date 6 =

Trust 10 =

Trustee 6 =

Court =

Date 7 =

Trust 11 =

Trust 12 =

Trust 13 =

Trust 14 =

Trustee 7 =

Trustee 8 =

Trustee 9 =

Trustee 10 =

Trustee 11 =

Grandchild 7 =

Grandchild 8 =

Grandchild 9 =

Dear

This letter responds to your letter, dated February 2, 2004, and prior correspondence requesting rulings regarding the income, estate, and generation-skipping consequences of naming a family-owned trust company as trustee of certain family trusts.

The descendants of Patriarch (collectively “the family”) have agreed to form Trust Company in State as a wholly-owned subsidiary of Corporation. The shareholders of Corporation are individual family members, trusts related to the family members, and foundations having a relationship with the family. Trust Company will serve as an independent trustee of certain family trusts.

Patriarch had five children: A, B, C, D, and E, all of whom are now deceased. This letter relates to the trusts currently operating for the benefit of the descendants of B.

Section 3.2 of the Trust Company Bylaws provides that the board of directors for Trust Company shall consist of no less than five nor more than twenty-five persons. The exact number of directors within the minimum and maximum limits is to be fixed and determined from time to time by resolution of a majority of the full board or by resolution of a majority of the shareholders at any meeting thereof. At any time such a resolution is not in effect, the number shall be five.

Section 4.5 of the Trust Company Bylaws provides in relevant part that the board may designate a Discretionary Decisions Review Committee (“DDRC”) whose responsibility shall be to review discretionary decisions made by the trust officers of the company upon the written request of a beneficiary of an affected trust. The DDRC shall be appointed by the board and shall include at least three directors. Upon the receipt of a written request from a beneficiary of an affected trust (as defined in section 12.5) for a review of a discretionary decision (as defined in section 12.5) that has been made by the senior trust officer or by another trust officer and reviewed and approved by the senior trust officer, the committee shall meet as soon as practicable to review the discretionary decision. The DDRC shall render its decision to affirm or alter the discretionary decision of the senior trust officer in writing and such action shall represent the final decision by the company on the discretionary decision in question.

Section 5.6 of the Trust Company Bylaws provides in relevant part that the senior trust officer shall review all discretionary decisions of other trust officers of the company upon the request of a beneficiary or other interested person of a trust.

Section 12.1 of the Trust Company Bylaws provides that there shall be at least one member of the board who is not a Family member (as that term is defined in section 12.5(d)) or a grantor of, a donor to, or a current or contingent beneficiary of an affected trust (as defined in section 12.5(a)).

Section 12.2 of the Trust Company Bylaws provides that all discretionary decisions (as defined in section 12.5(c)) shall be made by the trust officers of the company who are not Family members, subject to review by the senior trust officer and the DDRC. Therefore, at any time that the company serves as trustee of any affected trust, neither the board nor any committee that includes one or more board members, other than the DDRC, may make or participate in the making of any discretionary decision with respect to any affected trust.

Section 12.3 of the Trust Company Bylaws provides that at any time that the company serves as trustee of an affected trust, no officer or director, including directors serving on the DDRRC, of the company may participate in a decision of the company (nor be present during any committee discussion of or vote on such a decision) involving: (a) the making of any discretionary decision with respect to any affected trust if the officer or director, or his or her spouse, is a grantor, donor, or a current or contingent beneficiary; or (b) the making of any discretionary decision with respect to any affected trust if the officer or director, or his or her spouse, is a member of the Family. An officer or director who is subject to the restrictions contained in section 12.3 with respect to a discretionary decision of the company, although absent from at least that part of the meeting at which such matter is considered, shall be deemed present for the purpose of determining whether a quorum is present for that part of the meeting.

Section 12.5(a) of the Trust Company Bylaws provides that an “affected trust” is a trust (i) of which any member of the Family is a grantor, donor or current or contingent beneficiary and (ii) for which the Trustee has any discretionary power, other than an investment power, and the discretionary power is not limited by an ascertainable standard.

Section 12.5(c) of the Trust Company Bylaws provides that “discretionary decision” means, with respect to an affected trust, (i) the exercise of any incident of ownership with respect to any life insurance policy owned by that trust, or (ii) the exercise or non-exercise of a discretionary power (A) to distribute income or principal of that trust or any beneficiary, (B) to allocate receipts or disbursements between income and principal for purposes of affecting distributions of income or principal of that trust, or (C) to “adjust” income or principal or to make or terminate an election of “total return” or “unitrust” or like power.

Section 12.5(d) of the Trust Company Bylaws provides that “Family” includes each living lineal descendant and spouse of a lineal descendant of Patriarch and Matriarch.

B married F and had four children: Child 1, Child 2, Child 3, and Child 4. B, F, Child 1, and Child 3 are deceased.

On Date 1, Child 2 created Trust 1 for the benefit of Grandchild 1 and his descendants and Trust 2 for the benefit of Grandchild 2 and his descendants. On Date 2, Child 3 created Trust 3 for the benefit of Grandchild 3 and his descendants and Trust 4 for the benefit of Grandchild 4 and his descendants. On Date 3, Child 4 created Trust 5 for the benefit of Grandchild 5 and his descendants and Trust 6 for the benefit of Grandchild 6 and his descendants. Trustee 1 currently serves as the trustee of Trust 1

and Trust 2. Trustee 2 currently serves as the trustee of Trust 3 and Trust 6. Trustee 3 currently serves as the trustee of Trust 4. Trustee 4 currently serves as trustee of Trust 5. Date 1, Date 2, and Date 3 are prior to September 25, 1985. Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, and Trust 6 are collectively the Series I Trusts. The Series I Trusts each have the same operative provisions.

Article First of each Series I Trust Agreement provides that each trust is being held for the Beneficiary (named child). Article Second provides that the trustees may, but are not required to, distribute net income or principal to or for the benefit of any one or more of the members of a class consisting of the Beneficiary, the spouse of the Beneficiary, and the lawful issue in any degree of the Beneficiary. Any income not distributed shall be accumulated and added to principal.

Article Third of each Series I Trust Agreement provides that upon the death of the Beneficiary (if the Beneficiary is not survived by a spouse) or upon the death of the spouse of the Beneficiary (if the Beneficiary is survived by a spouse), the trustees shall divide the trust fund into as many separate and equal shares as there are children of the Beneficiary then surviving and deceased children of the Beneficiary with issue then living. Any share set aside for the issue of a deceased grandchild of the grantor shall be further divided into shares on a per stirpes basis for such issue. The trustees may, but are not required to, distribute net income or principal from each separate trust to or for the benefit of any one or more of the members of a class consisting of the primary beneficiary of the separate trust and that primary beneficiary's lawful issue in any degree. Any primary beneficiary of a separate trust under Article Third shall have a testamentary general power to appoint the remaining principal of the separate trust held for his or her benefit. If a primary beneficiary of a trust does not exercise his or her testamentary general power of appointment, then the principal will remain in trust for the benefit of the primary beneficiary's issue. If at any time during the continuance of the separate trust there are no living issue, the principal of the separate trust shall be distributed, per stirpes, to the then living issue of the named Beneficiary for whom the original trust was held. If there are none, then the principal of the separate trust shall be distributed, per stirpes, to the then living issue of the grantor. If a Beneficiary is not survived by issue, the trust held for the benefit of the Beneficiary shall terminate and the properties comprising the trust fund shall be distributed, per stirpes, to the then living issue of the grantor.

Article Fourth of each Series I Trust Agreement provides that notwithstanding any other provisions, each trust created under the trust agreement shall, unless sooner terminated, terminate on the expiration of twenty-one years after the date of the death of the last survivor of the descendants of Patriarch who were in being on the date of the execution of the trust instrument. Upon termination under Article Fourth, the principal shall be distributed in equal shares to the person or persons who are permissible income beneficiaries of the trust at the time of termination.

Article Sixteenth of each Series I Trust Agreement provides that the trustee(s), excluding any trustee who may be a beneficiary to whom income might then be distributed, may at any time appoint a successor trustee to fill any vacancy. Such successor trustee(s) may be any individual, other than the grantor, or may be any bank or trust company incorporated under the laws of State, under the laws of any other state of the United States, or under the laws of the United States or of any foreign country. During the continuance of the trust, no person shall act as trustee of a trust under the trust agreement if the person shall be the spouse of the grantor or if the person, at that time, shall be related or subordinate to the grantor as defined in § 672 of the Internal Revenue Code.

With respect to Trust 1, Trust 2, Trust 3, and Trust 4, Article Sixteenth further provides that if there is no trustee other than a beneficiary to whom income might then be distributed, then a majority of the persons (other than the grantor, or any person who is then related or subordinate to the grantor as defined in § 672) then acting as trustees of Fund 1 may appoint a successor trustee or co-trustee, as the case may be.

With respect to Trust 5 and Trust 6, Article Sixteenth further provides that if there is no trustee other than a beneficiary to whom income might then be distributed, then a majority of the persons (other than the grantor, or any person who is then related or subordinate to the grantor as defined in § 672) then acting as trustees of Fund 2 may appoint a successor trustee or co-trustee, as the case may be.

On Date 4, Child 3 created Trust 7 for the benefit of Grandchild 3 and his descendants and Trust 8 for the benefit of Grandchild 4 and his descendants (collectively the Series II Trusts). Trustee 5 currently serves as trustee of Trust 7 and Trust 8. Date 4 is after September 25, 1985. The Series II Trusts each have the same operative provisions.

Article 2(a) of each Series II Trust Agreement provides that income may be, but is not required to be, paid to or for the benefit of the Beneficiary (named child), the Beneficiary's issue, and each spouse of any such beneficiary. Principal may be, but is not required to be, paid to or for the benefit of the Beneficiary or the Beneficiary's issue. Article 2(c) provides that each trust shall terminate upon the death of the last living member of the class consisting of the Beneficiary and his issue. Upon such termination, the principal shall be distributed to the then living issue of the grantor, if any, per stirpes, and if there are none, to the then living issue (excluding the grantor) of B, and if there are none, to the then living issue (excluding the grantor) of Patriarch per stirpes. Article 2(d) provides that notwithstanding any other provision, each trust shall terminate upon the expiration of twenty-one years after the death of the last survivor of the descendants of B who were in being on the date of the execution of the trust agreement. Upon such termination, the principal shall be distributed to the then living issue of the grantor, if any, per stirpes, and if there are none, to the then living issue (excluding the grantor) of B, per stirpes, and if there are none, to the then living issue (excluding the grantor) of Patriarch, per stirpes.

Article 5(a) of each Series II Trust Agreement provides that if, during any calendar year (including the calendar year in which the trust is executed), any transfers that are treated as gifts under the federal gift tax laws are made, either directly or indirectly, to the trust, each of the persons who is a permissible distributee of trust income or principal under Article 2(a) who is living on the date that the property subject to the demand right is transferred to the trust shall have the absolute right to demand an immediate distribution from the trust equal to the amount of the transfer divided by the total number of persons having a demand right under Article 5(a). Article 5(b) provides that the annual demand right of any person in a single calendar year may not exceed the donor's maximum annual federal gift tax exclusion under § 2503(b), or if the donor is married on the date of the transfer to the trust, then the annual demand right shall not exceed twice the donor's maximum annual federal gift tax exclusion amount. Article 5(c) provides that all demand rights shall be cumulative, provided, however, each person's unexercised demand right shall lapse on December 31 each year (whether or not a contribution was made to the trust in that year) to the extent of the greater of five thousand dollars (\$5,000) or five percent (5%) of the value of the trust principal on that December 31. Demand rights for contributions made in December shall not lapse in the year in which the contribution is made, but shall continue to be exercisable in the following year or years.

Article 8(a) of each Series II Trust Agreement provides that if Trustee 5 should die, resign, become incapacitated, or for any other reason not act or continue to act as a trustee, Trustee 12 shall serve as successor trustee. Article 8(c) provides that Trustee 5 (at any time while he is serving as trustee) or Trustee 12 (at any time while he is serving as trustee), may designate a successor trustee to fill any vacancy. Article 8(d) provides that in the event no successor trustee has been designated, then a successor trustee shall be appointed by the then serving trustees of Fund 1.

On Date 5, Child 4 created Trust 9 for the benefit of Grandchild 5 and his descendants. On Date 6, Child 4 created Trust 10 for the benefit of Grandchild 6 and his descendants. Trustee 6 currently serves as the trustee of Trust 9 and Trust 10 (collectively, the Series III Trusts). Date 5 and Date 6 are after September 25, 1985. The Series III Trusts each have the same operative provisions.

Article 2 of each Series III Trust Agreement provides that each trust shall be administered for the Beneficiary (named child) during the beneficiary's life. Article 2(a) provides that during Beneficiary's life, the trustee has the discretion to distribute net income or principal to or for the benefit of the Beneficiary to provide for the reasonable care, comfort, convenience, support, maintenance, education, and other reasonable needs of the Beneficiary. Article 2(b) provides that each trust shall terminate on the death of the Beneficiary. Article 2(c) provides each Beneficiary with a testamentary general power of appointment. Article 2(d) provides that if the Beneficiary fails to exercise the general power of appoint, then, upon his death, all undistributed net income of the trust shall be paid to the executor of the Beneficiary's estate and the

remaining principal shall continue to be held in trust. Article 2(d)(i) provides that during the continuance of the trust, any portion of the income or principal of the trust may be paid to or applied for the health, education, support and maintenance of the members of a class consisting of the Beneficiary's issue living from time to time. The trustee may also distribute income to the spouse of any eligible beneficiary for health, education, support and maintenance. Article 2(d)(ii) provides that each trust shall terminate on the death of the last survivor of the Beneficiary's issue. Article 2(d)(iii) provides that if not terminated earlier, each trust shall terminate on the expiration of twenty-one years after the death of the last survivor of the descendants of B who were in being on the date the trust instrument was executed. Article 2(d)(iv) provides that upon termination, the trust assets shall be distributed to the then living issue of Beneficiary, per stirpes. If there are none, then to the then living issue of the grantor, per stirpes. If there are none, then to the then living issue of B, per stirpes. If there are none, then to the then living issue of Patriarch.

Article 4(a) of each Series III Trust Agreement provides that if, during any calendar year (including the calendar year in which the trust is executed), any transfers that are treated as gifts under the federal gift tax laws are made, either directly or indirectly, to the trust, each of the persons who is a permissible distributee of trust income or principal who is living on the date that the property subject to the demand right is transferred to the trust shall have the absolute right to demand an immediate distribution from the trust equal to the amount of the transfer divided by the total number of persons having a demand right under Article 4(a). The annual demand right of any person in a single calendar year may not exceed the donor's maximum annual federal gift tax exclusion under § 2503(b), or if the donor is married on the date of the transfer to the trust, then the annual demand right shall not exceed twice the donor's maximum annual federal gift tax exclusion amount. Article 4(b) provides that all demand rights shall be cumulative, provided, however, each person's unexercised demand right shall lapse (i) to the extent of Five Thousand Dollars (\$5,000) after thirty days after the beneficiary receives notice of the demand right, and then (ii) to the extent of the greater of Five Thousand Dollars (\$5,000) or five percent (5%) of the value of the trust on December 31 of each year until exhausted.

Article 10(b) of the Trust 9 Trust Agreement provides that if Trustee 6 should die, resign, become incapacitated, or for any other reason not act or continue to act as a trustee, Trustee 12 shall serve as successor trustee. Article 10(c) provides that Trustee 6 (at any time while he is serving as trustee) or Trustee 12 (at any time while he is serving as trustee), may designate a successor trustee to fill any vacancy. Article 10(d) provides that in the event no successor trustee has been designated, then a successor trustee shall be appointed by the Clerk of Court.

Article 10(b) of the Trust 10 Trust Agreement provides that Trustee 6 (at any time while he is serving as trustee), or if Trustee 6 is no longer living and serving as trustee, a majority of the group consisting of the Beneficiary and any of his then living adult children may designate a successor trustee to fill any vacancy. Article 10(c) provides

that in the event no successor trustee has been designated, then a successor trustee shall be appointed by the Clerk of Court.

On Date 7, B created Trust 11, Trust 12, Trust 13, and Trust 14 (collectively, the Series IV Trusts). Trust 11 is for the benefit of Child 1 and her descendants. Trust 12 is for the benefit of Child 2 and his descendants. Trust 13 is for the benefit of Child 3 and her descendants. Trust 14 is for the benefit of Child 4 and her descendants. Trustee 7, Trustee 8, and Trustee 9 currently serve as the trustees of Trust 11. Trustee 6, Trustee 8, Trustee 9, and Trustee 10 currently serve as the trustees of Trust 12. Trustee 7 and Trustee 11 currently serve as the trustees of Trust 13. Trustee 6, Trustee 7 and Trustee 8 currently serve as the trustees of Trust 14. Date 7 is before September 25, 1985. The Series IV Trusts each have the same operative provisions.

Paragraph 1 of each Series IV Trust Agreement provides that each trust shall continue during the lives of Child 1, Child 2, Child 3, Child 4, Grandchild 7, Grandchild 8, and Grandchild 9. Paragraph 2 provides that during the Beneficiary's (named child) lifetime, the trustees have the discretion to distribute net income to or for the benefit of the Beneficiary. After the Beneficiary's death, the trustee has the discretion to distribute net income to or for the benefit of the Beneficiary's descendants, per stirpes. If the Beneficiary has no descendants, the trustee has the discretion to distribute net income to or for the benefit of the Beneficiary's siblings then surviving and the descendants then surviving of any deceased sibling. Paragraph 3 provides that upon termination of a trust, the principal shall be distributed to the children and descendants of the Beneficiary per stirpes. If there are none, then in equal shares per stirpes among the Beneficiary's next of kin. In no event shall any of the income or corpus of the trust ever revert to the Donor.

Paragraph 11 of each Series IV Trust Agreement provides that the beneficiary or beneficiaries of a trust who are of age and who would be entitled to receive any part of the income if it were distributed shall appoint a successor trustee(s) so that there may be at all times not less than four trustees of the trust. If none of the income beneficiaries are then of age, the appointment of a successor trustee to fill a vacancy may be made by the remaining trustee(s), but in such event any successor trustee so appointed shall be either the surviving spouse of the Beneficiary, or shall be selected from the next of kin (other than a sibling) of the Beneficiary.

Of the trusts discussed in this letter, the following are trusts for which the grantor(s) is still living: Trust 1, Trust 2, Trust 5, Trust 6, Trust 9, and Trust 10. Potential beneficiaries of all trusts discussed in this letter include individuals who are two or more generations below the grantors' generation, therefore, distributions from each trust may be subject to the GST tax. Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 11, Trust 12, Trust 13 and Trust 14 were irrevocable on September 25, 1985.

## RULINGS REQUESTED

You have requested the following rulings: 1) Trust Company is not a “related or subordinate party” within the meaning of § 672(c) with respect to a grantor of the trusts for which Trust Company will serve as trustee. Trust Company will qualify as an independent trustee under § 672(c)(1). 2) Neither the appointment of Trust Company as trustee of the trusts nor Trust Company’s exercise of any discretionary powers as to distributions to beneficiaries of the trust will result in any grantor being treated as the owner of any portion of the trust assets under § 674(a). 3) Any grantor serving on Trust Company’s Trust Committee will not result in a grantor being treated as the owner of any portion of the trust under § 675(4). 4) Neither the appointment of Trust Company as trustee of the trusts nor Trust Company’s exercise of any discretionary distribution powers to beneficiaries of the trusts will result in a grantor’s being treated as the owner for any portion of the trust assets under § 677. 5) Neither the appointment of Trust Company as trustee of the trusts nor Trust Company’s exercise of any discretionary distribution powers will result in a grantor being treated as the owner of any portion of the trust assets under § 678. 6) Neither the appointment of Trust Company as trustee of the trusts nor Trust Company’s exercise of any discretionary powers with respect to distributions to beneficiaries will result in the inclusion of any portion of the trust assets in the estate of any grantor or beneficiary under §§ 2036, 2038, or 2041. 7) The appointment of Trust Company as trustee of the trusts created, funded, and irrevocable prior to September 25, 1985, will not constitute a constructive addition to the trust and affect the status of the pre-September 25, 1985 trusts as exempt from the generation-skipping transfer tax under § 2601.

## RULINGS 1 and 2

Section 672(c)(2) provides that for purposes of subpart E of part I of subchapter J, the term “related or subordinate party” means any nonadverse party who is any one of the following: the grantor’s father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stockholdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(c) provides that § 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor (1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or

within a class of beneficiaries; or (2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

Based solely on the facts and representations submitted, including the provision of the bylaws of Trust Company that prohibits any family member from taking part in any discretionary distribution decision with regard to any trust for which Trust Company is acting as trustee, we conclude that Trust Company is not a related or subordinate party, within the meaning of § 672(c)(2), to any of the grantors of the trusts for which it will be acting as trustee. Therefore, Trust Company may exercise the powers described in § 674(c) with regard to those trusts without causing the grantors to be treated as the owners of any portion of the trusts under § 674(a).

### RULING 3

Under § 675 and applicable regulations, the grantor is treated as the owner of any portion of a trust if, under the terms of the trust agreement or circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiary of the trust.

Section 675(4) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of § 675(4), the term "power of administration" means any one or more of the following powers: (A) a power to vote or direct the voting of stock or other securities of a corporation in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; (B) a power to control the investment of the trust funds either by directing investments or reinvestments, or by vetoing proposed investments or reinvestments, to the extent that the trust funds consist of stocks or securities of corporations in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; or (C) a power to reacquire the trust corpus by substituting other property of an equivalent value.

Based solely on the facts and representations submitted, we conclude that our examination of the terms of the trusts and the bylaws of Trust Company reveals none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the grantors of the trusts for which Trust Company will act as trustee under § 675, if those trusts are substantially identical to the trusts. Thus, the circumstances attendant on the operation of the Trust Company, its trust committee, and the trusts for which the Trust Company is acting as trustee will determine whether any grantor will be treated as the owner of any portion of the trusts under § 675. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office with responsibility for such examination.

### RULING 4

Section 677(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Section 1.677(a)-1(d) of the Income Tax Regulations provides that, under § 677, a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Our examination of the trusts does not reveal any provision that would allow distributions to be made to the grantor, the grantor's spouse, or in discharge of the grantor's legal obligations. Based solely on the facts and representations submitted, we conclude that a living grantor's ownership interest in Trust Company or membership on its board of directors or any of its committees will not give the grantor an interest or power that would cause that grantor to be treated as an owner of any portion of the trusts under § 677.

#### RULING 5

Section 678(a) provides, in general, that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of §§ 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

Based solely on the facts and representations submitted, including the provision of the bylaws of Trust Company that prohibits any family member from taking part in any discretionary distribution decision with regard to any trust for which Trust Company is acting as trustee, we conclude that no beneficiary of a trust for which Trust Company will act as trustee has a power exercisable solely by that beneficiary to vest the trust corpus or income in themselves as a result of that beneficiary's ownership interest in Trust Company or membership on its board of directors or any of its committees.

#### RULING 6

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full

consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period that does not in fact end before his death –

- (1) the possession or enjoyment of, or the right to the income from, the property, or
- (2) the right either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2036(b)(1) provides in part that for the purposes of § 2036(b)(1), a corporation shall be treated as a controlled corporation if, at any time after the transfer of the property and during the three-year period ending on the date of the decedent's death, the decedent owned (with the application of § 318), or had the right (either alone or in conjunction with any person) to vote, stock possessing at least twenty percent of the total combined voting power of all classes of stock.

Section 20.2036-1(b)(3) provides in part that if a decedent reserved the unrestricted power to remove or discharge a trustee at any time and to appoint himself as trustee, the decedent is considered as having the powers of the trustee.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired the power), to alter, amend, revoke, or terminate, or where any power is relinquished during the three-year period ending on the date of decedent's death.

Section 20.2038-1(a)(3) provides in part that if a decedent had the unrestricted power to remove or discharge a trustee at any time and appoint himself trustee, the decedent is considered as having the powers of the trustee.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has, at the time of his death, a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent the property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive. For purposes of § 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of

a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

Section 2041(b)(1) provides that a general power of appointment is a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate. However, a power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 20.2041-1(b)(1) provides, in part, that a donee may have a power of appointment if he has the power to remove or discharge a trustee and appoint himself. For example, if under the terms of the instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and the decedent has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, the decedent is considered as having a power of appointment. However, the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of the fiduciary duties is not a power of appointment.

Rev. Rul. 95-58, 1995-2 C.B. 191, holds that a decedent/grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or corporate successor trustee that is not related or subordinate to the decedent within the meaning of § 672(c), is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus was not included in the decedent's gross estate under §§ 2036 or 2038. The ruling notes that the Eighth Circuit in Estate of Vak v. Commissioner, 973 F.2d 1409 (8<sup>th</sup> Cir. 1992), concluded that the decedent had not retained dominion and control over assets transferred to a trust by reason of his power to remove and replace the trustee with a party that was not related or subordinate to the decedent. Accordingly, the court held that under § 25.2511-2(c), the decedent made a completed gift when he created the trust and transferred assets to it.

Section 672(c) defines the term "related or subordinate party" to mean any nonadverse party who is (1) the grantor's spouse if living with the grantor; or (2) any one of the following: the grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

In order for §§ 2036-2038 to apply, the decedent must have made a transfer of property or any interest therein (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent retained

an interest in, or power over, the income or corpus of the transferred property. For purposes of §§ 2036 and 2038, it is immaterial in what capacity the power was exercisable by the decedent.

The governing trust instruments prevent grantors and beneficiaries from directly participating in decisions regarding discretionary distributions from the trusts. Section 12.1 of the Trust Company Bylaws requires that at least one member of the board will not be a Family member, a grantor of, a donor to, or a current or contingent beneficiary of an affected trust. Affected trusts are trusts of which any member of the Family is a grantor, donor, or current or contingent beneficiary and for which the trustee does not have any discretionary power, other than an investment power, that is not limited by an ascertainable standard. Family is defined in section 12.5(d) as each living lineal descendant and spouse of a lineal descendant of Patriarch and Matriarch. Section 12.2, accordingly, restricts discretionary distribution decisions with respect to affected trusts to trust officers who are not descendants or the spouse of a descendant of Patriarch and Matriarch. Discretionary distribution decisions are initially made or reviewed by the Senior Trust Officer and can be appealed to the DDRC at a beneficiary's request. Under section 12.3 of the Trust Company Bylaws, neither a Senior Trust Officer nor a member of the DDRC may participate in discussions or decisions involving an affected trust if the officer or director, or his or her spouse, is a grantor, donor, or a current or contingent beneficiary of the trust. That section further prohibits Senior Trust Officers and members of the DDRC from participating in discussions or decisions with respect to any affected trust if the officer or director, or his or her spouse, is a member of the Family. Therefore, the grantors and the beneficiaries of the trusts discussed in this letter are sufficiently prohibited from participating in initial decisions and subsequent review of decisions regarding discretionary distributions from their own trusts. In addition, the structure of the bylaws prohibits the grantors and beneficiaries of B's branch and the other four branches of the family from participating in Trust Company's exercise of discretion to make distributions from any of the trusts by or for descendants of Patriarch and Matriarch, thus preventing the possibility of outside reciprocal agreements that may indirectly give members of B's branch of the family effective control over the discretionary distributions from the trusts discussed in this letter.

The combination of the firewall provision in the Trust Company Bylaws and the trustee provisions in each trust agreement preclude a donor of any of the trusts from having the retained dominion and control as contemplated by §§ 2036 or 2038. No grantor, therefore, will be considered as having the powers of the trustees under §§ 20.2036-1(b)(3) or 20.2038-1(a)(3) solely as a result of being a shareholder in or participating in the daily activities of Trust Company as they are precluded from participating in discretionary distribution decisions with respect to the trusts discussed in this letter, both directly by the trust agreement and indirectly when made by Trust Company. Therefore, neither the appointment of Trust Company as trustee of the trusts nor its exercise of the discretionary powers over distributions to beneficiaries of the trusts will result in the inclusion of any portion of the value of the trusts in the respective

estate of a grantor to one of the trusts discussed in this letter. Accordingly, based on the facts submitted and the representations made, we conclude that the appointment of Trust Company as a trustee of the trusts will not result in the inclusion of any portion of the value of the trusts in the estate of the respective grantor under §§ 2036 or 2038.

Furthermore, the combination of provisions also preclude a beneficiary from having the power to affect the beneficial enjoyment of the trust property as contemplated by § 2041. No beneficiary, therefore, will be considered as having the power of the trustees under § 20.2041-1(b)(1) solely as a result of being a shareholder in and participating in the daily activities of Trust Company as they are precluded from participating in discretionary distribution decisions with respect to the trusts discussed in this letter, both directly by the trust agreement and indirectly when made by Trust Company. Therefore, neither the appointment of Trust Company as trustee of the trusts nor its exercise of the discretionary powers over distributions to beneficiaries of the trusts will result in the inclusion of any portion of the value of the trusts in the respective estate of a beneficiary. We note that some of the trusts discussed in this letter provide certain beneficiaries a general power of appointment over part or all of the assets of the trust. The ruling provided in this letter does not imply that the value of the assets to which the general power of appointment pertains will not be included in a beneficiary's estate. Accordingly, based on the facts submitted and the representations made, we conclude that the implementation of the proposed trust restructuring plan and the appointment of Trust Company as an independent trustee of the trusts will not result in the inclusion of any portion of the value of the trusts in the estate of a beneficiary who is not granted a general power of appointment by the terms of the trust agreement under § 2041.

## RULING 7

Section 2601 imposes a tax on every generation-skipping transfer.

Section 2611(a) defines the term "generation-skipping transfer" to include a taxable distribution, taxable termination, and a direct skip.

Each of the trusts discussed in this letter is a generation-skipping transfer trust because the trusts provide for distributions to one or more generation of beneficiaries below the grantors' generations. Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 11, Trust 12, Trust 13, and Trust 14 were irrevocable on September 25, 1985. The trustees represent that there have been no additions, actual or constructive, to these trusts after September 25, 1985.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the generation-skipping transfer tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that the

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)(1)(ii)(A) provides that any trust in existence on September 25, 1985, is considered an irrevocable trust except as provided in §§ 26.2601-1(b)(ii)(B) or (C), that relate to property includible in a grantor's gross estate under §§ 2038 and 2042. In the present case, Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 11, Trust 12, Trust 13, and Trust 14 are considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies.

Section 26.2601-1(b)(1)(v)(B) provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) is not treated as an addition to a trust if - (1) the power of appointment was created in an irrevocable trust that is not subject to chapter 13 under paragraph (b)(1) of this section; and (2) in the case of an exercise, the power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of twenty-one years plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of paragraph (b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed ninety years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

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 generation-skipping transfer tax under § 26.2601-1(b)(1), (2), or (3)

(hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided for otherwise, the rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. Unless specifically noted, 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)(D)(1) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

Naming Trust Company as trustee of Trust 1, Trust 2, Trust 3, Trust 4, Trust 5, Trust 6, Trust 11, Trust 12, Trust 13, and Trust 14 is an administrative change and will not be considered a shift in a beneficial interest in a trust under § 26.2601-1(b)(4)(i)(D)(1)

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

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.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to your attorney.

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

Sincerely,

James F. Hogan  
Senior Technician Reviewer, Branch 9  
Office of Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosure

Copy of this Letter for § 6110 purposes

cc: