

## Internal Revenue Service

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
CC:PSI:B09 / PLR-162070-02  
Date:

October 10, 2003

### Legend

Grantor 1 =  
Grantor 2 =  
Trust Agreement =  
Date 1 =  
Date 2 =  
Date 3 =  
Trust 1 =  
  
Beneficiary 1 =  
Trustee 1 =  
Trustee 2 =  
Trust 2 =  
  
Beneficiary 2 =  
Trust 4 =  
  
Beneficiary 4 =

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Trust 6 =

Beneficiary 6 =

Trust 7 =

Beneficiary 7 =

Date 4 =

Trust 8 =

Beneficiary 8 =

Trust 3 =

Trust 5 =

Beneficiary 3 =

Beneficiary 5 =

Date 5 =

Family X =

Family Y =

Trust Company =

State 1 =

Date 6 =

Patriarch X =

Patriarch Y =

Child 1 =

Child 2 =

Date 7 =

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Probate Court =  
 State 2 =  
 Trustee 3 =

Dear :

This letter responds to your letter, dated April 17, 2003, and prior correspondence requesting rulings under §§ 2036, 2038, 2041, and 2601 of the Internal Revenue Code.

Grantor 1 and Grantor 2 (collectively referred to as “the grantors”) executed Trust Agreement on Date 1. Trust Agreement creates a series of irrevocable trusts for the grantors’ children and grandchildren. This letter ruling relates to the trusts created in Trust Agreement for the benefit of the grantors’ grandchildren. Trust Agreement was amended on Date 2. The trustees represent that transfers made to these trusts qualified for the gift tax annual exclusion and were deemed to have a zero inclusion ratio under § 2642(c).

Section 2.8 of the Trust Agreement provides for the creation of annual exclusion trusts for each of the grantors’ grandchildren. That article provides that anyone may transfer property to the trustees of an “annual exclusion trust” for a grandchild of the person initially making such transfer (for this purpose “grandchild” means anyone who is a “skip person” as to the initial transferor).

Section 2.8(a) of the Trust Agreement provides that during the remainder of a grandchild’s life, in the discretion of the independent trustee(s), any part or all of the trust’s net income and/or principal may be distributed to (or for the benefit of) the grandchild. At the end of each tax year, any income that is not distributed shall be added to principal.

Section 2.8(b) of the Trust Agreement provides that with the approval of the independent trustee(s) of such trust, the grandchild shall have the power to appoint any part or all of the assets of the trust, as of his or her death to any one or more of the initial transferor’s descendants and/or their spouses, but the power shall not be used to benefit the grandchild, his or her creditors, his or her estate, or its creditors, nor to benefit any spouse except in a trust (limited to income plus principal invasions as are needed, liberally, for the spouse’s health and accustomed manner of living).

Section 2.8(c) of the Trust Agreement provides that the grandchild shall have the power to appoint any part or all of the assets of the trust effective on his or her death to his or her estate.

Section 2.8(d) of the Trust Agreement provides that upon the death of a grandchild, his or her trust shall terminate and all of the then remaining trust property

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not appointed under paragraphs (b) and (c), subject to an optional provision for the reimbursement of tax payments attributable to the inclusion of trust property in the beneficiary's gross estate, shall be disposed of as provided in Section 2.3 (and in the incorporated technical provisions) as if the then remaining property of the terminating trust were the general power of appointment property of a nonexempt family trust standing in the name of the deceased grandchild.

Article 3 of the Trust Agreement provides that each of the trusts created under Trust Agreement must have one trustee and may have up to three trustees. The mandatory trustee is an independent trustee. The independent trustee must be a properly independent person or bank. The optional trustees are a second independent trustee and a family trustee. After the death of the last grantor to die, the independent trustee (or one of the independent trustees) of each trust must at all times be a bank or trust company.

Addendum A of the Trust Agreement, executed simultaneously, incorporates certain technical provisions that are intended to be a part of the trust agreement as though they were set forth verbatim in the agreement.

Section 5.1(b)(2) of the Trust Technical Provisions provides that all other provisions to the contrary notwithstanding, the trusts created under Trust Agreement, unless earlier terminated shall, in any and all events, terminate on the day prior to the expiration of twenty-one years after the death of the last survivor of a group of individuals composed of: (A) those whose names appear in Trust Agreement (other than solely as trustees, witnesses, notaries, etc.), (B) Grantor 1 and Grantor 2's parents, and (C) those of the lineal descendants of an any individual described in paragraphs (A) and (B) who are living at the effective date of the initial transfer (as determined for the transferor's federal gift or estate tax purposes).

On Date 3, the grantors funded Trust 1 under the Trust Agreement. Trust 1 is a trust for the benefit of Beneficiary 1. The funding document designates Trustee 1 as the initial family trustee and Trustee 2 as the initial independent trustee.

On Date 3, the grantors funded Trust 2 under the Trust Agreement. Trust 2 is a trust for the benefit of Beneficiary 2. The funding document designates Trustee 1 as the initial family trustee and Trustee 2 as the initial independent trustee.

On Date 3, the grantors funded Trust 4 under the Trust Agreement. Trust 4 is a trust for the benefit of Beneficiary 4. The funding document designates Trustee 1 as the initial family trustee and Trustee 2 as the initial independent trustee.

On Date 3, the grantors funded Trust 6 under the Trust Agreement. Trust 6 is a trust for the benefit of Beneficiary 6. The funding document designates Trustee 1 as the initial family trustee and Trustee 2 as the initial independent trustee.

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On Date 3, the grantors funded Trust 7 under the Trust Agreement. Trust 7 is a trust for the benefit of Beneficiary 7. The funding document designates Trustee 1 as the initial family trustee and Trustee 2 as the initial independent trustee.

On Date 4, the grantors funded Trust 8 under the Trust Agreement. Trust 8 is a trust for the benefit of Beneficiary 8. The funding document designates Trustee 1 as the initial family trustee and Trustee 2 as the initial independent trustee.

Grantors also created Trust 3 and Trust 5 under the Trust Agreement. Trust 3 is a trust for the benefit of Beneficiary 3, and Trust 5 is a trust for the benefit of Beneficiary 5. Trust 3 and Trust 5, however, are not the subject of this private letter ruling. This private letter ruling addresses Trust 1, Trust 2, Trust 4, Trust 6, Trust 7, and Trust 8.

On Date 5, Family X and Family Y entered into a participation agreement and later filed the Articles of Association for Trust Company, a limited banking association, in State 1. As part of that agreement, the initial participants adopted bylaws to provide for the orderly management of Trust Company. Trust Company was formed to provide specialized services to individuals and families facing the same challenges in trust management as Family X and Family Y. The bylaws and participation agreement were amended and restated on Date 6. Additional modifications have been proposed that are the subject of this private letter ruling request. Excerpts from the bylaws and participation agreement in this letter reflect the Date 6 modifications and the proposed modifications.

Trust Company initially had two classes of shares, Class A and Class B, each of which represent fifty percent of the total voting power of all Trust Company's outstanding shares. Family X owns all of the Class A shares and Family Y owns all of the Class B shares. The Class A shares were initially issued to and are still held by two trusts (not the subject of this letter ruling) whose grantor and beneficiaries are members of Family X and whose trustees are unrelated to members of Family Y. The Class B shares were initially issued to a voting trust of which eleven trusts for the benefit of the members of Family Y are the beneficial owners. Grantor 1 and Grantor 2 are members of Family X.

On Date 6, the Articles of Association of Trust Company were amended to authorize the issuance of shares of Class E stock. The Class E stock will have no voting rights except as set forth in Section 4.2(b)(2) of the Bylaws and Participation Agreement relating to the authorization of additional Class E shares and the amendment of the restrictions on transfer of ownership of the Class E shares. Under the amendment, Class A shares may only be transferred to Class A permitted transferees, Class B shares may only be transferred to Class B permitted transferees, and Class E shares may only be transferred with the approval the holders of more than sixty-five percent of the issued and outstanding Class E shares.

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Section 7.2 of the bylaws and participation agreement of Trust Company provides in part that there shall initially be nine directors of Trust Company. The board of directors may expand the number of director positions. Notwithstanding the foregoing, Trust Company shall not have less than five or more than fifteen directors.

Section 7.17(a) of the bylaws and participation agreement of Trust Company provides that no officer or director of Trust Company shall participate in a decision of Trust Company (nor be present during any board or committee discussion of or vote on such a decision) involving the exercise of any discretionary power, other than investment powers, with respect to any trust of which Trust Company is a trustee if the officer, director, or spouse of the officer or director is:

- (1) a grantor or donor to the trust;
- (2) a current or contingent beneficiary of the trust; or
- (3) a descendant, or spouse (or former spouse) of a descendant of either Patriarch X or Patriarch Y. Section 7.17(a)(3), however, shall apply only to a trust a current or contingent beneficiary of which is a descendant, or a spouse (or former spouse) of a descendant, of either Patriarch X or Patriarch Y.

Section 7.17(b) provides that no officer or director of Trust Company shall participate in a decision of Trust Company (nor be present during any board or committee discussion of or vote on such a decision) involving the exercise of any incidents of ownership of any life insurance policy insuring the life of the officer or director.

Section 7.17 further provides that a director that is subject to the restrictions of Section 7.17 with respect to a decision of Trust Company, although absent from at least that part of the meeting, shall be deemed present for the purpose of determining whether a quorum is present for that part of the meeting.

Section 7.18 of the bylaws and participation agreement provides that an "Independent Director" is a director who is neither an employee of Trust Company nor, with respect to a particular trust of which Trust Company is a trustee, related or subordinate within the meaning of § 672(c) to any individual described in Section 7.17(a)(1), (2), or (3). The board of directors and the participants shall take all necessary actions to cause there to be in office at all times at least one director who is not precluded under Section 7.18 or Section 7.19 from participating in the making of any decisions of Trust Company described in Section 7.17.

Section 7.19 of the bylaws and participation agreement provides that subject to the requirements of applicable law and to enable directors to comply when advisable with taxation laws, restrictions on self-dealing, or other matters, a director is authorized to renounce, either revocably or irrevocably, for any period of time, by an instrument in writing delivered to and accepted by Trust Company, his or her right and power to participate in the making of any Trust Company decision involving the exercise of any discretionary power, other than investment or administrative powers not affecting any

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beneficiary's beneficial enjoyment, with respect to any trust of which Trust Company is a trustee.

The current trustees propose to modify Trust Agreement to update each trust's administrative provisions and to revise each trust's trustee selection and trustee succession provisions to better provide for the long-term management of the trusts. Some of the modifications to the trusts redesignate substantive provisions from one article to another in order to provide uniformity in the structure of the Family X trusts. In addition to the proposed modifications, the current trustees intend to appoint Trust Company to serve as an independent trustee.

Section 2.8 of the Trust Agreement will provide that the first assets transferred to the trustees of an annual exclusion trust having as its "beneficiary" one of the grantors' grandchildren (or someone who is a "skip person" as to the transferor) shall constitute the initial principal of a separate annual exclusion trust for that beneficiary.

Section 2.8(a) of the Trust Agreement will provide that during the continuance of the trust, any part or all of its net income and/or principal may be distributed, in the sole discretion of its independent trustee(s), to (or for the benefit of) the trust's beneficiary. At the end of each tax year, any income that is not distributed shall be added to principal.

Section 2.8(b) of the Trust Agreement will provide that with the approval of the independent trustee(s) of a trust, its beneficiary shall have the power to appoint any part or all of the assets of the trust as of his or her death to any one or more of the initial transferor's descendants and/or their spouses, but the power shall not be used to benefit the beneficiary, his or her creditors, his or her estate, or its creditors, nor to benefit any spouse except in a trust (limited to income plus principal invasions as are needed, liberally, for the spouse's health and accustomed manner of living).

Section 2.8(c) of the Trust Agreement will provide that the beneficiary shall have the power to appoint any part or all of the assets of the trust effective on his or her death to his or her estate.

Section 2.8(d) of the Trust Agreement will provide that upon a beneficiary's death, the trust shall terminate and all of the then remaining trust assets, to the extent not appointed under paragraphs (b) and (c) above, subject to provision for the death tax payments, shall be disposed of as provided in Section 2.3 as if the trust's remaining assets were the general power of appointment assets of a nonexempt family trust standing in the name of the deceased beneficiary.

Section 3.1(a) of the Trust Agreement will provide that any one or more of the three trustee offices may either be occupied or left vacant, provided that the office of corporate independent trustee must at all times be occupied. Section 3.1(b) will provide that two of the trustee positions are "independent trustee" offices. One may be occupied by an individual and the other must be occupied by a corporate independent

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trustee. Section 3.1(c) will provide that the third trustee position will be the “family trustee” office.

Section 3.2(d) of the Trust Agreement will provide that the family trustee may remove the corporate independent trustee for the reasons set forth in Section 3.2(d)(1) of the Trust Technical Provisions. The individual independent trustee may remove the corporate independent trustee with or without cause.

Section 3.2(d)(1) of the Trust Technical Provisions will describe the circumstances in which the family trustee may remove the corporate independent trustee. Section 3.2(d)(1)(A) will provide that the removal power may not be exercised in a manner contrary to the specific restrictions on fiduciary actions listed in Section 4.2(a) of the Trust Technical Provisions.

Section 3.2(d)(1)(B) of the Trust Technical Provisions will provide that the notice of removal will set forth the reason(s) for the removal of the corporate independent trustee. The reasons need not be such as to justify judicial removal and include the following: (i) the family trustee believes the expense of administering the trust can be reduced, or its investment needs can be better served, by a trustee change; (ii) a personality conflict or difference of opinion as to the investment philosophy to be followed by the trust has arisen with the trustee (or the trust officer assigned); (iii) the trustee’s reports are not responsive to the needs of the family trustee; (iv) the trust would be more conveniently administered in another location; or (v) the trustee’s services are being adversely affected by ineffectiveness, unavailability, trust officer turnover, or inexperience.

Section 3.2(e) of the Trust Agreement will provide that the family trustee may remove the then acting individual independent trustee for the reasons set forth in Section 3.2(e) of the Trust Technical Provisions. Section 3.2(e) of the Trust Technical Provisions will describe the circumstances in which the family trustee may remove the individual independent trustee. Section 3.2(e)(1) will provide that the power may not be exercised in a manner contrary to the specific restrictions on fiduciary actions listed in Section 4.2(a) of the Trust Technical Provisions. Section 3.2(e)(2) will provide that the notice of removal will set forth the reason(s) for removal that must meet the criteria and, in general, be similar to those described in Section 3.2(d)(1)(B), except for sub-section 3.2(d)(1)(B)(v). In addition, Section 3.2(e)(2) will provide that the individual independent trustee may be removed if the trustee’s services are being adversely affected by age, health, ineffectiveness, unavailability, or inexperience.

Section 3.2(f) of the Trust Agreement will provide that the right to remove the family trustee of each trust (with or without cause) is held by the top control list person(s) who shall be the first in order and is “eligible” to act. Section 3.2(f)(1)(A) will provide that first level of the control list includes Child 1 (or her designees) or Child 2 (or her designees), as the case may be, if she or a descendant of hers is the primary beneficiary of the trust. Section 3.2(f)(1)(B) will provide that the second level of the control list includes the most senior generation descendant of Child 1 or Child 2, if any,

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who is an ancestor of the primary beneficiary of the trust (or such ancestor's designees). Section 3.2(f)(1)(C) will provide that the third level of the control list includes the primary beneficiary of the trust (or that individual's designees). Section 3.2(f)(1)(D) will provide that the fourth level of the control list includes the primary beneficiary of the trust's descendants of the most senior generation having an eligible descendant (or such descendant's or descendants' designees). Section 3.2(f)(1)(E) will provide that the last level of the control list includes the most senior generation descendant(s) of the closest ancestor of the primary beneficiary of the trust who has an eligible descendant, provided that each most senior generation descendant is a descendant of Patriarch X (or such descendant's or descendants' designees). An individual is "eligible" to act as a family trustee control list person if he or she is not incapacitated and at least twenty-five years old (or at least twenty-one years old if he or she is one of the "most senior generation" descendants of a particular individual). When two or more persons occupy a place on a control list, their removal, appointment, and other actions must be by a majority of them. Section 3.2(f)(6) of the Trust Technical Provisions will provide, in part, that when only two people hold a right or power with respect to a trust, the two must act together unanimously.

Section 3.3(a) of the Trust Agreement will provide that whenever a vacancy exists in the office of family trustee for any trust created under the trust instrument, the control list person(s) then having, and while continuing to have, the right to remove the family trustee of that trust, may, at any time, select and appoint an individual (age twenty-five or older), even the appointor himself or herself, to fill the vacancy (which, until thus filled, shall remain vacant).

Section 3.3(b) of the Trust Agreement will provide that whenever a vacancy exists in (i) the office of the corporate independent trustee of any trust, or (ii) the office of the individual independent trustee if the office is required to be kept filled (under the provisions of Section 3.5), the office shall be promptly filled by a qualified successor to that office (or to either office, if there is no stipulation then in effect under Section 3.5). The successor independent trustee shall be selected and appointed by the family trustee of the trust. If the vacancy is not filled within thirty days (or if there is no family trustee when the vacancy occurs), the successor independent trustee shall be selected and appointed by the top control list person(s) for the trust. If the vacancy is not filled within thirty days of when the top control list person (or all of those persons) first becomes aware that the vacancy had not been (or could not be) filled, the successor shall be selected and appointed by the representative beneficiary (or the representative beneficiaries) of the trust. If the vacancy is not filled within sixty days of when the representative beneficiary (or all of them) first becomes aware that the vacancy had not been filled, the successor shall be selected and appointed by the court having jurisdiction over the trust.

Section 3.3(c) of the Trust Agreement will provide that whenever a trust has only one independent trustee then acting and its other independent trustee office is not then required to be kept filled or left vacant (under Section 3.5), that trust's then family trustee may at any time appoint a second independent trustee (meeting the

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qualifications of the vacant office). Until such appointment is made, or until the circumstances change, the other independent trustee office shall remain vacant.

Section 3.4(a) of the Trust Agreement will provide that a corporate independent trustee must be an “independent” bank or trust company as described in Section 3.4(a) of the Trust Technical Provisions. Section 3.4(a) of the Trust Technical Provisions will provide that to be eligible to serve as an independent trustee of a specific trust under the trust agreement, a bank or trust company must have certain “corporate independent trustee qualifications.”

Section 3.4(a)(2) of the Trust Technical Provisions will provide that the corporate independent trustee position must be filled by a bank or trust company with respect to which no donor to or current or contingent beneficiary of that trust personally holds voting rights, regardless of whether the rights are held in an individual or a fiduciary capacity (or both) that, when aggregated with any voting rights held by that trust, are more than fifty percent of the total voting rights relating to the control of the bank or trust company.

Section 3.4(a)(3) of the Trust Technical Provisions will provide that the bank or trust company must maintain and enforce “firewall rules” prohibiting any individual who is “connected” to the bank or trust company (including an officer, director, employee, or “one percent shareholder”, as defined in the document) from participating in a decision of the bank or trust company involving the exercise of either: (A) any incidents of ownership with respect to any insurance on the life of such individual, whether owned by the bank or trust company or owned by any trust as to which the bank or trust company is acting as an independent trustee, and/or (B) any discretionary power, other than investment or administrative powers not affecting any current or contingent beneficiary’s enjoyment of that trust, the effect of which would be to make or withhold any distribution from (or to grant or withhold permission to enjoy any asset of) that trust in favor of: (i) any individual (if the connected individual is a living donor or an individual related to a living donor) or (ii) a current or contingent beneficiary or any individual whom the beneficiary is then under an obligation to support (if the connected individual is the beneficiary or an individual related to the beneficiary), but the paragraph (B) restriction shall not apply to any individual who would be eligible to serve as an individual independent trustee of that trust under paragraph (b)(3) of Section 3.4, substituting for this purpose, “one percent” for “fifty percent” in subparagraph (B) of Section 3.4(b)(3).

Section 3.4(a)(3)(B)(ii)(I) of the Trust Technical Provisions will provide that a “one percent shareholder” shall mean any individual who holds voting rights, whether the rights are held in an individual or a fiduciary capacity (or both) that, when aggregated with the voting rights of any trust of which the individual is a donor or a current or contingent beneficiary, represent more than one percent of the voting rights of all of the then issued and outstanding shares of the bank or trust company.

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Section 3.4(a)(3)(B)(ii)(II) of the Trust Technical Provisions will provide that an individual shall be considered to be “related” to a living donor or current or contingent beneficiary if related in any of the following classifications: spouse, ancestor, lineal descendant, brother or sister.

Section 3.4(b) of the Trust Agreement will provide that each individual independent trustee shall be an “independent” and “experienced” individual who is not related to nor employed by any trust donor or beneficiary as described in Section 3.4(b) of the Trust Technical Provisions. Section 3.4(b) of the Trust Technical Provisions will provide that to be eligible to serve as an independent trustee of a specific trust under the trust agreement, an individual must have certain “individual independent trustee qualifications.” Section 3.4(b)(3) will provide the individual may not be either (A) a donor to or a current or contingent beneficiary of the trust nor related to a donor or beneficiary who is then living in any of the following classifications: spouse, ancestor, lineal descendant, brother, or sister; or (B) an employee of a donor to or current or contingent beneficiary of the trust or of any corporation, firm, or partnership (I) in which a donor or beneficiary is an executive or (II) with respect to which a donor or beneficiary personally holds voting rights, regardless of whether the rights are held in an individual or a fiduciary capacity (or both), that when aggregated with any voting rights held by that trust, are more than fifty percent of the total voting rights relating to the control of the corporation, firm, or partnership.

Section 3.5 of the Trust Agreement will provide that the top control list person(s) for any present or future trust under the agreement may by stipulation require that, under certain circumstances: (a) the office of either individual or corporate independent trustee for the trust shall, while circumstances continue, be kept filled and (b) the other independent trustee office shall be (i) kept filled, (ii) left vacant, or (iii) be filled or left vacant as the family trustee may, from time to time, determine. However, after Grantor 1's incapacity or death, the corporate independent trustee office must be kept filled (this provision shall not apply while any individual nominated by Grantor 1 serves as an individual independent trustee of the affected trust).

Section 4.2(a) of the Trust Technical Provisions will provide that all trustees at any time acting with respect to any trust under the trust agreement, when exercising their powers and discretions as trustees, shall act as fiduciaries and not as the holders of powers for their own benefit. Specifically, Section 4.2(a)(6) provides that any power that any trustee of any trust(s) established under Trust Agreement may have to remove any trustee(s) shall be exercisable in accordance with the terms and procedures set forth regarding removal. Furthermore, unless a trustee removal power is expressly referred to or described either: (a) as an absolute right and power that the powerholder may exercise to remove a trustee from office that is exercisable by the powerholder with or without cause or (b) as a power that is not held (or not intended to be held) in a fiduciary capacity, all trustee removal rights shall be exercisable only in furtherance of trust purposes and not as a means of obtaining the personal goals of the powerholder (or a trust beneficiary) by influencing, through trustee removal, the manner in which discretions granted exclusively to the trustee(s) subject to removal are to be exercised.

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Section 4.2(a)(6)(B) will provide a procedure for a removed trustee to obtain judicial review regarding whether a decision to remove a trustee was in furtherance of trust purposes or intended to achieve personal goals.

Section 5.1(b) of the Trust Technical Provisions will provide that all other provisions of the agreement to the contrary notwithstanding, each trust that comes into existence under the agreement shall be subject to the following limitations on its duration. Unless earlier terminated, each trust under the agreement (except any trust all of the assets of which are then unqualifiedly withdrawable by its primary beneficiary) shall, in any and all events, terminate on the “rule against perpetuities required termination date” applicable to that trust. Section 5.1(b) will provide that the required termination date on which the trust shall terminate shall be the day prior to the expiration of twenty-one years after the death of the last survivor of a group of individuals composed of the grantors’ parents and their lineal descendants who were living on Date 3, for Trust 1, Trust 2, Trust 4, Trust 6, and Trust 7, and Date 4, for Trust 8, respectively.

On Date 7, Probate Court in State 2 issued an order affecting the trusts that are the subject of this private letter ruling. The order approves an interim trustee succession plan proposed by the trustees and agreed to by the adult beneficiaries of the various trusts and a guardian ad litem representing the minor and unborn beneficiaries. The agreement signed by the parties defines a “trust restructuring period” that begins on Date 7. The trust restructuring period ends after the Internal Revenue Service issues a private letter ruling and Probate Court issues a final order approving the trust restructuring plan. The Date 7 Probate Court order provides that during the trust restructuring period, the requirement that allows or requires (whether or not by stipulation) a bank or trust company independent trustee to be appointed as sole or co-independent trustee is suspended. In addition, the order appoints Trustee 3 to fill the second independent trustee office. If a vacancy occurs in a co-independent trustee office during the trust restructuring period, the vacancy shall be filled by a qualified individual or left vacant in the discretion of the person(s) who hold the power to appoint a successor independent trustee under the applicable section of the original Trust Agreement.

The trustees have requested the following rulings: (1) the implementation of the proposed trust restructuring plan will not cause the value of the assets of the trusts created under Trust Agreement to be included in the gross estate of any grantor or beneficiary under §§ 2036, 2038 or 2041; and (2) the implementation of the proposed trust restructuring plan will not result in any change in the inclusion ratio of any of the trusts created under Trust Agreement for purposes of the generation-skipping transfer tax.

#### Ruling 1

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

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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

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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 power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment. 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 not 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 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

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purposes of §§ 2036 and 2038, it is immaterial in what capacity the power was exercisable by the decedent.

In the present case, only the independent trustee(s) possess the power to make discretionary distributions from Trust 1, Trust 2, Trust 4, Trust 6, Trust 7, and Trust 8. Section 3.2 of the Trust Agreement and Technical Provisions governing all of the trusts will authorize the removal of the independent trustee(s) by either the family trustee (that may include the grantors or a beneficiary of the trusts) or the other independent trustee (that may include Trust Company). Section 3.3 of the Trust Agreement and Technical Provisions will describe how vacant trustee positions will be filled. Section 3.3(b) of the Trust Agreement will provide that if a vacancy occurs in the office of corporate independent trustee (or in the office of individual independent trustee and that office is required to be filled under Section 3.5), the appointment of a successor trustee will be made, in order of preference, by the family trustee, the top control list person, the representative beneficiary, or a court having jurisdiction over the trust. Section 3.3(c) of the Trust Agreement will provide that, if a vacancy in the office of individual independent trustee is not required to be filled under Section 3.5, the family trustee may fill the vacancy or allow the office to remain vacant. In either case, the person or corporation filling the independent trustee office must fill the requirements of the office as described in Section 3.4 of the Trust Technical Provisions.

Section 3.4(b) of the Trust Technical Provisions will preclude a donor to or a current or contingent beneficiary of a trust from serving as the individual independent trustee. In addition, Section 3.4(a) of the Trust Technical Provisions will preclude any donor to or current or contingent beneficiary of a trust from participating in discretionary distribution decisions if they are connected to a bank or trust company serving as the corporate independent trustee. Sections 3.4(a) and 3.4(b) of the Trust Technical Provisions will further preclude any individual related to a living donor or beneficiary as spouse, ancestor, lineal descendant, brother, sister, or employee from serving as the individual independent trustee of a trust. In addition, the sections preclude these individuals from participating in discretionary distribution decisions if they are connected to a bank or trust company serving as the corporate independent trustee.

Section 3.4(b) will provide that no employee of any corporation, firm, or partnership in which a donor or beneficiary is an executive or with respect to which a donor or beneficiary personally holds voting rights regardless of whether the rights are held in an individual or a fiduciary capacity (or both), that when aggregated with any voting rights held by that trust, are more than fifty percent of the total voting rights relating to the control of the corporation, firm, or partnership may serve as the individual independent trustee.

Section 3.4(a)(2) requires that the corporate independent trustee be a bank or trust company in which no donor to or current or contingent beneficiary of the trust personally holds voting rights that when aggregated with any voting rights held by that trust, are more than fifty percent of the total voting rights relating to the control of the bank or trust company. Section 3.4(a)(3) will also include a "firewall" provision

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precluding anyone connected to the bank from participating in discretionary distribution decisions in favor of any individual (if the connected individual is or is related to a living donor), a current or contingent beneficiary, or any individual whom the beneficiary is then under an obligation to support (if the connected individual is or is related to the beneficiary) unless the connected individual meets the requirements of an individual independent trustee and is not an employee of any corporation, firm, or partnership in which a donor or beneficiary personally holds voting rights, regardless of whether the rights are held in an individual or a fiduciary capacity (or both), that when aggregated with any voting rights held by that trust, are more than one percent of the total voting rights relating to the control of the corporation, firm, or partnership.

The provisions described above thus prohibit the grantors from participating, directly or indirectly, in discretionary distribution decisions. In addition, the provisions prohibit any individual beneficiary from participating, directly or indirectly, in discretionary distribution decisions. Finally, the provisions preclude anyone closely related to a donor or a current or contingent beneficiary from participating in discretionary distribution decisions.

Furthermore, under the Trust Company bylaws and participation agreement, the grantors, beneficiaries and other family members are all eligible to participate as a director of Trust Company. However, Section 7.17 expressly prohibits any officer or director from participating in a decision of Trust Company involving the exercise of a discretionary power, other than investment powers, of any trust of which the officer, director, or spouse of the officer or director is a grantor or donor to the trust or a current or contingent beneficiary of the trust. In addition, family members are prohibited from participating in Trust Company decisions relating to discretionary distributions from trusts where the current or contingent beneficiary of the trust (or his or her spouse) is a descendant of either Patriarch X or Patriarch Y. Therefore, the grantors and the beneficiaries of the trusts created under Trust Agreement are sufficiently prohibited from participating in decisions regarding discretionary distributions from their own trusts. In addition, the structure of the bylaws prohibits the grantors and beneficiaries of the Family X and Family Y trusts from participating in Trust Company's exercise of discretion to make distributions from any of either family's trusts preventing the possibility of outside reciprocal agreements that may indirectly give members of Family X effective control over the discretionary distributions from Trust 1, Trust 2, Trust 4, Trust 6, Trust 7, and Trust 8.

The combination of the firewall provisions in the revised Trust Agreement, Trust Technical Provisions, and the Trust Company Bylaws preclude a donor of any of the trusts from having the retained dominion and control as contemplated by §§ 2036 or 2038. Neither 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 possessing, directly or indirectly, the power to remove and/or to replace either independent trustee under Trust Agreement. In addition, although both grantors may be shareholders in and participate in the daily activities of Trust Company, they are precluded from participating in discretionary distribution decisions made by Trust Company with respect to trusts created under Trust Agreement. Accordingly, based on the facts submitted

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and the representations made, we conclude that the implementation of the proposed trust restructuring plan, including the appointment of Trust Company as trustee of the trusts and Trust Company's future exercise of discretionary powers over distributions to the beneficiaries of the trusts, will not result in the inclusion of any portion of the trusts in the estate of a grantor under § 2038 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 powers of the trustee under § 20.2041-1(b)(1) solely as a result of possessing, directly or indirectly, the power to remove and/or replace either independent trustee under Trust Agreement. In addition, although beneficiaries may be shareholders in and participate in the daily activities of Trust Company, they are precluded from participating in discretionary distribution decisions made by Trust Company with respect to trusts created under Trust Agreement. Accordingly, based on the facts submitted and the representations made, we conclude that the implementation of the proposed trust restructuring plan, including the appointment of Trust Company as trustee of the trusts and Trust Company's future exercise of discretionary powers over distributions to the beneficiaries of the trusts, will not result in the inclusion of any portion of the trusts in the estate of a beneficiary under § 2041.

## Ruling 2

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.

The trusts created under Trust Agreement are generation-skipping transfer trusts because they provide for distributions to one or more generations below the grantors' generation. The taxpayers represent that, prior to the proposed modifications, all of the transfers made to Trust 1, Trust 2, Trust 4, Trust 6, Trust 7, and Trust 8 qualified for the gift tax annual exclusion and were deemed to have a zero inclusion ratio under § 2642(c).

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.

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In this case the proposed modifications do not shift a beneficial interest in any trust to a beneficiary who occupies a lower generation than the person(s) who held the beneficial interest prior to the modification. In addition, the modifications do not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. We therefore conclude that the proposed modifications will not change the inclusion ratio of Trust 1, Trust 2, Trust 4, Trust 6, Trust 7, or Trust 8.

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 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  
Acting Branch Chief, Branch 9  
Office of Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure

Copy of this Letter for § 6110 purposes