

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:

October 10, 2003

Legend

Grantor 1 =
Grantor 2 =
Trust Agreement =
Date 1 =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Trust 2 =
Trust 3 =
Trust 4 =
Trustee 1 =
Trustee 2 =
Date 2 =
Date 3 =
State 2 =

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- Date 4 =
- Trust X =
- Trust Y =
- Trust Z =
- Date 5 =
- Family X =
- Family Y =
- Trust Company =
- State 1 =
- Date 6 =
- Patriarch X =
- Patriarch Y =
- Child 2 =
- Child 3 =
- Measuring Life 1 =
- Measuring Life 2 =
- Measuring Life 3 =
- Date 7 =
- Probate Court =
- Trustee 3 =

Dear :

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

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Grantor 1 and Grantor 2 (collectively referred to as “the grantors”) executed Trust Agreement on Date 1, to create irrevocable trusts to benefit their grandchildren: Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4. Date 1 is before September 25, 1985. The trust created to benefit Grandchild 1 is not the subject of this private letter ruling. This private letter ruling addresses the trusts created to benefit Grandchild 2 (Trust 2), Grandchild 3 (Trust 3), and Grandchild 4 (Trust 4). The Trust Agreement designates Trustee 1 as the family trustee and Trustee 2 as the independent trustee. Grantor 1 died on Date 2. Grantor 2 died on Date 3.

Section 1.1 of the Trust Agreement provides that the trustees shall divide the initial trust property into equal parts, one part for each Grandchild 1, Grandchild 2, Grandchild 3, and Grandchild 4. Each part will be a separate and distinct trust for the primary benefit of one of the grantors’ grandchildren (hereinafter referred to as the “beneficiary” of that particular trust).

Section 1.2 of the Trust Agreement provides that at least quarterly during the remainder of each specific beneficiary’s lifetime, the trustees shall distribute to or for the direct benefit of the trust’s beneficiary (a) all of the net income of the separate trust and, (b) so much of the corpus of the separate trust, even to the exhaustion thereof, as may, in the sole and uncontrolled discretion of the independent trustee of the trust, be deemed necessary and proper under all of the then circumstances (insofar as they can reasonably be ascertained by the trustee) for the health, education (including the highest forms of education), and support in reasonable comfort of the beneficiary, or for any other purpose that the trustee shall deem to be in the best interests of the beneficiary.

Section 1.4 of the Trust Agreement provides that after the death of both of the grantors, during the remainder of each beneficiary’s lifetime if the beneficiary is at least twenty-eight years of age, the beneficiary shall have the right and power to appoint any part or all of the net assets contained in a separate trust on the effective date to or among or for the benefit of any one or more of the grantors’ lineal descendants (whether or not then in being) and/or the spouses of the descendants (whether or not then in being), in any amounts or proportions. However, the power shall not be exercisable to any extent for the benefit of the beneficiary, his or her estate, his or her creditors or the creditors of his or her estate. Any appointment under the power may be made for any present or future, vested or contingent estate or estates either outright or in trust, and if in trust, subject to the limitations of Section 3.1, and with one or more objects as beneficiaries and with the trustee or trustees, the administration powers, the newly created powers of appointment and subject to lawful spendthrift provisions, all as specified in the instrument. No apportionment under the power, however, shall benefit directly or indirectly one who is not a permissible object of the power.

Section 1.5 of the Trust Agreement provides that upon the death of the beneficiary of a separate trust established under the trust agreement, all of the remaining net assets shall be disposed of as follows and the trust shall terminate. Section 1.5(a) provides that all net assets shall be distributed to, among or for the

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benefit of the person or persons, in amounts and proportions, and for the estates and interests, and outright or upon the terms, trusts (as limited by Section 3.1), conditions, and limitations as the beneficiary may appoint in and by a provision in his or her Last Will and Testament specifically referring to the power. No appointment under the power, however, may benefit directly or indirectly either the beneficiary, his or her estate, his or her creditors or the creditors of his or her estate. Section 1.5(b) provides that in the event that a beneficiary fails to exercise his or her testamentary special power of appointment, or if an appointment is void or does not take effect, then upon the beneficiary's death, the net assets, or the part not effectively appointed, shall be divided among the beneficiary's lineal descendants who are then living, per stirpes, or if none are then living, then among those of the grantors' lineal descendants who are then living per stirpes. If there is a trust in existence for the primary benefit of any above-designated descendant, however, his or her share shall be transferred and added to the corpus of the trust and thereafter held, managed, and disposed of in the same manner as the corpus to which the share is added. If there is no trust in existence under the instrument for the primary benefit of any above-designated descendant, his or her share shall nevertheless continue in trust as the corpus of a separate and distinct trust of which the descendant shall be the primary beneficiary, the provisions of each separate trust being set forth in Section 1.6. If, however, at the time specified for termination of a separate trust there is no lineal descendant of the grantors then living, the net assets shall instead be distributed one-half to the person or persons (other than either grantor), and in the proportions to which the persons would be so entitled, had both of the grantors died at that time intestate and residents of State 2 (regardless of the actual time or place of their deaths or of the fact that one or both of them may still be then living).

Section 1.6 of the Trust Agreement provides that a new separate trust for the primary benefit of any grandchild of the grantors who is born or adopted after the date of the instrument, having provisions identical to those of the original separate trusts, may be brought into existence by an endorsement to the instrument setting forth (i) the name of the after-born or adopted grandchild who is to be the "beneficiary" of a new separate trust, (ii) the names of the initial family trustee and independent trustee of the trust, and (iii) a description of the property being transferred to the trust as its initial corpus. The instrument will be effective when signed by the person or persons making the transfer of property and by the designated trustees of the new trust accepting the office and acknowledging receipt of the initial corpus. The dispositive provisions of each separate trust that may come into existence under the provisions of Section 1.5(b) above for the primary benefit of a descendant of the grantors shall be exactly identical to the provisions of each separate trust as set forth in Sections 1.2 through 1.5, the descendant being the "beneficiary" of his or her new separate trust.

Section 3.1 of the Trust Agreement provides that notwithstanding all other provisions to the contrary (a) if at the end of any trust accounting year the net assets then contained in any trust shall have become too small in value in relation to minimum fiduciary fees and expenses to warrant further reasonably economic continuance of the trust, its trustees shall terminate the trust. (b) Also, every trust that comes into

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existence under Trust, 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 those now living persons whose names appear in the instrument (other than witnesses and notaries) and those of their respective lineal descendants who are living on Date 1. Upon termination of a trust under Section 3.1, its trustees shall pay over all of the net assets then contained in the trust to the beneficiary to whom distributions of the income of the trust might then be properly made.

Section 4.1 of the Trust Agreement provides that any trustee may resign at any time by written notice, setting forth the effective time and date. The grantor whose name appears first in the instrument, personally, and after the grantor's death or incapacity to act rationally (certified to in writing by two licensed physicians), the other grantor, while living and not incapacitated, shall have the absolute right at any time or times, with or without cause, to remove any then acting family trustee of any trust by causing written notice of the removal setting forth the effective time and date thereof to be delivered personally or sent by registered mail to the trustee prior to the effective time. After the death or incapacity (as above certified) of both grantors, any family trustee of any trust established under the trust agreement may, at any time or times, be removed, with or without cause, by the descendant of the grantors who is a parent of the beneficiary of the trust, and after the descendant's death or incapacity, by the beneficiary of the trust, acting personally, or, if the beneficiary is then under a legal disability or is incapacitated, by the beneficiary's legally appointed guardian (the beneficiary's parent or spouse, in that order, may act in this regard if there is then no legally appointed guardian). Furthermore, the then acting family trustee of each separate trust shall have the absolute right at any time or times with or without cause, to remove, by the foregoing procedure, the then acting independent trustee of that separate trust.

Section 4.2 of the Trust Agreement provides that in the event of any vacancy at any time or times occurring in the office of independent trustee with respect to any trust, whether caused by resignation, removal, incapacity (as above certified), death or otherwise, the vacancy in office shall be promptly filled by a bank or trust company that is located in some State of the United States, that has trust powers, and that has a capital and surplus in excess of \$10,000,000, or by an individual who is sui juris, who is experienced in business and finance or who is an attorney experienced in the trust and tax fields, and who is neither a grantor nor a beneficiary nor related to a grantor or to any beneficiary in any of the following classifications: spouse, ancestor, lineal descendant, brother or sister; nor an employee of a grantor or of any beneficiary or of any corporation, firm or partnership in which a grantor or any beneficiary is an executive or has stock or other holdings that are significant from the viewpoint of control. The selection and appointment of a successor independent trustee shall be made, in the following order of preference, (a) by the then acting family trustee of the trust, or if there is none, (b) by the person then having the right under Section 4.3 to fill a vacancy in the office of family trustee with respect to the affected trust. If the appointment is made by anyone other than one of the grantors or the original family trustee, however, the

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appointment shall be limited to a corporate, rather than individual, successor independent trustee.

Section 4.3 of the Trust Agreement provides that in the event of any vacancy at any time or times occurring in the office of family trustee with respect to any trust, whether caused by resignation, removal, incapacity, death or otherwise, the person then, and subsequently at any specific point in time involved, having the right under Section 4.1 to remove the family trustee of the trust, may, at any subsequent time, select and appoint an individual who is sui juris and who is at least twenty-five years of age (including even the person making the appointment) to fill the vacancy in office. In absence of or until an appointment is made, the independent trustee of the trust shall act alone as the sole trustee of the trust (although the trustee may appoint an individual as a trustee or as a successor trustee of any "Secondary Trust" provided for in Section 5.13 should that at any time be necessary). Whenever under the provisions of the instrument one or more separate trusts are created out of the assets of a then existing trust, the then acting trustees of the existing trust shall automatically be the initial trustee of the new separate trusts.

The trustees represent that additions were made to Trust 2, Trust 3, and Trust 4 after September 25, 1985, pursuant to the terms of a separate trust agreement dated Date 4. The Date 4 trust agreement requires that undistributed net income from Trust X, Trust Y, and Trust Z be distributed to certain trusts at the end of each income tax year, including Trust 2, Trust 3, and Trust 4. The trustees represent that Trust X, Trust Y, and Trust Z were irrevocable prior to September 25, 1985, and are exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i).

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.

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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.

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

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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 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 requirements, 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.

The modified trust will incorporate comprehensive technical provisions that govern all aspects of the administration of the trusts created under the Trust Agreement.

Section 1.1 of the Trust Agreement will provide for a separate trust for each grandchild (as primary beneficiary).

Section 1.2 of the Trust Agreement will provide that at least quarterly during the remainder of the primary beneficiary's lifetime, the trustees shall distribute to or for the direct benefit of the primary beneficiary: (a) all of the trust's net income and, (b) any part or all of the trust's principal as may, in the sole and uncontrolled discretion of the independent trustee(s), be necessary and proper for any purpose that the trustee(s) deem to be in the primary beneficiary's best interests.

Section 1.4 of the Trust Agreement will provide that after attaining the age of twenty-eight, the primary beneficiary shall have the power to appoint any part or all of that trust's assets, effective at any time during the affected trust's existence, to or for the benefit of any one or more of Grantor 1's descendants and/or their spouses, but the power shall not be exercisable to benefit the primary beneficiary, the primary beneficiary's estate, or the creditors of either.

Section 1.5(a) of the Trust Agreement will provide that unless the primary beneficiary has directed otherwise the primary beneficiary shall have the power by a provision in his will to appoint any part or all of that trust's assets, effective upon his death, to (or in trust for) any person or persons, but the power shall not be exercisable

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to benefit the primary beneficiary, the primary beneficiary's estate, or the creditors of either.

Section 1.5(b) of the Trust Agreement will provide that all unappointed trust assets shall be divided, per stirpes, among the then living lineal descendants of: (1) the primary beneficiary or, if none, (2) the primary beneficiary's parent who was a descendant of Grantor 1 or, if none, (3) Grantor 1. The share of each descendant shall be added to the trust for the primary benefit of the descendant under the agreement or constitute the principal of a separate trust of which the descendant shall be the primary beneficiary.

Section 1.6 of the Trust Agreement will provide that if no family member is then living (that is, no descendant designated in Section 1.5), the trustees shall instead distribute the assets one-half to the heirs of Grantor 1 and one-half to the heirs of Grantor 2, all as set forth in the technical provisions.

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 at least one of the two independent trustee offices 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 by a corporate independent 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.

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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 the grandchild of Grantor 1 (or his or her designees) if he or she (or his or her descendant) 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 grandchild's most senior generation descendant, if any, who is an ancestor of the primary beneficiary of the trust (or the 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's descendant(s) of the most senior generation having an eligible descendant (or the 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 the 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 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 (that, until thus filled, shall remain vacant).

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Section 3.3(b) of the Trust Agreement will provide that whenever a vacancy exists in (i) the office of the sole remaining independent trustee of any trust, or (ii) one of the two independent trustee offices 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 not 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 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

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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.

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

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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.

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. 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 3.1(b) of the original Trust Agreement will be moved to Section 5.1(b) of the Trust Technical Provisions by the modification. 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. 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 lineal descendants of Grantor 1, Trustee 2, and Trustee 2's lineal descendants who were living on Date 1, namely: Trustee 1, Child 2, Child 3, Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, Trustee 2, Measuring Life 1, Measuring Life 2, and Measuring Life 3.

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 when 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 a currently acting individual trustee must resign in favor of a bank or trust company upon the death of Trustee 1 is suspended.

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In addition, the order creates an additional independent trustee office and appoints Trustee 3 to fill the 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 beneficiary under § 2041; and (2) the implementation of the proposed trust restructuring plan will not affect the status of any of the trusts created under Trust Agreement as exempt from the generation-skipping transfer tax.

Ruling 1

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 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.

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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 (8th 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 the present case, only the independent trustee(s) possess the power to make discretionary distributions from Trust 2, Trust 3, and Trust 4. 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 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 the sole remaining independent trustee office (or in the office of one of the two independent trustee offices 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 an office of 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 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 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 beneficiary as spouse, ancestor, lineal descendant, brother, sister, or employee from serving as the individual independent trustee of a

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trust. In addition, these 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 beneficiary is an executive or with respect to which a 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 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 precluding anyone connected to the bank from participating in discretionary distribution decisions in favor of 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 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 the 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 any individual beneficiary from participating, directly or indirectly, in discretionary distribution decisions. In addition, the provisions preclude anyone closely related to a current or contingent beneficiary from participating in discretionary distribution decisions.

Furthermore, under the Trust Company bylaws and participation agreement, the 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 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 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 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

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Family X effective control over the discretionary distributions from Trust 2, Trust 3, and Trust 4.

The combination of firewall provisions in the revised Trust Agreement, Trust Technical Provisions, and the Trust Company Bylaws 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.

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), which relate to property includible in a grantor's gross estate under §§ 2038 and 2042.

The trusts created under Trust Agreement are generation-skipping transfer trusts because they provide for distributions to one or more generations of beneficiaries below the grantors' generation. Date 1 is prior to September 25, 1985, and Trust 2, Trust 3, and Trust 4 were irrevocable on September 25, 1985. In the present case, the trusts created under Trust Agreement are considered to have been irrevocable on September 25, 1985, because neither § 2038 nor § 2042 applies. Trust 2, Trust 3, and Trust 4, therefore, are exempt from the generation-skipping transfer tax pursuant to § 26.2601-1(b)(1)(i). The trustees represent that the only additions made to Trust 2,

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Trust 3, and Trust 4 after September 25, 1985, were income distributions from Trust X, Trust Y, and Trust Z as required under the Date 4 trust agreement governing Trust X, Trust Y, and Trust Z.

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. 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. 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.

Section 26.2601-1(b)(5)(i) provides that any addition to a trust made pursuant to an instrument or arrangement covered by the transition rules in paragraph (b)(1), (2), or (3) of this section is not treated as an addition for purposes of this section.

In this case, the trustees represent that Trust X, Trust Y, and Trust Z are exempt from the generation-skipping transfer tax under the effective date provision in § 26.2601-1(b)(1)(i). Under § 26.2601-1(b)(5)(i), the income distributions from Trust X, Trust Y, and Trust Z do not constitute constructive additions to Trust 2, Trust 3, or Trust 4. With respect to Trust 2, Trust 3, and Trust 4, 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 modification does 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 affect the status of Trust 2, Trust 3, or Trust 4 as exempt from the generation-skipping transfer tax.

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.

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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