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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 - PLR-157973-02
Date:
October 20, 2003

Grantor 1 =

Grantor 2 =

Child 1 =

Child 2 =

Child 3 =

Grandchild 1 =

Grandchild 2 =

Grandchild 3 =

Grandchild 4 =

Grandchild 5 =

Grandchild 6 =

Grandchild 7 =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

D1 =

D2 =

D3 =

D4 =

Year 1 =

Year 2 =

Year 3 =

Corporation =

Bank =

Trust Company =

State =

County =

Dear :

This letter responds to a letter dated October 16, 2002, and subsequent correspondence, submitted on behalf of Grandchild 5 by Grandchild 5's authorized representative, requesting certain rulings under the Internal Revenue Code.

The information submitted states that Grantor 1 and Grantor 2 (collectively the Grantors), husband and wife, both died prior to September 25, 1985, survived by Child 1, Child 2, and Child 3. On D1, Grantors established three separate irrevocable individual trusts, Trust 1, Trust 2, and Trust 3 (collectively the D1 Trusts) for the benefit of their three children. The trust agreements have identical terms except that each trust designates a different child as beneficiary. The current trustee of the D1 Trusts is Bank.

Under Article I(a) of each D1 Trust, the beneficiary shall receive all of the income of his or her trust during his or her lifetime. If the beneficiary becomes disabled, then the income distributions will be discretionary based on the “general comfort, well-being, education and support of said beneficiary.”

Article I(b) of the D1 Trusts provides that upon the death of a beneficiary, the trustee is to pay the net income from the trust estate to his or her descendants "per stirpes." Each D1 Trust will terminate twenty years after the death of the last to die of Child 1, Child 2, and Child 3, at which time the trustee will distribute the Trust corpus to the beneficiary's then living issue "per stirpes."

Article III(a) of the D1 Trusts provides that the trustee may hold any shares of corporate stock comprising any part of the trust estate in its own name as trustee or in the name of its nominee or nominees; it may give proxies to any person it may select to vote such stock at any stockholders' meeting of any such corporation, but shall, during the life of Grantor 1, nominate Grantor 1 as such proxy in all instances except where Grantor 1 shall be unable to serve or be disqualified, and, following Grantor 1's death, so long as it shall continue to hold any stock of Corporation in the trusts therein created, it shall nominate as proxy for the voting of all such shares Child 3.

Article IV of the D1 Trusts provides that in the case of a vacancy in the office of trustee resulting from resignation or disqualification for any cause, then the trustors or the survivor of them, or, after their deaths, a majority of their living children, may nominate a successor trustee, but if a majority of the children of the trustors are unable to agree upon a successor trustee within thirty days after such resignation or disqualification, then any one of them may apply to any court of original general jurisdiction in the County and State for the appointment of a new trustee on such notice as shall be in accordance with the rules and practice of that court.

On D2, Grantor 1 established an inter vivos revocable trust, Trust 4. Pursuant to Article VIII of the Trust 4 agreement, on Grantor 1's death in Year 1, the Trust corpus was divided into two equal parts, the "Deceased Spouse's Share" and the "Surviving Spouse's Share". Under Article XII, the Surviving Spouse's Share was held for the exclusive benefit of Grantor 2. Grantor 2 had the power during her lifetime to invade trust corpus for any amount or for any purpose. On her death, a portion of the trust was to be distributed to a private foundation, and the balance pursuant to Grantor 2's exercise of a general power to appoint the trust corpus. In default of exercise, the trust corpus was to be added to the Deceased Spouse's Share. In general, under Article XI, the Deceased Spouse's Share was administered for the benefit of Grantor 2 and the Grantors' children. Pursuant to Article XIII, on Grantor 2's death in Year 2, the remaining balance of the Deceased Spouse's Share (and additions from the Surviving Spouse's Share) was divided into three parts, each part constituting a separate trust share for the benefit of each of the Grantors' three children, Child 1, Child 2, and Child 3, and their descendants. The current trustee of Trust 4 is Bank.

Article XIV, Paragraph (b) of the Trust 4 agreement defines "beneficiary" to include each named child if he or she is living at the death of Grantors 1 or 2, whichever event occurs later, and all the descendants of the named child born prior to the termination of Trust 4.

Under Article XV, Paragraph A of the Trust 4 agreement, the trustee shall distribute the net income of each separate trust among its beneficiaries "in such proportion equal or unequal as the trustee shall determine."

Article XV, Paragraph B of the Trust 4 agreement provides that "the trustee may, in its sole discretion, invade the principal of each trust for the support, education and emergency needs of any beneficiary of such trust."

Article XV, Paragraph C of the Trust 4 agreement provides that Trust 4 will terminate "by the exhaustion of all the principal" or "one day before the twenty-first anniversary of the date of death of the last survivor of Grantors 1 and 2 and all descendants of Grantor 1 living at the time of execution of this amendment, but not later than such earlier termination date as is required to prevent violation of the rule against perpetuities or any applicable rule against remoteness." Upon termination, the entire balance of the principal and any accumulated income of each separate trust share shall be distributed outright, free of trust, per stirpes, among the beneficiaries of such trust share, then living.

Article XVII, Paragraph B, subparagraph 1, of the Trust 4 agreement provides that upon the death of Grantor 1 or during any period of his incapacity, the trustee shall appoint as proxies of all Corporation stock, Grantor 2, Child 1, and Child 2. Upon the death, resignation, or incapacity of any of these proxies, the named spouse of Child 2 shall be appointed proxy. When all of the previously named proxies are no longer able or willing to serve as proxies, then the trustee shall appoint Child 3 to serve as proxy if Child 3 is able and willing to serve.

Article XVIII of the Trust 4 agreement provides that in the event of the resignation or disqualification of the trustee, then the trustor, or after the trustor's death, any two of the trustor's three children, may appoint a successor. If no two children of the trustor's are then living, or if living but are unable to agree upon a successor trustee, then a successor trustee shall be chosen by the Court of the State for the County in the manner provided for in the State Trust Act. Any successor trustee shall be a national bank or trust company authorized to do trust business in the State and having an unimpaired capital stock of at least $1,000,000.

As noted above, Grantor 1 died in Year 1, and Grantor 2 died in Year 2. Child 1 died in Year 3, and Child 2 and Child 3 are currently living. There are also 7 grandchildren (Grandchildren 1 through 7) currently living.

The D1 Trusts and Trust 4 are funded with common stock of Corporation, a State corporation. Pursuant to Article IIIA of the D1 Trusts, Child 3 holds a proxy to vote any Corporation stock held by the D1 Trusts. In addition, pursuant to Article XVIIB(1) of the Trust 4 agreement, Child 3 holds a proxy to vote the Corporation stock held by Trust 4.

On D3, the Trust Company, a State nonprofit corporation, was formed by the filing of the Articles of Incorporation and Bylaws of the Trust Company with the Secretary of State of State. One of the purposes of the Trust Company, as stated in Article III of the Articles of Incorporation, is to serve as the successor trustee of the D1 Trusts and Trust 4.

Article IV of the Articles of Incorporation provides that Trust Company has three members of a single class. Each member is a lineal descendant of the Grantors. The relative rights and responsibilities of each member are identical to those of every other member. The three initial members were Child 1, Child 2, and Child 3 (each a "founding member"). Should a founding member be unwilling or unable to serve, or after the death of a founding member, a successor member ("successor") must be selected by and from among the adult lineal descendants (the "family") of that founding member. Lineal descendants include adopted children. Each family determines for itself the term of any successor from that family and the procedure by which the successor will be selected and must designate the successor to the Secretary of the corporation.

Article X of the Articles of Incorporation provides, in part, that Trust Company has seven directors and no founding member may be a director. Each member is entitled to appoint two directors, each of whom must be from the family of that appointing member. All members are entitled to vote for the election of a seventh director who may or may not be a member of any family. The number of directors constituting the board of directors may be increased or decreased only by an amendment to the Articles of Incorporation. Any director may be removed with or without cause by the vote of two-thirds of the board of directors; provided, however, in the case of a director from the family of a founding member, at least one vote for removal must be made by a director from the same family as the director to be removed. The initial directors of Trust Company are Grandchildren 1 through 7.

Article IV, Paragraph 4.1 of the Bylaws provides, in part, that the management of all the affairs, property, and interests of Trust Company is vested in a board of directors consisting of seven persons, appointed and elected as provided in the Articles. Directors need not be members. No founding member may be a director. Subject to the limitations and requirements of Article XII with respect to discretionary distributions from the D1 Trusts and Trust 4, the board of directors as a whole has the authority to make any and all decisions regarding Trust Company's actions as trustee of the D1 Trusts and Trust 4. The affirmative vote or written consent of not less than five directors is required to sell assets of the D1 Trusts and Trust 4.

On D4, the members of Trust Company consented to amendment to the Bylaws adding new Article XII. Under new Article XII, a special "Discretionary Distribution Committee" will make all decisions regarding discretionary distributions to any beneficiary under the D1 Trusts and Trust 4 and will have no other purpose or function.

The Discretionary Distribution Committee is subject, in part, to the following requirements and limitations:

1. The Committee will consist solely of not less than one and not more than three member(s);
2. The Board of Directors will appoint each member of the Committee for a term of two years, subject to removal only for malfeasance or bad faith conduct;
3. No member of the Committee may be a grantor or have any beneficial interest in the D1 Trusts or Trust 4;
4. No member of the Committee may be an employee of the Trust Company or Corporation or any subsidiary or affiliate of either entity; and,
5. No member of the Committee may be a "related or subordinate party" within the meaning of § 672(c) as to any Grantor of any of the D1 Trusts or Trust 4 or any beneficiary of the D1 Trusts or Trust 4.

Bank has filed a petition in the appropriate court of State and County stating that it no longer desires to serve as trustee and asking the court for directions regarding the appointment of a successor trustee.

After the filing of Bank's petition, Bank, Trust Company, current and remainder adult beneficiaries, and the Special Representative appointed by the court to represent all minor and unborn remainder beneficiaries of the D1 Trusts and Trust 4 entered into a Settlement Agreement. The Settlement Agreement will be effective upon the confirmation by the court and the issuance of a favorable private letter ruling by the Internal Revenue Service.

Paragraph 3 of Settlement Agreement provides, in part, that the parties intend that Trust Company replace Bank as trustee of the D1 Trusts and Trust 4. All parties waive certain requirements of Trust 4 that the trustee be a corporate trustee with capitalization of $1 million or more.

The Settlement Agreement has been signed by all parties and confirmed by order of the court. The D1 Trusts and Trust 4 were irrevocable prior to September 25, 1985, and no additions to the D1 Trusts and Trust 4 have been made since that date.

RULING 1

Section 671 of the Internal Revenue Code provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

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

Based on the facts and representations submitted, none of Grandchildren 1 through 7 will have the power to vest the corpus or income from the D1 Trusts or Trust 4 in themselves. Therefore, we conclude that Grandchildren 1 through 7 will not be treated as the owners of any portion of the D1 Trusts or Trust 4 under §§ 671 and 678(a).

RULING 2

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 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 such a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1)(A) 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) of the Estate Tax Regulations provides 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 a trust 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.

Section 2514 and the regulations promulgated under that section provide similar rules regarding the application of the gift tax in the case of the release, exercise or lapse of a general power of appointment.

Rev. Rul. 95-58, 1995-2 C.B. 191, revoking Rev. Rul. 79-353, 1979-2 C.B. 325, holds that a decedent-settlor'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-settlor to the trust, for purposes of §§ 2036 and 2038.

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. For purposes of §§ 672(f), 674, and 675, a related or subordinate party shall be presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence.

In this case, under Article XII of the Bylaws, no beneficiary under the D1 Trusts or Trust 4 can participate, directly or indirectly, in any decisions regarding discretionary distributions to any beneficiary under the Trusts. Furthermore, any decisions regarding discretionary distributions are made by the Distributions Committee which must consist of individual(s) who are not related or subordinate within the meaning of § 672(c) to any Grantor, or to any beneficiary. The Distributions Committee cannot include any employee of Trust Company, Corporation, or any affiliate. Accordingly, based on the facts presented, the directors of Trust Company will not be deemed to possess a general power of appointment under §§ 2041 and 2514 with respect to the D1 Trusts or Trust 4.

RULING 3

Section 2601 imposes a tax on each generation-skipping transfer made by a transferor to a skip person.

Under § 2611 and § 26.2611-1 of the Generation-Skipping Transfer Tax Regulations, a generation-skipping transfer is an event that is either a direct skip, a taxable distribution, or a taxable termination. The determination as to whether an event is a generation-skipping transfer is made by reference to the most recent transfer subject to the estate or gift tax.

Under § 1433(a) of the Tax Reform Act of 1986, the generation-skipping transfer tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Tax Reform Act and § 26.2601-1(b)(1)(i) of the regulations, the tax does not apply to a transfer from a trust, if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification 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 for in the original trust. A modification that does not result in an increase in the amount of a GST transfer or the creation of a new GST transfer will not cause the trust to lose its exempt status.

Under the facts presented, the replacement of Bank as trustee with Trust Company will not shift a beneficial interest in the D1 Trusts or Trust 4 to any beneficiary who occupies a lower generation (as defined in § 2651) than the 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 Trusts beyond the period provided for in the original trusts.

Accordingly, we conclude that the replacement of Bank as trustee with Trust Company will not cause the D1 Trusts or Trust 4 to lose exempt status for generation-skipping transfer tax purposes under § 2601.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to Grandchild 5's authorized representative.

Sincerely,
J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes