

Dear :

This letter responds to your letter, dated January 28, 2004, requesting rulings regarding the income and estate tax consequences of naming a family-owned trust company as trustee of certain family trusts.

Trust Company was formed on Date 1 as a corporation under the laws of State 1. Trust Company has two classes of stock, Class A Voting stock and Class B Non-Voting stock. Each class of stock has identical economic rights with respect to current distributions and liquidation value. The holders of Class A Voting stock are permitted to vote on shareholder and corporate matters, while the holders of Class B Non-Voting are not. Patriarch owns all of the Class B Non-Voting shares of Trust Company. Trust 1, an irrevocable trust established by Patriarch, owns all of the Class A Voting shares of Trust Company. Trust Company will not solicit trust customers from the public-at-large.

Article 5.1 of the Trust Company Articles of Incorporation provides in relevant part that there shall be no fewer than three and no more than five directors on the Board of Directors. No more than half of the number of directors serving at any time may be related or subordinate to Patriarch. Patriarch may not serve as a director. Article X defines related or subordinate as having the same meaning attributed in § 672(c) of the Internal Revenue Code of 1986 and any Treasury Regulations promulgated thereunder.

Article VI, paragraph 1 of the Trust Company Bylaws provides that to the extent a trust indenture confers any “discretionary distribution powers” on Trust Company as trustee of a trust held thereunder, the powers shall be exercised by a Distribution Committee of the Trust Company. A “discretionary distribution power” includes any power exercisable by the Corporation as the trustee that pertains to (i) any non-mandatory distribution of income or principal for the benefit of one or more beneficiaries of the trust, regardless whether the distribution is to be made pursuant to an ascertainable standard as that term is used in § 2041 of the Internal Revenue Code of 1986 and the Treasury Regulations promulgated thereunder or (ii) the granting or withholding of permission to use or otherwise enjoy any asset of the trust.

Article VI, paragraph 2 of the Trust Company Bylaws provides that the Distribution Committee shall be composed of not less than one nor more than three members, all of whom shall be directors of the Trust Company. The number of Distribution Committee members shall be determined from time to time by the Board of Directors. Each committee member shall be appointed by a majority vote of the Board of Directors and shall serve at the discretion of the Board of Directors. Each member of the Distribution Committee must be a person who: (a) is not a grantor of or donor to any trust of which the Trust Company is trustee, nor the spouse of any such grantor or donor; (b) is not a current or contingent beneficiary of any trust of which the Trust Company is trustee, nor the spouse of any such beneficiary; and (c) is not related or subordinate (as defined in the Trust Company Articles of Incorporation) to any grantor of or donor to any trust of which Trust Company is trustee nor to any current beneficiary of any trust of which the Trust Company is trustee. A current beneficiary of a trust is any

person who (i) is entitled or eligible to receive a mandatory or discretionary distribution of income or principal of the trust, (ii) has a right to withdraw property from the trust, or (iii) is entitled or eligible to use or otherwise enjoy any asset of the trust.

Article VI, paragraph 3 of the Trust Company Bylaws provides that at no time shall a majority of the members of the Distribution Committee also be employees or officers of the Trust Company. Further, no Distribution Committee member may participate in the exercise of any discretionary distribution power with respect to any trust beneficiary to whom a legal obligation of support is owed by the member (as an individual), the member's spouse, or an individual to whom such member is related or subordinate.

Article IX, paragraph 1(a) of the Trust Company Bylaws provides that no director, officer or committee member of the Trust Company shall participate or vote in a Trust Company decision, nor be present during any board or committee discussion of or vote on a decision, involving the power to exercise any incidence of ownership of any life insurance policy insuring the life of such director, officer or committee member.

Article IX, paragraph 1(b) of the Trust Company Bylaws provides that if a director, officer or committee member of the Trust Company has transferred voting stock of any corporation to a trust of which the Trust Company is serving as trustee, then such director, officer or committee member shall not participate or vote in a Trust Company decision, or be present during any board or committee discussion of or vote on such a decision, involving the exercise of the power: (1) to vote the shares of stock of such corporation as to which such director, officer or committee member is the transferor, if the corporation is a "controlled corporation" (as defined in § 2036(b)(2)) as to the transferor, or would become a "controlled corporation" as to the transferor if he were permitted to participate in the vote of such shares; or (2) to vote the shares of stock of such corporation as to which any other director, officer or committee member is the transferor, if such corporation is a "controlled corporation" (as defined in § 2036(b)(2)) as to such transferor, or would become a "controlled corporation" as to such transferor if such director, officer or committee member were permitted to participate in the vote of the shares.

During Patriarch's lifetime, the property held by Trust 1 is held as a single trust for the benefit of Patriarch's lineal descendants. The trustees of Trust 1 may distribute income or principal to Patriarch's lineal descendants for a beneficiary's health, education, maintenance, support, and welfare to the extent they determine that such distributions will not jeopardize Trust 1's stated purpose of holding the voting stock of Trust Company.

Upon Patriarch's death, the trustees of Trust 1 will pay such amounts of its principal to or for the benefit of such of Patriarch's lineal descendants as Patriarch appoints by will. Such testamentary power of appointment shall not be exercisable with respect to any "Accumulations" in Trust 1, defined as that part of the trust consisting of

the gross income of the trust, including proceeds from capital gains, undistributed income which the trustees have added to principal, and other corpus income, which income was earned or generated during Patriarch's life. Article II, paragraph 3(k) provides in part that "accumulations" include all income (within the meaning of § 674(b)(3)). The unappointed portion of Trust 1 shall continue to be held in trust for the benefit of Patriarch's lineal descendants. Article IV, paragraph 5 provides that Patriarch acknowledges that the reserved testamentary power of appointment over Trust 1 will cause Trust 1 to be includable in Patriarch's gross estate for federal estate tax purposes.

Trust 1 shall have at least three trustees at all times. The current trustees are Trustee 1, Trustee 2, and Trustee 3. No lineal descendant of Patriarch, nor any person who is "related or subordinate" to any such lineal descendant, may serve as a trustee. Neither Patriarch, Patriarch's spouse, nor any other donor to Trust 1 may act as a trustee. No more than half of the trustees may be persons who are "related or subordinate" to Patriarch.

Patriarch created Trust 2 for the benefit of Child 1 and Trust 3 for the benefit of Child 2 on Date 2 (collectively the Series I Trusts). Trustee 1, Trustee 2, and Trustee 3 currently serve as the voting trustees of Trust 2 and Trust 3. It is represented that Trustee 1, Trustee 2, and Trustee 3 are not related or subordinate to Patriarch. Each child serves as a nonvoting trustee of his respective Series I Trust. It is represented that neither child has ever been a voting trustee of his respective Series I Trust. The Series I Trusts each have the same operative provisions. The Series I Trusts are governed by State 2 law.

Article Second of each Series I Trust Agreement provides that during the continuance of a trust, the trustees have the discretionary power to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries; or to pay out principal to or for a beneficiary or beneficiaries, or to or for a class of beneficiaries (whether or not income beneficiaries). The class of beneficiaries entitled to receive income or principal, within the discretion of the trustees, shall consist of (i) the named child for whom the trust was created and his lawful issue, and (ii) one or more descendants of the Patriarch or organizations described in § 170(c), which may be added to the class of beneficiaries by the trustees. Any person or organization added by the trustees to the class of beneficiaries in any year may be removed by the trustees in any subsequent year. The power of the trustees to add beneficiaries designated to receive income or principal within the discretion of the trustees shall exist only with respect to that portion of the trust estate prior to its distribution under the provisions of Article Third; provided further that the named child may terminate the trustees' power to add permissible beneficiaries at any time by written instrument delivered to the trustees.

Article Third of each Series I Trust Agreement provides that when the named child for whom the trust was created attains thirty-five years of age, he shall be entitled to a distribution of one-fourth of the trust estate, one-third of the balance of the trust

estate upon attaining age forty, one-half of the balance of the trust estate upon attaining age forty-five, and the balance at age fifty. If the named child dies prior to becoming entitled to a distribution of all of the trust estate, the trust estate remaining, including accrued and undistributed income, shall vest in and be distributed to the then living lawful issue of the named child, by right of representation, or should there be no such issue then living, the same shall be distributed to the named child's brother, if he is then living, or if he is deceased, to his lawful issue then living, by right of representation, and if there is none, then to the then living lawful issue of the Patriarch, by right of representation; provided that if there is in existence a trust for the benefit of any issue of the Patriarch who would otherwise be entitled to a distribution of the trust property, the provisions and terms of which are substantially identical to the provisions and terms of any trust established under a Series I Trust Agreement, and where the trustees are identical, the trustees shall add the issue's share to the principal of the trust and the share shall be held, applied and distributed in like manner. Notwithstanding anything herein to the contrary, the trustees shall have the power to accelerate or postpone the termination, whether a partial termination or the complete termination, of the trust, if the trustees, in their sole and absolute discretion, determine that it would be in the best interest of the named child to accelerate or postpone the termination, taking into consideration all circumstances at the time, including the size of the trust estate and the named child's maturity and responsibility.

Article Eighth of each Series I Trust Agreement provides that notwithstanding anything to the contrary, unless sooner terminated, all Series I Trusts shall terminate twenty-one years after the death of the last survivor of all beneficiaries in being on Date 2. Upon such termination, the trust property, including accrued and undistributed income, shall vest in and be distributed to the person(s) then entitled to the income of the trust, whether absolute or discretionary.

Article Ninth of each Series I Trust Agreement provides that when the named child for whom the trust was created attains twenty-five years of age, he shall become a non-voting co-trustee. When the named child attain thirty years of age, he shall become a voting co-trustee unless the remaining trustees determine, in their sole and absolute discretion, that the named child has not demonstrated an interest or commitment to the business interests of the trust, in which case the named child's voting power shall be deferred until such time as the remaining trustees are satisfied that he is prepared to assume full responsibilities as a voting trustee.

Article Tenth, paragraph B of each Series I Trust Agreement provides that successor trustees may be appointed by the then acting trustees. If there is a trustee vacancy, the trustees may appoint an individual as successor trustee, other than Patriarch, Individual 1, or Individual 2. Further, the trustees then acting shall have the right to appoint an additional individual trustee to serve, making a total of five trustees, including the named child. Upon the failure of all trustees to act without a successor trustee having been appointed pursuant to the foregoing provisions, a majority of the legally competent beneficiaries then entitled to receive income from the trust estate, or

the guardian(s) of the beneficiaries, if they are all minors, then entitled to receive income from the trust estate shall have the right to appoint a successor trustee other than the Patriarch, Individual 1, or Individual 2.

The trustees of the Series I Trusts propose to obtain a court order modifying Article Tenth, paragraph B of the Series I Trust Agreements. After the modifications, the section will provide that upon the failure of any trustee to act, a successor trustee may be appointed by the then acting trustee(s), even if the then acting trustee(s) will cease to act upon the acceptance of the appointment by the successor trustee. If there is a trustee vacancy, the trustees may appoint an individual or corporation as successor trustee, other than the Patriarch, Individual 1, or Individual 2. Further if Trust Company is not acting as trustee, the trustee(s) then acting shall have the right to appoint a corporation or one or more individuals to act as additional trustees, so long as the total number of trustees then acting does not exceed five. If Trust Company is appointed as successor trustee, then upon the acceptance of the appointment by Trust Company, each other trustee then serving as such, if any, shall be deemed to have resigned and renounced all rights to serve as trustee (unless subsequently reappointed by the trustee(s) then serving), and Trust Company shall serve as sole successor trustee. All other provisions of the Series I Trust Agreements will remain the same. The trustees have the authority to seek the modifications under State 2 law. After obtaining court approval to modify the Series I Trust Agreements, Trust Company will be appointed and will serve indefinitely as sole trustee of Trust 2 and Trust 3.

Patriarch created Trust 4 for the benefit of Child 1 and Trust 5 for the benefit of Child 2 on Date 3 (collectively the Series II Trusts). Trustee 1, Trustee 2, and Trustee 3 currently serve as the "independent trustees" of Trust 4 and Trust 5. The Series II Trusts each have the same operative provisions. The Series II Trusts are governed by State 2 law.

Article I, paragraph 1 of the Series II Trust Agreement provides that the trustee shall initially divide the trust estate into two separate equal trusts, one to be held for Child 1 and Child 2, each of whom shall be referred to as the "primary beneficiary" of his trust. Paragraph 2(a) provides that the trustee shall pay to the primary beneficiary of a trust such amounts of the net income and principal of his trust (if any) as the trustee deems proper for his needs and welfare.

Article I, paragraph 2(b) of the Series II Trust Agreement provides that the trustee shall then determine the amounts of income and principal (if any) it deems proper for the needs and welfare of the primary beneficiary's lineal descendants; provided, no such distribution shall be made if it would satisfy or discharge a legal obligation of the primary beneficiary. A primary beneficiary may appoint any such distribution among his lineal descendants, and may provide that such distributions be charged against the shares of such lineal descendants upon the death of the primary beneficiary as provided in paragraph 2(e). No appointment, however, shall reduce or defray any legal obligation of the primary beneficiary. Any trust principal the primary beneficiary does not or cannot

effectively appoint during his life shall be distributed by the trustee as follows: (i) Any unappointed parts of income shall be allocated among and for the benefit of the primary beneficiary's lineal descendants as the trustee deems proper. (ii) Any unappointed parts of principal shall be allocated among and for the benefit of such lineal descendants as the trustee deems proper for the welfare of each. Paragraph 2(c) provides that any income not paid under the foregoing provisions shall be added to the principal.

Article I, paragraph 2(d) of the Series II Trust Agreement provides that upon his death, a primary beneficiary may appoint his trust among any of Patriarch's lineal descendants (but not to or for the benefit of the primary beneficiary or his estate), and one or more "qualified charities." Further, the primary beneficiary may appoint the assets of his trust in further trust for the benefit of his spouse, granting to such spouse the right to receive income (mandatory or discretionary) and principal for her needs provided that the remainder interest passes in favor of Patriarch's lineal descendants or qualified charities.

Article I, paragraph 2(e) of the Series II Trust Agreement provides that any part of a trust the primary beneficiary does not or cannot effectively appoint shall, upon his death, be divided among and held in separate trusts for the following persons as primary beneficiaries (each of whom shall have with respect to his or her own trust the same rights, powers and interests as Patriarch's children had as the initial primary beneficiaries): (i) for the primary beneficiary's then living lineal descendants, per stirpes; provided, in making such division the amount of each payment of principal of the trust made to a lineal descendant to the extent, in the opinion of the trustee, it was not made for his or her needs shall be charged against the share of the lineal descendant, if he or she is to receive a share, or, if not, per stirpes against any shares of his or her ancestor or lineal descendant's (or ancestor's) share as to any principal payments made pursuant to a primary beneficiary's exercise of his limited power of appointment under paragraph 2(b), unless the primary beneficiary notifies the trustee in writing that any or all of the payments are to be charged against the share; or (ii) if the primary beneficiary leaves no lineal descendants then living, per stirpes, for the lineal descendants then living of his nearest ancestor (among Patriarch and Patriarch's lineal descendants) with a lineal descendant then living.

Article I, paragraph 6 of the Series II Trust Agreement provides that regardless of anything in the Series II Trust Agreement to the contrary, any trust that exists twenty years after the death of the last survivor of: (a) all of the lineal descendants of Patriarch's parents and Patriarch's spouse's parents who are living on Date 3; and (b) the unborn children in gestation as of Date 3 of any person named in paragraph 6(a), provided that such unborn children shall be included in the measuring period only if they are born alive, and only if, under applicable law, their respective lives may be used in the measuring period without violating the rule against perpetuities; shall become vested in its primary beneficiary and shall thereafter be held as a "vested trust." Provided, prior to the conversion of any trust to a "vested trust," in exercising its

discretion under paragraph 2, the trustee shall consider the tax advantages of distributions to the beneficiaries belonging to more remote generations or to the most remote generation. The trustee shall pay to the primary (and sole) beneficiary of a vested trust such amounts of the net income and principal of his trust as it deems proper for his welfare. Any income not so distributed shall be added to the principal from which derived. Any portion of his vested trust that remains undistributed at such beneficiary's death shall be paid to his estate.

The preamble to the Series II Trust Agreement provides that no beneficially interested trustee shall have any powers or participate in the exercise of any powers (including investment or administrative powers) that would constitute a general power of appointment under § 2041. Article III, paragraph 3(e) describes a trustee or other person as "beneficially interested" during any period when discretionary payments may be made to him or to any person to whom he is then legally obligated to support. The term "independent trustee" is defined as all persons or entities serving as trustee who are not "beneficially interested" in any trust created under the Series II Trust Agreement. Only an independent trustee may decide a matter at issue when a person beneficially interested in any Series II Trust is precluded from making or participating in a decision.

Article III, paragraph 3 of the Series II Trust Agreement provides that no donor of a trust (including the Patriarch) may serve as a trustee of any trust created hereunder nor may Patriarch's wife serve as trustee. The act of a majority of trustees (who are not barred from participating in the decision or matter under Article III, paragraph 2(e)) is the act of the trustee. At least three independent trustees shall serve as a trustee of each trust. So long as Patriarch is living, no more than one-half of the trustees then serving shall be related or subordinate to Patriarch. No more than two of the trustees serving at any time as trustee of any trust shall have a beneficial interest in that trust or any other Series II Trust. No more than five trustees shall serve at any time. No more than one corporate trustee shall serve at any one time. A child of Patriarch shall serve as a non-voting co-trustee of his trust upon attaining the age of twenty-five years, and upon attaining the age of thirty years, he shall become a voting co-trustee unless a majority of the independent trustees determine, in their sole and absolute discretion, that such child has not demonstrated an interest or commitment to the business interests of the trust, in which case such child's voting power shall be deferred until such time as the independent trustees are satisfied that he is prepared to assume full responsibilities as a voting trustee. In no event shall a beneficially interested trustee exercise or participate in the exercise of the powers specifically delegated to the independent trustee, or denied to a beneficially interested trustee. Any primary beneficiary may appoint any lineal descendant of Patriarch to serve as a co-trustee of the primary beneficiary's trust, subject to the other requirements of this paragraph.

Article III, paragraph 3(c) of the Series II Trust Agreement provides that upon the occurrence of any event requiring the appointment of a successor independent trustee, or if a trustee of any trust for any other reason ceases to be trustee, the other persons or entities then serving as the independent trustee shall appoint as successor to such

trustee any individual (other than any donor) or corporation qualified to act as such. Further, the independent trustee may appoint by a majority vote co-trustees at any time such appointment will not cause the total number of trustees then serving to exceed five. If the independent trustee does not appoint a successor in circumstances where a successor trustee is necessary, or if there is no independent trustee then serving, then either the trustee or the primary beneficiary may petition a court of competent jurisdiction to appoint a successor.

The trustees of the Series II Trusts propose to obtain a court order modifying Article III, paragraph 3 of the Series II Trust Agreement. After the modifications the section will provide that no donor of a trust may serve as a trustee of any Series II trust nor may Patriarch's spouse serve as trustee. The act of a majority of the independent trustees is the act of the trustee. At least a majority of the trustees of each trust shall be independent trustees, and if only one trustee is serving as trustee, such one shall be an independent trustee. So long as Patriarch is living, no more than one-half of the trustees shall be related or subordinate to Patriarch. No more than two of the trustees serving at any time as trustee of any trust shall have a beneficial interest in that trust or any other Series II Trust. No more than five trustees shall serve as trustee of any Series II Trust at any one time. No more than one corporate trustee shall serve as trustee of any Series II Trust at any time. In no event shall a beneficially interested trustee exercise or participate in the exercise of the powers specifically delegated to the independent trustee, or denied to a beneficially interested trustee. If Trust Company is appointed as a successor trustee, then upon the acceptance of such appointment by Trust Company, each other trustee of the affected trust then serving as such, if any, shall be deemed to have resigned and renounced all rights to serve as trustee (unless subsequently reappointed by the independent trustee then serving pursuant to the provisions of this paragraph), and Trust Company shall serve as the sole successor trustee of the affected trust.

Furthermore, the first sentence of Article III, paragraph 3(b) will be modified to provide that upon the occurrence of any event requiring the appointment of a successor independent trustee, the persons or entities then serving as the independent trustee (including any resigning independent trustee) shall appoint as successor any individual (other than any donor) or corporation qualified to act as an independent trustee. If the independent trustee does not appoint a successor in circumstances where a successor independent trustee is necessary, or if there is no independent trustee then serving, then either the trustee or the primary beneficiary may petition a court of competent jurisdiction to appoint a successor. If any trustee fails or ceases to serve as such and the appointment of a successor independent trustee is not required, the independent trustee may, but shall not be required to, appoint a successor to such trustee, subject to the other provisions of paragraph 3. Further, if Trust Company is not serving as trustee, the independent trustee then serving by a majority vote, may appoint co-trustees, subject to the other provisions of paragraph 3. All other provisions of the Series II Trust Agreement will remain the same. The trustees have the authority to seek the modifications under State 2 law. After obtaining court approval to modify the Series II

Trust Agreement, Trust Company will be appointed and will serve indefinitely as sole trustee of Trust 4 and Trust 5.

Patriarch is living and has two living lineal descendants: Child 1 and Child 2.

RULINGS REQUESTED

You have requested the following rulings: 1) Patriarch's reserved testamentary limited power of appointment will not cause Patriarch to be treated as the owner of any portion of Trust 1 under § 674(a). 2) Trust Company is not a "related or subordinate party" to the Patriarch within the meaning of § 672(c) with respect to the Series I and Series II Trusts. 3) Trust Company is an independent trustee within the meaning of § 674(c) with respect to the Series I and Series II Trusts. 4) Neither the appointment of Trust Company as successor trustee of the Series I and Series II Trusts, nor its exercise of discretionary distribution powers under the Series I or Series II Trust Agreements, will cause any beneficiary of the Series I and Series II Trusts to be treated as the owner of any part of the trust under § 678(a)(i). 5) Neither the appointment of Trust Company as successor trustee of the Series I and Series II Trusts, nor its exercise of discretionary distribution powers under these trusts, will result in the inclusion of any portion of these trusts in Patriarch's estate under §§ 2036 or 2038. 6) Neither the appointment of the Trust Company as successor trustee of the Series I and Series II Trusts, nor its exercise of discretionary distribution powers under these trusts, will cause any beneficiary of the Series I and Series II Trusts to be deemed to possess a general power of appointment over the trust under § 2041.

RULING 1

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

Section 674(b)(3) provides that § 674(a) shall not apply to a power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Based solely on the facts and representations submitted, we conclude that Patriarch's testamentary power of appointment under Trust 1 will not cause Patriarch to be treated as the owner of any portion of Trust 1 under § 671 and 674.

RULINGS 2 & 3

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

Section 674(c) provides that § 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor (1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries; or (2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

Based solely on the facts and representations submitted, including the provisions of the Trust Company Bylaws that preclude Patriarch, Patriarch’s spouse, or any beneficiary of the Series I or Series II Trusts from serving on the Distribution Committee and the Trust 1 provisions that preclude Patriarch, Patriarch’s spouse, or any lineal descendant of Patriarch from serving as trustee and that provide no more than half the trustees of any trust held under Trust 1 may be “related or subordinate” to Patriarch, we conclude that Trust Company is not a “related or subordinate” party to Patriarch, within the meaning of § 672(c)(2). Therefore, Trust Company may exercise the powers described in § 674(c) with regard to the Series I and Series II Trusts without causing Patriarch to be treated as the owner of any portion of those trusts under § 674(a).

RULING 4

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 that 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, including the provisions of the Trust Company Bylaws that preclude any beneficiary from serving on the Distribution Committee and the provisions of Trust 1 that preclude any lineal descendant from acting as trustee, we conclude that, after the appointment of Trust Company as trustee of the Series I and Series II Trusts, none of the beneficiaries of the Series I or Series II Trusts will have the power to vest the corpus or income from the Series I or Series II Trusts in themselves. Therefore, we further conclude that the appointment of Trust Company as trustee of the Series I and Series II Trusts, and its exercise as trustee of any discretionary distribution powers, will not cause any beneficiary of the Series I or Series II Trusts to be treated as an owner of any portion of the Series I or Series II Trusts under § 678(a), during the Patriarch's lifetime.

RULINGS 5 & 6

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period that does not in fact end before his death –

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

Section 2036(b)(1) provides that for purposes of § 2036(a)(1), the retention of the right to vote (directly or indirectly) shares of stock of a controlled corporation shall be considered to be a retention of the enjoyment of transferred property.

Section 2036(b)(2) 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 2036-1(b)(3) provides in part that if a decedent reserved the unrestricted power to remove or discharge a trustee at any time and to appoint himself as trustee, the decedent is considered as having the powers of the trustee.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the exercise of a

power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired the power), to alter, amend, revoke, or terminate, or where any power is relinquished during the three-year period ending on the date of decedent's death.

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

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has, at the time of his death, a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent the property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive. For purposes of § 2041(a)(2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

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

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

Rev. Rul. 95-58, 1995-2 C.B. 191, holds that a decedent/grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or corporate successor trustee that is not related or subordinate to the decedent within the meaning

of § 672(c), is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus is not includable 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 order for §§ 2036-2038 to apply, the decedent must have made a transfer of property or any interest therein (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. For purposes of §§ 2036 and 2038, it is immaterial in what capacity the power was exercisable by the decedent.

The governing trust instruments preclude Patriarch and the beneficiaries from directly participating in decisions regarding discretionary distributions from the trusts. Furthermore, under the Trust Company Articles of Incorporation no more than half of the directors may be related or subordinate to Patriarch. Discretionary distribution decisions are made by a Distribution Committee of the Board of Directors. The Trust Company Bylaws require that the members of the Distribution Committee be members who: (a) are not grantors of or donors to any trust of which the Trust Company is trustee, nor the spouse of any grantor or donor; (b) are not current or contingent beneficiaries of any trust of which the Trust Company is trustee, nor the spouse of any such beneficiary; and (c) are not related or subordinate, as defined in § 672(c), to a grantor, donor or any current beneficiary of any trust of which the Trust Company is trustee. The Bylaws define a current beneficiary of a trust as any person who (i) is entitled or eligible to receive a mandatory or discretionary distribution of income or principal of the trust, (ii) has a right to withdraw property from the trust, or (iii) is entitled or eligible to use or otherwise enjoy any asset of the trust. Under these circumstances, Patriarch and the beneficiaries of the Series I and Series II Trusts are sufficiently prohibited from participating in decisions regarding discretionary distributions.

The combination of the firewall provision in the Trust Company Bylaws and the trustee provisions in each trust agreement preclude Patriarch from having the retained dominion and control contemplated by §§ 2036 or 2038. Patriarch, therefore, will not be

considered as having the powers of the trustees under §§ 20.2036-1(b)(3) or 20.2038-1(a)(3) solely as a result of being a shareholder in or participating in the daily activities of Trust Company as he is precluded from participating in discretionary distribution decisions with respect to the Series I and Series II Trusts, both directly by the trust agreements and indirectly when made by Trust Company. Therefore, neither the appointment of Trust Company as trustee of the Series I and Series II Trusts nor its exercise of the discretionary powers over distributions to beneficiaries of the trusts will result in the inclusion of any portion of the trusts in Patriarch's gross estate for federal estate tax purposes. Accordingly, based on the facts submitted and the representations made, we conclude that the appointment of Trust Company as a trustee of the Series I and Series II Trusts will not result in the inclusion of any portion of the trusts in Patriarch's estate under §§ 2036 or 2038.

Furthermore, the combination of provisions also preclude a beneficiary from having the power to affect the beneficial enjoyment of the trust property as contemplated by § 2041. No beneficiary, therefore, will be considered as having the power of the trustees under § 20.2041-1(b)(1) solely as a result of being a shareholder in and participating in the daily activities of Trust Company as they are precluded from participating in discretionary distribution decisions with respect to the Series I and Series II Trusts, both directly by the trust agreements and indirectly when made by Trust Company. Therefore, neither the appointment of Trust Company as trustee of the Series I and Series II Trusts nor its exercise of the discretionary powers over distributions to beneficiaries of the trusts will result in the inclusion of any portion of the trusts in the respective estate of a beneficiary. Accordingly, based on the facts submitted and the representations made, we conclude that the implementation of the proposed trust modifications and the appointment of Trust Company as an independent trustee of the Series I and Series II Trusts will not result in the inclusion of any portion of the trusts in the estate of a beneficiary under § 2041.

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. Specifically, we make or imply no ruling as to whether any beneficiary of the Series I and Series II Trusts shall be treated as the owner of any portion of those trusts after the death of Patriarch and the possible exercise of Patriarch's testamentary power of appointment under Trust 1. In addition, we note that Child 1 and Child 2 potentially have a general power of appointment over the Series I Trusts if they are named as voting trustees; and the beneficiaries of a "vested" Series II Trust will have a general power of appointment. The rulings provided in this letter relate only to the effect of naming Trust Company as trustee of the Series I and Series II Trusts and do not imply that a trust will not be included in a beneficiary's estate where the beneficiary is granted a general power of appointment by the terms of the trust agreement. Finally, we make or imply no rulings on whether Trust 1 will be included in Patriarch or a beneficiary's estate.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings it is subject to verification on examination.

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

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

Sincerely,

James F. Hogan
Senior Technician Reviewer, Branch 9
(Passthroughs & Special Industries)

Enclosure

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