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Date:
October 6, 2017

Legend

Grantor
Spouse
Daughter
Trust

Trustee
Date 1
Date 2
Date 3
County Court
Year
State Statute 1
State Statute 2
State Statute 3
State
a
b
c

Dear :

This letter responds to your authorized representative's letter dated April 4, 2017, and subsequent correspondence, requesting rulings concerning the gift, estate, and generation-skipping transfer (GST) tax consequences of certain proposed transactions involving Trust.

The facts and representations submitted are summarized as follows:

On Date 1, a date that is prior to October 22, 1942, Grantor and Spouse, Grantor's wife, created Trust, an irrevocable trust, for the benefit of Daughter (generally referred to in the trust instrument as "the Beneficiary"). Trust has been amended and restated twice by court order. The trust instrument states that "[Grantor] and [Spouse] are the parents of [Daughter] . . . and it is the desire and purpose of the said [Grantor] and [Spouse] to create an irrevocable trust, known as the [Daughter] Trust Estate, for the use and benefit of [Daughter]." Trustee is currently acting as trustee of Trust.

Article III, Section 1 of Trust provides that the Beneficiary has no right to the corpus of Trust and does not have a right to partition, divide, or dissolve Trust. The Beneficiary has no right with respect to Trust other than to receive distribution of net earnings awarded her by the trustee with the consent of Trust's advisory board and the right to distribution of Trust estate made by the trustee at the termination of Trust.

Article III, Section 2 provides that the death, insolvency or bankruptcy of the Beneficiary or the transfer of her interest in any manner, or by descent or otherwise, during the continuance of Trust, will not operate as a dissolution of, nor terminate the Trust, nor will it have any effect whatever upon said Trust, its operation or mode of business, nor will it entitle her heirs or assigns or representatives to take any action in the courts of law or equity against Trust, its trustees or property or its business operations of any kind, all of which will remain intact and undisturbed thereby; but they will succeed only to the rights of the Beneficiary.

Article III, Section 3 provides that at the time of the death of the Beneficiary, her equitable interest in the Trust Estate, unless disposed of otherwise by said Beneficiary, will pass to and vest in her heirs in accordance with the laws of descent and distribution then in force, applicable to the equitable interest of such Beneficiary in said Trust. (The term "beneficiary" applies not only to Daughter but to all her successors to beneficial interests under this trust.)

Article IV, Section 2 provides that the trust will continue during Daughter's life and for a period of 21 years after her death. On termination, the trustee is to distribute the trust corpus among the then existing beneficiaries.

Article IV, Section 3 provides, in relevant part, that the beneficiary may receive from time to time, a portion of the net profits accruing from time to time to Trust, as the trustee, acting with the advice and consent of the advisory board, may see fit to pay over and deliver to the beneficiary. No duty is imposed upon the trustee to distribute net profits, but the power is conferred upon the trustee, acting with advice and consent of the advisory board, to do so, and in exercising this discretion, the trustee and

Advisory Board will give full consideration to the interest of both the beneficiary and the Trust Estate.

In Year, certain beneficiaries of Trust (both children and grandchildren of Daughter) sought a declaratory judgment concerning the operation, construction, and effect of certain planned disclaimers by the beneficiaries. On Date 2, County Court ruled, in relevant part, that, under the terms of Trust, Daughter and the successor beneficiaries have a testamentary general power of appointment. Upon the death of Daughter or a successor beneficiary, the heirs at law of the beneficiary will succeed to the beneficiary's interest in Trust. Each heir's interest in Trust as a successor beneficiary will be separate; the heirs will not be common beneficiaries of an undivided trust.

The County Court also found that after Daughter's death, each successor beneficiary will have three separate beneficial interests: an income interest for 21 years after Daughter's death, a remainder interest which vests in possession 21 years after Daughter's death, and a (pre-1942) general power of appointment, each of which may be disclaimed independently of the others. In the event a successor beneficiary survives Daughter but dies within 21 years after her death, both of the successor beneficiary's retained and disclaimed interests in Trust will pass to the heirs at law. In the event a successor beneficiary survives Daughter and disclaims all or a part of his or her income interest in Trust, the beneficial ownership of the disclaimed income interest will pass at Daughter's death to her heirs who are also lineal descendants of the disclaimant. Further, County Court stated that the class of beneficiaries who are lineal descendants of disclaimant will remain open to new members who are born during the 21 years after Daughter's death. Finally, County Court construed Trust to provide that if a beneficiary disclaims a greater remainder interest than income interest, the retained and disclaimed interests would be administered as a distinct portion as follows: (i) following the disclaimer, each portion of Trust as to which a person is a beneficiary of both income and remainder interests is to be administered as a distinct portion, with the undistributed income produced by a particular portion added to the principal of that particular portion; and (ii) in addition, the portion of Trust as to which the disclaimant retained an income interest but disclaimed the remainder interest, is to be administered as another distinct portion, with the undistributed income produced by principal relating to such remainder interest added to the principal of the particular remainder interest.

Following the Date 2 court order, the grandchildren of Grantor (who are also the children of Daughter) issued partial disclaimers of their future income and remainder interests in Trust.

Several years later, Daughter proposed to "partially release" her general power of appointment. The release was intended to restrict the power of appointment in two respects. First, the power to appoint Daughter's beneficial interest in the trust was to be exercisable in a manner such that the interest in the trust could be appointed only to her

estate. Second, the power to appoint her beneficial interest could not be exercised in a manner that would take effect during her life time.

Daughter intends to allow her power of appointment over Trust to lapse at her death. Several of the beneficiaries succeeding to her interest in Trust intend to disclaim all or a portion of their beneficial interests in the trust within nine months of Daughter's death. Several great-grandchildren of Grantor (who are grandchildren of Daughter) likewise intend to disclaim all or an undivided portion of his or her interest in the trust within nine months of Daughter's death. It is represented that a disclaiming great-grandchild will not accept an interest in or any benefit from the property subject to the disclaimer or voluntarily assign, convey, encumber, pledge, or transfer the interest or property subject to the disclaimer. Each disclaimer will be irrevocable and in a writing delivered to the trustee. As a result, the proposed disclaimer will pass without any direction from the disclaiming great-grandchild and the interest will pass to someone other than the disclaiming great-grandchild. Finally, a disclaiming great-grandchild will not serve on the advisory board of Trust or as a trustee of Trust.

On Date 3, Trustee petitioned County Court, with the consent of Daughter and the other beneficiaries, to modify Trust to provide that when Trust terminates 21 years after the death of Daughter, any share distributable to a beneficiary who is then under the age of a is to be held in a continuing trust until the beneficiary reaches the age of a. If the beneficiary survives Daughter but dies before reaching age a, the beneficiary will have a general testamentary power of appointment over his or her continuing trust. If the beneficiary dies before reaching age a and does not exercise his or her general testamentary power of appointment, the continuing trust is to be includible in the beneficiary's estate (as a post-1942 general power of appointment). The proposed modification provides that the trustee may distribute income and principal of the continuing trust to the beneficiary for the beneficiary's health, education, maintenance, and support. The proposed modification also provides for a partial distribution of the continuing trust's principal when the beneficiary reaches the ages of b and c.

The Date 3 petition also requests that County Court clarify Trust in a way that will allow for ease of administration of the separate trusts created after Daughter's death. After the death of Daughter or another beneficiary, the trustee is to create the fewest number of trusts under a particular family branch that can be established with only one income beneficiary of each trust. When an income beneficiary of a separate trust dies within the 21-year period following Daughter's death with an heir at law who is already an income beneficiary of a separate trust under Trust, such heir's share of the deceased income beneficiary's trust is to be added to his or her existing trust. If a grandchild or great-grandchild survives Daughter, and disclaims all or a part of his income or remainder interest in Trust, and has another child within the 21-year term after Daughter's death, a new trust is formed for that child which will be funded from the existing separate trusts.

State Statute 1 provides that a person other than a fiduciary may disclaim, in whole or in part, any interest in or power over property, including a power of appointment.

State Statute 2 provides that if an interest in property passes because of the death of a decedent, a disclaimer of the interest takes effect as of the time of the decedent's death, and relates back for all purposes to the time of the decedent's death. In addition, a disclaimed interest passes according to any provision in the instrument creating the interest that provides for the disposition of the interest if the interest were to be disclaimed, or the disposition of disclaimed interests in general. If the instrument creating the disclaimed interest does not contain such a provision, the disclaimed interest passes as if the disclaimant had died immediately before the time as of which the disclaimer takes effect. A disclaimed interest that passes by intestacy passes as if the disclaimant died immediately before the decedent.

State Statute 3 provides that on the petition of a trustee or a beneficiary, a court may order that the trustee be changed, that the terms of the trust be modified, that the trustee be directed or permitted to do acts that are not authorized or that are forbidden by the terms of the trust, that the trustee be prohibited from performing acts required by the terms of the trust, or that the trust be terminated in whole or in part, if the order is not inconsistent with a material purpose of the trust.

You have requested the following rulings:

1. Trust grants to the great-grandchildren (and more remote descendants) who succeed to Daughter's interest in Trust a general power of appointment created on or before October 21, 1942, under §§ 2041(a)(1) and 2514(a), and therefore the complete release or lapse of such a power of appointment will not subject any portion of Trust to federal estate, gift, or GST tax.
2. The proposed disclaimer by any one or more of the great-grandchildren (and more remote descendants): (a) will be a qualified disclaimer under § 2518; (b) will not result in a taxable gift by the disclaimant; (c) will not subject any portion of Trust to estate tax in the gross estate of the disclaimant; and (d) will not result in Trust losing GST tax exempt status.
3. The assets of a continuing trust created pursuant to the proposed modification after Daughter's death will be included in the gross estate for federal estate tax purposes of the continuing beneficiary if the beneficiary dies before the continuing trust terminates.
4. The proposed construction of Trust will not cause Trust to be subject to GST tax pursuant to chapter 13.

5. The proposed construction of Trust will not result in a taxable gift by any of the beneficiaries of Trust.

Ruling 1

Section 2041(a)(1) 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 a general power of appointment created on or before October 21, 1942, is exercised by the decedent (A) by will, or (B) by a disposition which 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; but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof.

Section 2041(b)(1) defines the term "general power of appointment" as a power exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or creditors of the decedent's estate.

Section 20.2041-1(b) of the Estate Tax Regulations states that a power of appointment includes all powers that are in substance and effect powers of appointment, regardless of the nomenclature used in creating the power.

Section 20.2041-2(d) provides that a failure to exercise a general power of appointment created before October 22, 1942, or a complete release of the power is not an exercise of the power. The phrase "a complete release" means a release of all powers over all or part of the property subject to the power of appointment, as distinguished from the reduction of a power of appointment to a lesser power. Thus, if the decedent completely relinquished all powers over one-half of the property subject to a power of appointment, the power is completely released as to that one-half.

Under § 20.2041-1(e), Example 3, F created an irrevocable inter vivos trust before October 22, 1942, providing for payment of income to G for life with remainder as G shall appoint by will, but in default of appointment income to H for life with remainder as H shall appoint by will. If G died after October 21, 1942, without having exercised his power of appointment, H's power of appointment is considered a power created before October 22, 1942, even though it was only a contingent interest until G's death.

Section 2514(a) provides that an exercise of a general power of appointment created on or before October 21, 1942, shall be deemed a transfer of property by the individual possessing such power, but the failure to exercise such a power or the complete release of such a power shall not be deemed an exercise thereof.

Section 25.2514-2(c) of the Gift Tax Regulations provides that a failure to exercise a general power of appointment created on or before October 21, 1942, or a complete release of such a power is not considered to be an exercise of a general

power of appointment. The phrase “a complete release” means a release of all powers over all or a portion of the property subject to a power of appointment, as distinguished from the reduction of a power of appointment to a lesser power. Thus, if the possessor completely relinquished all powers over one-half of the property subject to a power of appointment, the power is completely released as to that one-half.

Section 2601 imposes a tax on every GST, which is defined under § 2611 as a taxable distribution, a taxable termination, and a direct skip.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act), 1986-3 (Vol. 1) C.B. 1, and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, provide that the GST tax shall not apply to any GST under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer was 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)(v) provides, in relevant part, that where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

In this case, Trust provides Daughter with a general power of appointment. This power was created before October 22, 1942. After Daughter dies, the grandchildren will succeed to her power of appointment. To the extent that any grandchild disclaims his or her interest in the pre-1942 power of appointment or dies during the 21-year period following Daughter’s death, some great-grandchildren (or more remote beneficiaries) will also succeed to her power of appointment. As in the case of § 20.2041-1(e), Example 3, the power of appointment held by the great-grandchildren (and more remote beneficiaries) is considered a power created before October 22, 1942, even though it is only a contingent interest until Daughter’s death. The release or lapse of such a power is not treated as an exercise of the power and will not result in an inclusion into the powerholder’s estate for purposes of chapter 11 or a gift by the powerholder for purposes of chapter 12. Further, because the release or lapse is not treated as a taxable transfer under chapters 11 and 12, the release or lapse will not be treated as an addition to trust for GST purposes. Therefore, based on the facts submitted and the representations made, we conclude that the complete release or lapse of such a power of appointment will not subject any portion of Trust to federal estate, gift, or GST tax.

Ruling 2

Section 2518(a) provides that if a person makes a qualified disclaimer with respect to any interest in property, subtitle B shall apply with respect to such interest as if the interest had never been transferred to such person.

Section 2518(b) provides that the term “qualified disclaimer” means an irrevocable and unqualified refusal by a person to accept an interest in property but only if (1) the refusal is in writing, (2) the writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than the date that is nine months after the later of (A) the date on which the transfer creating the interest in the person is made, or (B) the day on which the person attains age 21, (3) the person has not accepted the interest or any of its benefits, and (4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either (A) to the spouse of the decedent, or (B) to a person other than the person making the disclaimer.

Section 2518(c)(1) provides that a disclaimer with respect to an undivided portion of an interest which meets the requirements of § 2518(b) shall be treated as a qualified disclaimer of such portion of the interest. Section 2518(c)(2) provides that a power over property is to be treated as an interest in that property.

Section 25.2518-1(b) of the Gift Tax Regulations provides, in relevant part, that if a person makes a qualified disclaimer as described in § 2518(b) and § 25.2518-2, for purposes of the federal estate, gift, and generation-skipping transfer tax provisions, the disclaimed interest in property is treated as if it had never been transferred to the person making the qualified disclaimer. Instead, it is considered as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer. Accordingly, a person making a qualified disclaimer is not treated as making a gift. Similarly, the value of a decedent’s gross estate for purposes of the federal estate tax does not include the value of property with respect to which the decedent, or the decedent’s executor or administrator on behalf of the decedent, has made a qualified disclaimer.

Section 25.2518-2(c)(3) provides, in relevant part, that the nine-month period for making a disclaimer generally is to be determined with reference to the transfer creating the interest in the disclaimant. With respect to inter vivos transfers, a transfer creating an interest occurs when there is a completed gift for federal gift tax purposes regardless of whether a gift tax is imposed on the completed gift. With respect to transfers made by a decedent at death or transfers that become irrevocable at death, the transfer creating the interest occurs on the date of the decedent’s death, even if an estate tax is not imposed on the transfer.

Section 25.2518-2(c)(3) further provides that if a person to whom any interest in property passes by reason of the exercise, release, or lapse of a general power of appointment desires to make a qualified disclaimer, the disclaimer must be made within

a nine-month period after the exercise, release, or lapse regardless of whether the exercise, release, or lapse is subject to estate or gift tax. A person who receives an interest in property as the result of a qualified disclaimer of the interest must disclaim the previously disclaimed interest no later than nine months after the date of the transfer creating the interest in the preceding disclaimant. Thus, if A were to make a qualified disclaimer of a specific bequest and as a result of the qualified disclaimer the property passed as part of the residue, the beneficiary of the residue could make a qualified disclaimer no later than nine months after the date of the testator's death.

Section 25.2518-3(a)(2) states that a disclaimer of an undivided portion of an interest in a trust may be a qualified disclaimer. Under § 25.2518-3(b), the disclaimer of an undivided portion of a disclaimant's separate interest in property will be a qualified disclaimer if the undivided portion consists of a fraction or percentage of each and every substantial interest or right owned by the disclaimant in the property and extends over the entire term of the disclaimant's interest in the property. A disclaimer of some specific rights while retaining other rights with respect to an interest in the property is not a qualified disclaimer of an undivided portion of the disclaimant's interest in the property.

In the present case, Daughter's power of appointment under Trust was created before October 22, 1942, and is a general power of appointment described in §§ 2041(a)(1) and 2514(a). Under the terms of Trust, Daughter's heirs cannot succeed to any interests in Trust until Daughter's death. If Daughter releases any part of her general power of appointment before her death, the release will, for purposes of § 2518, create for each of the disclaimants interests in the trust that will be contingent upon surviving Daughter. If Daughter does not exercise her power of appointment, the income and contingent remainder interests and the power of appointment of each of the disclaimants will be considered for purposes of § 2518 to be created in each of the disclaimants on the date of Daughter's death, the date when Daughter's general power of appointment lapses.

Daughter's great-grandchildren propose to disclaim an undivided portion of their interest in Trust to which he or she may be entitled at Daughter's death. See State Statute 1 and State Statute 2. It is represented that a disclaiming great-grandchild will not accept an interest in or any benefit from the property subject to the disclaimer or voluntarily assign, convey, encumber, pledge, or transfer the interest or property subject to the disclaimer. Each disclaimer will be irrevocable and in a writing delivered to the trustee. As a result, the proposed disclaimer will pass without any direction from the disclaiming great-grandchild and the interest will pass to someone other than the disclaiming great-grandchild. Finally, a disclaiming great-grandchild will not serve on the advisory board of Trust or as trustee of Trust.

Accordingly, based on the facts submitted and the representations made, we conclude that the proposed disclaimer by any one or more of the great-grandchildren

(and more remote descendants) will not result in a taxable gift by the disclaimant, will not subject any portion of Trust to estate tax in the gross estate of the disclaimant, and will not result in Trust losing GST tax exempt status.

Rulings 3 and 4

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 GST tax under § 26.2601-1(b)(1), (b)(2), or (b)(3), will not cause the trust to lose its exempt status. The rules of § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST 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)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument will not cause an exempt trust to be subject to the provisions of chapter 13 if the judicial action involves a bona fide issue and the construction is consistent with applicable state law that would be applied by the highest court of the state.

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 for in the original trust. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST or the creation of a new GST.

In the present case, the proposed modification of Trust, under State Statute 3, provides that when Trust is set to terminate, 21 years after the death of Daughter, any share distributable to a beneficiary who is then under the age of b is to be held in a continuing trust until the beneficiary reaches the age of b. If the beneficiary survives Daughter but dies before reaching age b, the beneficiary will have a general power of appointment over the continuing trust. If the beneficiary survives the 21-year term following Daughter's death but dies without exercising the power of appointment, the remaining assets in the continuing trust is to be distributed to the beneficiary's estate and will be subject to estate tax in the estate of the beneficiary. Accordingly, based on the facts presented and the representations made, we conclude that the assets of a

continuing trust created pursuant to the proposed modification after Daughter's death will be included in the gross estate for federal estate tax purposes of the continuing beneficiary if the beneficiary dies before the continuing trust terminates.

Furthermore, the proposed construction in the Date 3 petition to County Court will clarify Trust in a way that will allow for ease of administration of the separate trusts created after Daughter's death. The proposed construction involves a bona fide legal issue to clarify how to divide Trust in light of the proposed disclaimers. Moreover, the construction is consistent with State law as it would be applied by the highest court of State. Accordingly, based on the facts presented and the representations made, we conclude that the proposed construction of Trust will not cause Trust to be subject to GST tax pursuant to chapter 13.

Ruling 5

Section 2501 provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual resident or nonresident.

Section 2511 provides that the tax imposed by § 2501 will apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(c) provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Whether a construction to clarify how to divide Trust in light of the proposed disclaimers is effective for gift tax purposes depends on whether the construction is based on a valid enforceable claim asserted by the parties and, to the extent feasible, produces an economically fair result. See Ahmanson Foundation v. United States, 674 F.2d 761, 774-75 (9th Cir. 1981), citing Commissioner v. Estate of Bosch, 387 U.S. 456 (1967). Thus, State law must be examined to ascertain the legitimacy of each party's claim. If it is determined that each party has a valid claim, the Service must determine that the settlement reflects the result that would apply under State law. If there is a difference, it is necessary to consider whether the difference may be justified because of the uncertainty of the result if the question were litigated.

As discussed above, the issues and ambiguities resolved by the proposed construction in the Date 3 petition are bona fide issues based upon valid enforceable claims by the interested parties. The terms of the proposed construction clarify ambiguous terms of Trust and reflect the rights of the parties under applicable State law. Accordingly, based on the facts submitted and representations made, we conclude

that the proposed construction of Trust will not result in a taxable gift by any of the beneficiaries of Trust.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

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

Sincerely,

Leslie H. Finlow

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures:

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cc: