

TEXT

I. Overview and Purpose

This notice sets forth the contents of a proposed revenue ruling concerning the income, estate, gift, and generation-skipping transfer tax consequences in situations in which family members create a private trust company to serve as the trustee of trusts having family members as grantors and beneficiaries.

This notice solicits public comments regarding the proposed revenue ruling. The IRS and the Treasury Department anticipate issuing a final revenue ruling after the comments have been considered. The IRS and the Treasury Department intend that the revenue ruling, once issued, will confirm certain tax consequences of the use of a private trust company that are not more restrictive than the consequences that could have been achieved by a taxpayer directly, but without permitting a taxpayer to achieve tax consequences through the use of a private trust company that could not have been achieved had the taxpayer acted directly. Comments are specifically requested as to whether or not the draft revenue ruling will achieve that intended result.

II. Proposed Revenue Ruling

Part 1

Section 2036.—Transfers With Retained Life Estate

26 CFR 20.2036-1(b)(3): Transfers with retained life estate.

Also: § 2038, § 20.2038-1, § 2041, § 20.2041-1, § 2501, § 2511, § 25.2511, § 2601, § 26.2601-1, § 671, § 672(c), § 674, § 675, § 677, § 678)

- (1) If the private trust company (PTC) described in Situation 1 or Situation 2 is appointed and serves as the trustee of a trust, will the value of the trust assets be included in a grantor's gross estate under §§ 2036(a) or 2038(a)?
- (2) If the PTC described in Situation 1 or Situation 2 is appointed and serves as the trustee of a trust, will the value of the trust assets be included in a beneficiary's gross estate under § 2041?
- (3) If the PTC described in Situation 1 or Situation 2 is appointed and serves as the trustee of a trust that provides the trustee with the discretionary power to distribute income and/or principal to the grantor's child or descendants, will the grantor's transfer to that trust constitute a completed gift?
- (4) Does the appointment and service of a PTC as the trustee of a trust affect the exempt status of a trust that is otherwise exempt from the generation-skipping transfer (GST) tax under § 2601, or change the inclusion ratio of a trust?
- (5) If the PTC described in Situation 1 or Situation 2 is appointed and serves as the trustee of a trust, is the grantor or any beneficiary of that trust treated as the owner of any portion of the trust under §§ 671 through 678?

FACTS

A and B, who are husband and wife, have three children, C, D, and E. C, D, and E are each married, and each has children. References to Family include A, B, their children, the spouses and former spouses of their children, and each other descendant

of A and B (both now living and future) and the spouses and former spouses of such descendants.

A and B have established separate irrevocable trusts for each of their children and grandchildren. In addition, C, D, and E have established irrevocable trusts for their respective descendants. Each child or grandchild of A and B is the primary beneficiary of the trust established for that child or grandchild. Each trust receives contributions only from the person who created the trust. All grantors and beneficiaries are United States persons and no trust is a foreign trust.

Each trust instrument provides the trustee with discretionary authority to distribute income and/or principal to the primary beneficiary of the trust during the primary beneficiary's lifetime. In addition, each trust provides the primary beneficiary with the testamentary power to appoint the trust corpus to or for the benefit of one or more members of Family (other than the primary beneficiary) and/or one or more organizations described in §§ 170(c), 2055(a) and 2522(a) of the Internal Revenue Code. Each trust also provides that the grantor, or the primary beneficiary if the grantor is not living, may appoint a successor trustee other than himself or herself if the current trustee either resigns or is no longer able to fulfill the duties of trustee. Finally, each trust provides that the trust will terminate, in all events, no later than 21 years after the death of the last to die of certain designated individuals living at the time of the creation of the trust.

Situation 1 -- PTC formed under laws of a state that has enacted a private trust company statute. The facts and the terms of the trusts are as described above. All trusts are governed by the laws of State 1, a state that has enacted a private trust

company statute (Statute). Statute provides that any PTC formed under Statute must create a Discretionary Distribution Committee (DDC) and delegate to the DDC the exclusive authority to make all decisions regarding discretionary distributions from each trust for which it serves as trustee. Discretionary distributions are defined as permissible distributions that are not mandated in the trust instrument or by applicable law. Statute does not restrict who may serve on the DDC, but provides that no member of the DDC may participate in the activities of the DDC with regard to any trust of which that DDC member or his or her spouse is a grantor, or any trust of which that DDC member or his or her spouse is a beneficiary. In addition, Statute provides that a DDC member may not participate in the activities of the DDC with respect to any trust with a beneficiary to whom that DDC member or his or her spouse owes a legal obligation of support. Statute provides that only officers and managers of the PTC may participate in decisions regarding personnel of the PTC (including the hiring, discharge, promotion and compensation of employees). Statute also provides that nothing in Statute or in PTC's governing documents may override a more restrictive provision in the trust instrument of a trust for which PTC is acting as a trustee. Finally, Statute provides that no Family member may enter into any reciprocal agreement, express or implied, regarding discretionary distributions from any trust for which PTC is serving as a trustee.

In 2008, Family formed a corporation that is a PTC under Statute. PTC's governing documents create a DDC that will make all decisions with respect to discretionary distributions from all trusts for which it serves as trustee, consistent with Statute. PTC's governing documents do not restrict who may serve on the DDC.

Family owns all of the stock in PTC, either outright or through trusts and/or other entities. A, C, and D are officers of PTC and serve on PTC's Board of Directors. A, C, and D also serve on the DDC. B and E own shares of PTC, but neither is on the DDC and neither is an officer or director of PTC. E is a manager and employee of PTC.

X, a financial institution organized under the banking laws of State 1, has served as trustee of each of the trusts since their inception. No grantor of any of the trusts has a relationship with X other than as a customer or client of X.

Subsequent to PTC's formation, X resigned as trustee of each of the trusts and PTC was appointed as the successor trustee of each trust. In addition, A created and transferred property to three additional irrevocable trusts (the 2008 trusts), one for the primary benefit of each of A's children, C, D, and E, and that child's descendants. The terms of each of the 2008 trusts are the same as those described above, except that these trusts provide that the trustee has discretionary authority to distribute income and/or principal to any one or more beneficiaries during the beneficiary's life. Each 2008 trust receives contributions only from A. PTC will serve as the initial trustee of each of the 2008 trusts.

Situation 2 -- PTC formed in a state without a statute governing private trust companies. The facts and the terms of the trusts are as described above. In 2008, Family formed a corporation that is a PTC in State 2, a state that has not enacted specific legislation governing the formation or operation of a private trust company. PTC is established for the specific purpose of acting as the trustee for the various trusts established by members of Family. Family owns all of the stock in PTC, either outright or through trusts and/or other entities.

PTC's governing documents create a DDC and delegate to the DDC the exclusive authority to make all decisions regarding discretionary distributions from each trust for which it serves as trustee. Discretionary distributions are defined as permissible distributions that are not mandated in the trust instrument or by applicable law. PTC's governing documents do not restrict who may serve on the DDC, but provide that no member of the DDC may participate in the activities of the DDC with regard to any trust of which that DDC member or his or her spouse is a grantor, or any trust of which that DDC member or his or her spouse is a beneficiary. In addition, the governing documents provide that a DDC member may not participate in the activities of the DDC with respect to any trust with a beneficiary to whom that DDC member or his or her spouse owes a legal obligation of support. PTC's governing documents also provide that only officers and managers of the PTC may participate in decisions regarding personnel of the PTC (including the hiring, discharge, promotion and compensation of employees). PTC's governing documents also provide that nothing in PTC's governing documents may override a more restrictive provision in the trust instrument of a trust for which PTC is acting as a trustee. In addition, PTC's governing documents also provide that no Family member may enter into any reciprocal agreement, express or implied, regarding discretionary distributions from any trust for which PTC is serving as a trustee.

PTC's governing documents also provide for the creation of an Amendment Committee, a majority of whose members must always be individuals who are neither Family members nor persons related or subordinate (as described in §672(c)) to any shareholder of PTC. The governing documents further provide that the Amendment

Committee, by no less than majority vote, shall have the sole authority to make any changes to PTC's governing documents regarding the creation, function, or membership of the DDC or of the Amendment Committee itself, the provisions delegating exclusive authority regarding personnel decisions to the officers and managers, and the prohibition of reciprocal agreements between Family members. The vesting of these powers exclusively in the Amendment Committee is not contrary to any applicable provision of the law of State 2. F, G, and A are the initial members of the Amendment Committee. F and G are not members of Family, are not employed by PTC, and are not otherwise related or subordinate to any Family member as defined in § 672(c).

A, C, and D are officers of PTC. A, C, D, F, and G serve on PTC's Board of Directors. A, C, and D also serve on the DDC. B and E own shares of PTC, but neither is on the DDC and neither is an officer or director of PTC. E is a manager and employee of PTC.

X, a financial institution organized under the banking laws of State 2, has served as trustee of each of the trusts since their inception. No grantor of any of the trusts has a relationship with X other than as a customer or client of X.

Subsequent to PTC's formation, X resigned as trustee of each of the trusts and PTC was appointed as the successor trustee of each trust. In addition, A created and transferred property to three additional irrevocable trusts (the 2008 trusts), one for the primary benefit of each of A's children, C, D, and E, and that child's descendants. The terms of each of the 2008 trusts are the same as those described above, except that these trusts provide that the trustee has discretionary authority to distribute income

and/or principal to any one or more beneficiaries during the beneficiary's life. Each 2008 trust receives contributions only from A. PTC will serve as the initial trustee of each of the 2008 trusts.

LAW AND ANALYSIS

Issue 1

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at 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 20.2036-1(b)(2) of the Estate Tax Regulations provides that the "use, possession, right to the income, or other enjoyment of the transferred property" is considered as having been retained by or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent, or otherwise for the decedent's pecuniary benefit. The term "legal obligation" includes a legal obligation to support a dependent during a decedent's lifetime.

Section 20.2036-1(b)(3) provides, in part, that the phrase "right . . . to designate the person or persons who shall possess or enjoy the transferred property or the

income therefrom” includes a reserved power to designate the person or persons to receive the income from the transferred property, or to possess or enjoy non-income-producing property, during the decedent’s life. With respect to such power, it is immaterial: (i) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; and (iii) whether the exercise of the power was subject to a contingency beyond the decedent’s control which did not occur before his death. The phrase, however, does not include a power over the transferred property itself which does not affect the enjoyment of the income received or earned during the decedent’s life. (See, however, § 2038 for the inclusion of property in the gross estate on account of such a power.) Nor does the phrase generally apply to a power held solely by a person other than the decedent.

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 enjoyment thereof was subject at the date of the decedent’s death to any change through 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 the decedent’s death.

Under § 2038, the discretionary authority to distribute or withhold income is a right to alter, amend, revoke, or terminate a trust. Thus, if a grantor holds these powers at death, or if any such power is relinquished during the three-year period ending on the date of the decedent's death, the value of the trust corpus is includible in the grantor's gross estate under § 2038 and § 2035, respectively. See Rev. Rul. 70-348, 1970-2 C.B. 193.

In Situation 1, PTC is the trustee of the Family trusts. All distribution decisions are to be made by the DDC, and no Family member serving on the DDC may participate in making discretionary distribution decisions with respect to any trust of which that person or his or her spouse is either a grantor or a beneficiary, or with respect to any trust of which the beneficiary is a person to whom the Family member or his or her spouse owes an obligation of support. Further, Statute prohibits any shareholder(s) of PTC from changing the governing provisions regarding the DDC. Therefore, no Family member, either alone or with any other person, has any right or power described in § 2036(a) or § 2038(a) with regard to a Family trust solely by reason of PTC's service as trustee or of the Family member's ownership of or relationship(s) with PTC. In addition, no Family member may insert themselves into the position of holding such a power. As a result, provided that PTC operates as required by State 1's Statute, no portion of the value of a Family trust will be includible in the gross estate of A, C, or D under § 2036(a) or § 2038(a) by reason of PTC's service as trustee or that person's service as an officer, director, or member of the DDC. Finally, for the same reasons, no portion of the value of the trust will be includible in the gross estate of B or E solely because B and E are shareholders and/or a manager or employee of PTC.

In Situation 2, no Family member currently has a power described in § 2036(a) or § 2038(a) because of the provisions in PTC's governing documents regarding the DDC. With regard to whether any Family member may acquire such a power, however, Situation 2 differs from Situation 1. As in Situation 1, Family owns all of the stock in PTC but, unlike Situation 1, State 2 has no state statute restricting the ability of PTC's shareholders to change the applicable provisions governing the DDC. In Situation 2, Family members who are PTC's shareholders do have a power to amend PTC's governing documents. However, PTC's Amendment Committee has the sole authority to amend PTC's governing documents with regard to the DDC and the Amendment Committee, with regard to the authority to make personnel decisions, and with regard to the prohibition on reciprocal agreements. Thus, as in Situation 1, even a sole shareholder of PTC does not have the authority to change the provisions regarding the Amendment Committee. Under these facts, no Family member, including A who is a member of the Amendment Committee, will be deemed to have a power to change the governing provisions regarding the DDC that would thereby result in the inclusion of any part of a Family trust in a Family member's gross estate. Therefore, if PTC operates in a manner consistent with its governing documents as described above, and if the provisions described above are not changed (those regarding the DDC, the Amendment Committee, the authority over personnel decisions, and the prohibition of reciprocal agreements), no portion of the value of a Family trust will be includible in the gross estate of a grantor under § 2036(a) or § 2038(a) by reason of PTC's service as Trustee, a grantor's interest in PTC, or a grantor's service as an officer, director, manager, employee, or member of the DDC or the Amendment Committee of PTC.

Issue 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 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 notice has been given or the power has been exercised on or before the date of the decedent's death.

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 the 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 that a donee may have a power of appointment if he has the power to remove or discharge a trustee and appoint himself as trustee. For example, if under the terms of the instrument, the trustee or a successor trustee has the power to appoint the principal of the trust for the benefit of individuals including the

decedent, and the decedent has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself or herself as trustee, the decedent is considered to have 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 fiduciary duties, is not a power of appointment.

Section 2041(b)(1) defines a general power of appointment as a power exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate. The regulations contemplate that a beneficiary may possess a power of appointment over trust property. Section 20.2041-1(b)(1). Thus, if a trust instrument provides a beneficiary with the power to appropriate or consume the principal of a trust, the power is a general power of appointment. The fact that the beneficiary holds the power in a fiduciary capacity as a trustee will not prevent the power from being a general power of appointment. Estate of Lanigan v. Commissioner, 45 T.C. 247, 251 (1965).

In Situation 1, the governing documents of the Family trusts provide a trustee with the discretionary authority to distribute income or principal to a beneficiary of a trust. Under State 1's Statute, however, PTC's powers to make discretionary distributions are delegated exclusively to the DDC, and no beneficiary who is a member of the DDC is permitted to participate in discretionary distribution decisions with respect to a trust in which that beneficiary has a beneficial interest (including a trust whose

beneficiary is a person to whom the beneficiary owes an obligation of support). In addition, Family members are prohibited from entering into reciprocal arrangements designed to affect distribution decisions. Under these circumstances, C and D, as beneficiaries who also serve as officers, directors, and members of PTC's DDC, do not have the unrestricted power to distribute trust assets to themselves as contemplated by § 2041. Similarly, neither E nor any other beneficiary will be deemed to have a general power of appointment under § 2041 solely because a particular beneficiary is a shareholder or otherwise participates in the daily activities of PTC, such as decisions regarding investments, or the retention of attorneys, accountants, or other professional advisors.

In Situation 2, the PTC's governing documents rather than applicable law restrict the powers of members of the DDC. PTC's governing documents preclude a beneficiary from having the power as a member of the DDC to affect the beneficial enjoyment of the trust property as described in § 2041. In addition, Family members are prohibited from entering into reciprocal arrangements designed to affect distribution decisions. Therefore, C and D, as beneficiaries who also serve as officers, directors, and members of PTC's DDC, do not have the power to distribute trust assets to themselves as contemplated by § 2041. Further, neither E nor any other beneficiary will be deemed to have a general power of appointment under § 2041 solely because a particular beneficiary is a shareholder or otherwise participates in the daily activities of PTC. In addition, based on the facts of Situation 2, and for the reasons discussed regarding Issue 1, no beneficiary who is a member of the Amendment Committee will

be deemed to have a general power of appointment under § 2041 solely because such beneficiary serves on the Amendment Committee.

Issue 3

Section 2501 imposes a tax on any transfer of property by gift by any individual. Section 2511 provides for application of the gift tax regardless of the nature of the property transferred and whether the transfer is direct or indirect, or in trust or otherwise.

Section 25.2511-1(g)(1) provides, in part, that a transfer by a trustee of trust property in which the trustee has no beneficial interest does not constitute a gift by the trustee (but such a transfer may constitute a gift by the creator of the trust, if until the transfer the creator had the power to change the beneficiaries by amending or revoking the trust).

Section 25.2511-2(b) provides that, as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case.

Section 25.2511-2(c) provides that a gift is incomplete if the grantor has reserved the power to revest the beneficial title to the property in the grantor, or to the extent that the grantor has reserved a power to name new beneficiaries or to change the interests

of the beneficiaries as between themselves, unless the power is a fiduciary power limited by a fixed or ascertainable standard.

Section 25.2511-2(e) provides that a grantor is considered to hold a power if the power is exercisable by the grantor in conjunction with any other person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. A trustee, merely by reason of that fiduciary position, does not have such an adverse interest.

In Situation 1 and Situation 2, subsequent to the formation of PTC, A, a Family member, creates and transfers property to the 2008 trusts, one for the benefit of each of A and B's children, C, D, and E, and that child's descendants. Each trust instrument provides the trustee with discretionary authority to distribute income and/or principal to the child and/or the child's then-living descendants. PTC will serve as the trustee of each trust, and the DDC will make all of the decisions with respect to discretionary distributions. Statute in Situation 1 and the governing documents in Situation 2 do not prohibit A from serving on the DDC, and in each situation, A is a member of the DDC. However, pursuant to Statute in Situation 1 and the governing documents in Situation 2, no member of the DDC may participate in the activities of the DDC with regard to any trust of which that DDC member or his or her spouse is a grantor, or any trust of which that DDC member or his or her spouse is a beneficiary. Further, in both situations, Family members are prohibited from entering into any reciprocal agreements designed to affect distribution decisions. If PTC operates in accordance with Statute in Situation 1 or the governing documents in Situation 2 as the case may be, A will not have the power to change the interests of the beneficiaries of the 2008 trusts. In addition, A will

not be considered to hold a power exercisable by A in conjunction with any other person not having a substantial adverse interest in the disposition of the transferred property or the property's income merely because of A's membership on the DDC. Thus, in each situation, the value of the property transferred by A to the 2008 trusts will be considered completed gifts for purposes of chapter 12 of the Code. Also, in Situation 1 and Situation 2, the provisions of the DDC prohibit any beneficiary who is a member of the DDC from participating in decisions with regard to any trust in which the beneficiary has a beneficial interest. Thus, distributions of income or principal from a trust of which PTC is the trustee will not be deemed to be a gift by any member of the DDC. See § 25.2511-1(g).

Issue 4

Section 2601 imposes a tax on every generation-skipping transfer. Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i), the GST tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(ii)(A) provides that any trust in existence on September 25, 1985, is considered an irrevocable trust, except as provided in §§ 26.2601-1(b)(ii)(B) or (C) relating to property includible in a grantor's gross estate under §§ 2038 and 2042, respectively.

Section 26.2601-1(b)(1)(v)(B) provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in

§ 2041(b)) is not treated as an addition to a trust if – (1) the power of appointment was created in an irrevocable trust that is not subject to chapter 13 under § 26.2601-1(b); and (2) in the case of an exercise, the power of appointment is not exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of § 26.2601-1(b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b)(1), (2), or (3) (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Unless specifically noted, the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the

trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13 if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and if the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided in the original trust. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

In Situation 1 and Situation 2, X resigned as trustee of each of the pre-2008 trusts and PTC replaced X as trustee. Under the facts of Situation 1 and Situation 2, the change in trustee will not subject the value of the trust corpus to the tax under Chapter 11 or 12, and this modification is an administrative change that does not shift a beneficial interest in a trust to any beneficiary who occupies a lower generation (as described in § 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, each trust will terminate no later than 21 years after the death of the last to die of certain designated individuals living at the time of the creation of the trust. Thus, even if PTC is formed and operates in a jurisdiction other than that of the original trustee, the appointment of PTC alone will not extend the time for vesting of

any beneficial interest in a trust for which PTC acts as trustee beyond the date provided for in the original trust. See § 26.2601-1(b)(4)(i)(E), Example 4 and Example 10.

Therefore, under the facts of Situation 1 and Situation 2, the appointment of PTC as trustee does not change the status of a trust that was otherwise exempt from the GST tax by virtue of having been irrevocable (as defined in § 26.2601-1(b)(1)(ii)(A)) on September 25, 1985.

Further, as discussed in Issues 1 and 2, if PTC operates in a manner consistent with Statute and/or its governing documents, no portion of the value of a Family trust will be includible in the gross estate of a grantor under § 2036(a) or § 2038(a) by reason of PTC's service as trustee, the grantor's interest in PTC, or the grantor's service as an officer, director, manager, employee, or member of the DDC or the Amendment Committee of PTC. Similarly, beneficiaries who also serve as officers, directors, and members of PTC's DDC, do not have the power to distribute trust assets to themselves as contemplated by § 2041, and no beneficiary will be deemed to have a general power of appointment under § 2041 solely because a particular beneficiary is a shareholder, or otherwise participates in the daily activities, of PTC. Therefore, under the circumstances described in Situation 1 and Situation 2, appointing PTC as the trustee of the Family trusts does not affect the inclusion ratio of a trust subject to Chapter 13.

Issue 5

Section 671 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 the trust's income, deductions, and credits against tax 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 672(a) provides that the term "adverse party" means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust.

Section 672(c) provides that, for purposes of subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code, the term "related or subordinate party" means any nonadverse party who is any one of the following: the grantor's spouse if living with the grantor; 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.

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(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).

Under § 675 and applicable regulations, the grantor is treated as the owner of any portion of a trust if, under the terms of the trust agreement or circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust.

Section 675(4) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of § 675(4), the term "power of administration" means any one or more of the following powers: (A) a power to vote or direct the voting of stock or other securities of a corporation in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; (B) a power to control the investment of the trust funds either by directing investments or reinvestments, or by vetoing proposed investments or reinvestments, to the extent that the trust funds consist of stocks or securities of corporations in which the holdings of the grantor and the trust are

significant from the viewpoint of voting control; or (C) a power to reacquire the trust corpus by substituting other property of an equivalent value.

Section 677(a)(1) provides that the grantor shall be treated as the owner of any portion of a trust, whether or not the grantor is treated as such owner under § 674, whose income, without the approval or consent of any adverse party, is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse.

Section 1.677(a)-1(d) of the Income Tax Regulations provides that, under § 677, a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor or, in certain situations, of the grantor's spouse. However, § 1.677(b)-1(a) provides that a grantor is not treated as the owner of a trust merely because its income may, in the discretion of any person other than the grantor (except when the grantor is acting as trustee or cotrustee), be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse in the case of income from property transferred in trust after October 9, 1969), such as the child of the grantor, whom the grantor or his spouse is legally obligated to support. If income of the current year of the trust is actually so applied or distributed, the grantor may be treated as the owner of any portion of the trust under § 677 to that extent, even though that income might have been applied or distributed for other purposes.

Section 678(a)(1) provides that a person other than the grantor is treated as the owner of any portion of a trust with respect to which the person has a power,

exercisable solely by that person, to vest the corpus or the income therefrom in that person. This rule does not apply, however, to a power over income if a grantor or other transferor is otherwise treated as the owner of the trust.

In Situation 1, the existence of and provisions governing the DDC, as well as the provisions of Statute regarding the DDC, render the identity of the trustee irrelevant to the determination of whether any person is treated as an owner of a trust under §§ 675, 677, or 678. None of the terms of the Family trusts, the provisions of Statute, or the governing documents of PTC reveal any of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the grantors of the Family trusts for which PTC will act as trustee under § 675.

Nevertheless, the circumstances attendant on the operation of the PTC, the DDC, and the Family trusts for which the PTC is acting as trustee will determine whether any grantor will be treated as the owner of any portion of those trusts under § 675. Whether or not a trust is a grantor trust by reason of a power described in § 675 is a question of fact, the determination of which is deferred until the examination of the federal income tax returns of the parties involved.

Similarly, nothing in the facts indicates that any grantor or beneficiary of the trust would be deemed to be an owner of a trust under § 673, § 676, § 677, or § 678, and Statute would prevent any grantor or beneficiary from acquiring any right or power that would result in such treatment. Under § 677(b), the grantor will be deemed to be the owner of the trust to the extent that trust income is actually used to discharge a support obligation of the grantor, but this will be true regardless of the identity of the trustee. Thus, the appointment and service of PTC as trustee does not affect whether or not the

grantor or any other person will be treated as the owner of a trust under these provisions, and none of the grantors or beneficiaries of the Family trusts for which PTC is acting as trustee will be treated as an owner of those trusts or any portion thereof under §§ 673, 675, 676, 677, or 678 solely by reason of their ownership or management of, or employment by, PTC.

The identity of the trustee is relevant with regard to whether the grantor will be treated as the owner of a trust under § 674. The general rule is that powers must be subject to the approval or consent of an adverse party as defined in § 672(a) in order to avoid treating the grantor as the owner of a trust for income tax purposes. In Situation 1 and Situation 2, Statute or the governing documents, as the case may be, prohibit a DDC member from acting with regard to each trust in which that DDC member has an interest, so there will be no adverse party with the power to grant approval or consent.

Some powers (specifically, those described in § 674(b) and (d)) may be held by any trustee without causing the grantor to be deemed to be the owner of the trust under this section. The appointment and service of PTC as trustee is irrelevant with regard to these powers. Section 674(c), however, describes powers that will not cause the grantor to be treated as the owner of the trust as long as those powers are held by trustees, none of whom is the grantor and no more than half of whom are related or subordinate to the grantor as defined in § 672(c).

Two clauses of § 672(c)(2) have relevance with regard to the facts described in Situation 1 and Situation 2. The first is the clause defining “related or subordinate party” as including 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.

For purposes of this test, voting control of PTC has been made irrelevant as it applies to the power to make distributions from the Family trusts by the provisions of Statute (in Situation 1) or the presence of the Amendment Committee (in Situation 2) with regard to the DDC and by the delegation of all PTC personnel decisions to the officers and managers of PTC. Thus, the ownership of voting stock of PTC (even the sole ownership of all of that voting stock) should not be deemed to be “significant” under § 672(c) for this purpose. “Voting control” is relevant insofar as it gives a grantor or trusts created by a grantor power over distributions made in the discretion of the corporate trustee or power over the employees of the corporate trustee who make such discretionary distribution decisions on behalf of the corporation. Under Situation 1 and Situation 2, adequate safeguards protect against the exercise of such powers.

The second relevant clause of § 672(c)(2) is that which defines “related or subordinate party” as including a subordinate employee of a corporation in which the grantor is an executive.

In Situation 1 and Situation 2, the trust instruments do not require the trustee to be a person or entity that is not related or subordinate to the grantor as defined in § 672(c). In fact, it is possible that more than half of the members of the DDC may be nonadverse parties who are related or subordinate to the grantor.

In determining whether or not PTC as trustee is related or subordinate for purposes of this second clause, one must look at the members of the DDC who are authorized to act with regard to that particular trust (as if those DDC members individually were the trustees). This partial look-through is necessary to ensure that a grantor cannot achieve income tax results indirectly through a PTC trustee that could

not be achieved with an individual trustee or trustees. A subordinate employee of a corporation in which the grantor is an executive will still be deemed to be subordinate to the grantor under § 672(c). Thus, under Situation 1 and Situation 2 a non-Family member serving on the DDC who is an employee of PTC will be related and subordinate to A, C, D, and E, but not to B who is not an officer or manager of PTC.

In summary, whether or not a grantor will be treated as the owner of a trust or any portion thereof under § 674 depends both upon the powers of the trustee and upon the proportion of the members of the DDC with authority to act with regard to that trust who are related or subordinate to the grantor applying a “look-through” test in which each employee of PTC serving on the DDC, if any, is tested as if that employee was a trustee of the trust in his or her individual capacity, rather than as a member of a committee existing within and functioning on behalf of PTC. For purposes of this test, the ownership of the voting stock of PTC in Situation 1 and Situation 2 shall be deemed to be not significant.

For these purposes, the analysis and tax consequences under Situation 1 and Situation 2 are substantially identical.

HOLDINGS

Under the facts set forth in Situation 1 and Situation 2:

(1) Neither the appointment nor the service of PTC as the trustee of a Family trust described in Situation 1 or Situation 2 will alone cause the value of the trust assets to be included in a grantor’s gross estate under §§ 2036(a) or 2038(a).

(2) Neither the appointment nor the service of PTC as the trustee of a Family trust described in Situation 1 or Situation 2 will alone cause the value of the trust assets to be included in a beneficiary's estate under § 2041.

(3) Neither the appointment nor the service of PTC as the trustee of the trusts in which the trustee has the discretionary power to distribute income and/or principal to the grantor's child or descendants in Situation 1 or Situation 2 will alone cause the grantor's transfer to that trust to be deemed to be an incomplete gift under § 2511, or any distribution from the trust to be a gift by any DDC member.

(4) Neither the appointment nor the service of PTC as trustee of a Family trust in Situation 1 and Situation 2 will alone affect the exempt status of that trust if the trust is otherwise exempt from the GST tax under § 26.2601-1(b)(1)(i), or change the inclusion ratio of a trust.

(5) Neither the appointment nor the service of PTC as the trustee of a Family trust in either Situation 1 or Situation 2 will alone cause any grantor or beneficiary of that trust to be treated as the owner of that trust or any portion thereof under §§ 673, 676, 677, or 678. Whether any grantor is treated as an owner of the trust or any portion thereof under § 675 is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office with responsibility for such examination. Whether any grantor is treated as an owner of the trust or any portion thereof under § 674 will depend upon the particular powers of the trustee and may depend upon the proportion of the members of the DDC with authority to act with regard to that trust who are related or subordinate to the

grantor. For purposes of this determination, the ownership of voting stock of PTC shall be deemed to be not significant under § 672(c).

The conclusions regarding the tax consequences of PTC as trustee of the Family trusts would not change even if (1) in Situation 2, F and/or G also serve on the Board of Directors, (2) any of the discretionary distributions are made pursuant to a reasonably definite external standard provided in the trust instrument; or (3) a single Family member was the sole owner of PTC. Distribution powers subject to such a standard would generally not cause the grantor or beneficiary to be treated as the owner of a trust or any portion of a trust under §§ 674 and 678, unless a grantor or spouse of a grantor is the trustee, regardless of the terms of Statute or the existence of the Amendment Committee.

The conclusions in Situation 1 and Situation 2 are otherwise limited to the facts of those situations. If the Statute in Situation 1 was changed, or if the Amendment Committee in Situation 2 exercised its powers to change the provisions regarding the DDC and/or the Amendment Committee itself, then the federal tax treatment of the Family trusts for which PTC acts as trustee, and/or the grantors and/or beneficiaries of those trusts, may be different from that described for Situation 1 and Situation 2.

III. Request for Comments

Comments are requested regarding the proposed revenue ruling. The IRS and the Treasury Department also welcome comments regarding any potential alternative scenarios that should be addressed in the final revenue ruling. In particular, the IRS and the Treasury Department request comments on whether additional guidance is necessary where trust assets include stock in a controlled corporation or life insurance,

and whether the creation of similar special committees for tax sensitive issues relating to such assets would be helpful. All comments will be available for public inspection and copying. Comments must be submitted by November 4, 2008. Comments should be addressed to:

Internal Revenue Service
Office of the Associate Chief Counsel
(Passthroughs and Special Industries), CC:PSI
Attn: Mary Berman, Room 5300
1111 Constitution Avenue, NW
Washington, DC 20224.

In addition, comments may be submitted electronically via the Internet by sending them in an e-mail to notice.comments@irs.counsel.treas.gov and specifying that the comments concern Notice 2008-63.

DRAFTING INFORMATION

The principal authors of this notice are Mary Berman and Bradford Poston of the Office of the Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the IRS and the Treasury Department participated in its development. For further information regarding the estate, gift, and generation-skipping transfer tax issues, contact Ms. Berman at (202) 622-3090 (not a toll-free call); for further information regarding the income tax issues, contact Mr. Poston at (202) 622-3060 (not a toll free call).