



NEW YORK STATE BAR ASSOCIATION

One Elk Street, Albany, New York 12207 • 518.463.3200 • www.nysba.org

TAX SECTION

2008-2009 Executive Committee

DAVID S. MILLER

Chair
Cadwalader Wickersham & Taft LLP
One World Financial Center
23rd Floor
New York, NY 10281
212/504-6318

CHARLES MORGAN

First Vice-Chair
212/735-2470

ERIKA W. NIJENHUIS

Second Vice-Chair
212/225-2980

PETER H. BLESSING

Secretary
212/848-4106

COMMITTEE CHAIRS:

Bankruptcy and Operating Losses

Stuart J. Goldring
Russell J. Kestenbaum

Compliance, Practice & Procedure

Elliot Pisem
Bryan C. Skarlatos

Consolidated Returns

Lawrence M. Garrett
David H. Schnabel

Corporations

Deborah L. Paul
David R. Sicular

Employee Benefits

Andrew L. Gaines
Andrew L. Oringer

Estates and Trusts

Carlyn S. McCaffrey
Jeffrey N. Schwartz

Financial Instruments

Michael S. Farber
Stephen B. Land

"Inbound" U.S. Activities of Foreign

Taxpayers

Peter J. Connors
David R. Hardy

Individuals

Elizabeth T. Kassenides
Sherry S. Kraus

Multistate Tax Issues

Robert E. Brown
Paul R. Comeau

New York City Taxes

Robert J. Levinsohn
Irwin M. Stomka

New York State Franchise and

Income Taxes

Maria T. Jones
Arthur R. Rosen

"Outbound" Foreign Activities of

U.S. Taxpayers

Andrew H. Braileman
Douglas R. McFadyen

Partnerships

Andrew W. Needham
Joel Scharfstein

Pass-Through Entities

James R. Brown
Marc L. Silberberg

Real Property

Robert Cassanos
Jeffrey Hochberg

Reorganizations

Jodi J. Schwartz
Linda Z. Swartz

Securitizations and Structured

Finance

Jiyoon Lee-Lim
W. Kirk Wallace

Tax Accounting

Edward E. Gonzalez
Yaron Z. Reich

Tax Exempt Bonds

Bruce M. Serchuk
Patti T. Wu

Tax Exempt Entities

Michelle P. Scott
Richard R. Upton

Tax Policy

David W. Mayo
Diana L. Wollman

S. Douglas Borisky
Kathleen L. Ferrell
Lisa A. Levy
John T. Lutz

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE

Charles I. Kingson
Gary B. Mandel
William L. McRae
David M. Schizer

Peter F. G. Schuur
Andrew P. Solomon
Andrew Walker
Gordon Warnke

Victor Zonana

November 4, 2008

Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Room 3000 IR
Washington, DC 20224

Honorable Eric Solomon
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Comments On Notice 2008-63 (Proposed Revenue Ruling Dealing With Tax Consequences Of Use Of Private Trust Company)¹

Dear Sirs:

We write in response to the request for comments in Notice 2008-63 on a proposed ruling (the "Proposed Ruling") concerning the income, estate, gift, and generation-skipping transfer tax consequences of using a private trust company to serve as the trustee of trusts having family

¹ This letter was prepared by the Committee on Estates and Trusts of the Tax Section of the New York State Bar Association. Its principal drafters were Elyse G. Kirschner and Carlyn S. McCaffrey. Helpful comments were received from Kathleen Citera, Amy Guss, David Miller and Jeffrey Schwartz.

FORMER CHAIRS OF SECTION:

Edwin M. Jones
John E. Morrissey, Jr.
Martin D. Ginsburg
Peter L. Faber
Hon. Renato Beghe
Alfred D. Youngwood
Gordon D. Henderson
David Sachs

J. Roger Mentz
Willard B. Taylor
Richard J. Hiegel
Dale S. Collinson
Richard G. Cohen
Donald Schapiro
Herbert L. Camp
William L. Burke

Arthur A. Feder
James M. Peaslee
John A. Corry
Peter C. Canellos
Michael L. Schler
Carolyn Joy Lee
Richard L. Reinhold
Richard O. Loengard

Steven C. Todrys
Harold R. Handler
Robert H. Scarborough
Robert A. Jacobs
Samuel J. Dimon
Andrew N. Berg
Lewis R. Steinberg
David P. Hariton

Kimberly S. Blanchard
Patrick C. Gallagher

members as grantors and beneficiaries.² We submitted a report on this subject to the Internal Revenue Service (the “Service”) and Treasury on May 30, 2006.³ Several other groups and individuals also submitted reports and comments on private trust company issues.⁴ We are pleased that the Proposed Ruling reflects many of the suggestions we, as well as others, made in 2006. We believe, on balance, that the Proposed Ruling does an excellent job of resolving the private trust company issues, thereby removing much of the aura of uncertainty surrounding their use. Nevertheless, we recommend certain modifications in order to complete the job.

I. Background

The use of family controlled private trust companies to serve as trustees of trusts created by family members and/or held for the benefit of family members raises estate, gift, generation-skipping transfer (“GST”), and income tax issues. The concern is that some level of participation in or control over the administration or governance of a private trust company by particular family members could prompt the Service to attribute tax-sensitive powers to those individuals. This attribution could result in the imposition of estate, gift, GST, or income taxes that might have been avoided by the use of a more independent trustee.

II. The Proposed Ruling

The goal of the Proposed Ruling (and the revenue ruling that will result when it is finalized) is to “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.”⁵

A. The Facts

The Proposed Ruling discusses the income, estate, gift and GST tax consequences in two separate situations in which members of the same family create a private trust company (“PTC”) to serve as the trustee of trusts of which family members are grantors and beneficiaries. In both situations, 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. A

² Notice 2008-63, 2008-31 IRB 261 (July 11, 2008).

³ 2006 TNT 105-12.

⁴ These include, for example, the reports submitted by Don Kozusko or Kozusko, Harris, Vetter & Wareh LLP (2006 TNT 18-24), by the American Institute of Certified Public Accountants (2006 TNT 61-13) and by John Duncan and Michael Conway, Jr., of Duncan Associates, Chicago (2006 TNT 87-38).

⁵ Notice 2006-63, 2008-31 I.R.B. 261 (July 11, 2008).

and B, their current and future descendants, and the spouses and former spouses of their descendants are referred to in the Proposed Ruling as the “Family.” A and B have established separate irrevocable trusts for each of their children and grandchildren. C, D and E also have established separate irrevocable trusts for their respective descendants. Each child or grandchild of A and B is the primary beneficiary of the trust established for him or her. Each trust receives contributions only from the person who created the trust. All grantors and beneficiaries are U.S. persons and no trust is a foreign trust.

Each trust agreement gives the trustee discretionary authority to distribute income and/or principal to the primary beneficiary of the trust during his or her lifetime. In addition, the primary beneficiary of each trust has the power to appoint any portion of the principal of the trust to any one or more members of the Family (other than the primary beneficiary) and/or to charity. The grantor of each trust (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 for any reason cannot fulfill the duties of trustee.

In Situation 1, the Family formed a PTC under the laws of a state that has enacted a PTC statute. That statute provides as follows:

- Any PTC formed under the statute must create a Discretionary Distributions Committee (the "Distributions Committee") and delegate to the Distributions Committee the exclusive authority to make all decisions regarding discretionary distributions from each trust for which it serves as trustee. State law defines “discretionary distributions” as permissible distributions that are not mandated in the trust agreement or by applicable law.
- Anyone may serve on the Distributions Committee, but no member of the Distributions Committee may participate in the activities of the Distributions Committee with regard to (1) any trust of which the Distributions Committee member or his or her spouse is a grantor, or (2) any trust of which the Distributions Committee member or his or her spouse is a beneficiary.
- A Distributions Committee member may not participate in the activities of the Distributions Committee with respect to any trust with a beneficiary to whom such Distributions Committee member or his or her spouse owes a legal obligation of support.
- Only officers and managers of the PTC may participate in the decisions regarding the PTC personnel, such as those decisions regarding hiring, promotion and compensation.
- No provision in the statute or in the PTC’s governing documents may override a more restrictive provision in the trust agreement of a trust of which the PTC is acting as trustee.

- No Family member may enter into any express or implied reciprocal arrangement regarding discretionary distributions from any trust of which the PTC is serving as trustee.

In Situation 1, the Family owns all of the stock in PTC, either outright or through trusts and/or other entities. The PTC's governing documents conform to the provisions of the state's PTC statute described above. A, C and D are officers of the PTC and serve on the PTC's board of directors, as well as on the Distributions Committee. B and E own shares of the PTC, but neither is on the Distributions Committee nor is an officer or director of the PTC. E is a manager and employee of the PTC.

In Situation 2, the Family formed a corporation that is a PTC in a state that has not enacted specific legislation governing the formation or operation of a PTC. The PTC's governing documents provide as follows:

- The governing documents create a Distributions Committee and delegate to the Distributions Committee the exclusive authority to make all decisions regarding discretionary distributions from each trust for which it serves as trustee. The governing documents define "discretionary distributions" as permissible distributions that are not mandated in the trust agreement or by applicable law.
- Anyone may serve on the Distributions Committee, but no member of the Distributions Committee may participate in the activities of the Distributions Committee with regard to (1) any trust of which that Distributions Committee member or his or her spouse is a grantor, or (2) any trust of which that Distributions Committee member or his or her spouse is a beneficiary.
- A Distributions Committee member may not participate in the activities of the Distributions Committee with respect to any trust with a beneficiary to whom such member or his or her spouse owes a legal obligation of support.
- Only officers and managers of the PTC may participate in the decisions regarding the PTC personnel, such as those decisions regarding hiring, promotion and compensation.
- No provision in the governing documents may override a more restrictive provision in the trust agreement of a trust of which the PTC is acting as trustee.
- No Family member may enter into any express or implied reciprocal arrangement regarding discretionary distributions from any trust of which the PTC is serving as trustee.
- The governing documents create an Amendment Committee. A majority of the members of this committee must always be individuals

who are neither members of the Family nor persons related or subordinate (within the meaning of Code section 672(c)) to any shareholder of the PTC.⁶ The Amendment Committee has the sole authority to make changes to the PTC's governing documents regarding (1) the creation, function or membership of the Distributions Committee or of the Amendment Committee, (2) the provisions delegating exclusive authority regarding personnel decisions to the officers and managers, and (3) the prohibition of reciprocal agreements between members of the Family.

In Situation 2, the Family owns all of the stock in PTC, either outright or through trusts and/or other entities. A, C and D are officers of the PTC and serve on the PTC's board of directors, as well as on the Distributions Committee. B and E own shares of the PTC, but neither is on the Distributions Committee nor is an officer or director of the PTC. E is a manager and employee of the PTC. A, F and G are the initial members of the Amendment Committee. F and G are not members of the Family, are not employed by the PTC and are not otherwise related or subordinate to any Family member.

B. The Holdings

Under the facts set forth in Situation 1 and Situation 2, as long as the PTC operates as provided by state statute or the PTC's governing instruments, as the case may be, the Service proposes the following rulings:

- Neither the appointment nor the service of the PTC as the trustee of a Family trust will cause the value of the assets of such trust to be included in the grantor's gross estate under Code section 2036(a) or Code section 2038(a).
- Neither the appointment nor the service of the PTC as the trustee of a Family trust will cause the value of the trust assets to be included in the beneficiary's gross estate under Code section 2041.
- Neither the appointment nor the service of the PTC as the trustee of any Family trust in which the trustee has the discretionary power to distribute income and/or principal to the grantor's descendants will cause the grantor's transfer to the trusts to be incomplete gifts under Code section 2511 or any distribution from the trust to be a gift by any Distributions Committee member.
- Neither the appointment nor the service of the PTC as the trustee of any Family trust will affect the exempt status of that trust if the trust

⁶ All references to "Code section" refer to sections of the Internal Revenue Code of 1986, as amended, and all references to "Treas. Reg. section" refer to the Treasury regulations promulgated thereunder.

is otherwise exempt from the GST tax under Treas. Reg. section 26.2601-1(b)(1)(i) or change the inclusion ratio of the trust.

- Neither the appointment nor the service of the PTC as the trustee of any Family trust by itself will cause any grantor or beneficiary of that trust to be treated as the owner of that trust or any portion thereof under Code sections 673, 676, 677 or 678. Whether any grantor is treated as an owner of the trust or any portion thereof under Code section 675 is a question of fact to be determined once the federal income tax returns of the grantor and/or the trust have been examined by the IRS. Whether any grantor is treated as the owner of the trust or any portion thereof under Code section 674 will depend on the particular powers of the trustee and may depend on the composition of the Distributions Committee.

The Proposed Ruling, in effect, creates two separate sets of safe harbors. As long as any PTC is formed and operated in accordance with the facts set forth in Situation 1 or Situation 2, the grantors and beneficiaries of the trusts of which the PTC is serving as trustee can be certain that they will not be subject to any adverse income, estate, gift or GST tax consequences.

III. Comments

The Proposed Ruling, if finalized, will give grantors and beneficiaries a degree of certainty that the designation of a family-run PTC as trustee of family trusts will not by itself cause negative tax consequences as long as the PTC is organized and operated in the manner set forth in the safe harbors of Situation 1 and Situation 2. Therefore, we welcome the Proposed Ruling. However, we offer the following suggestions to allow the ruling to apply to a broader range of PTCs without compromising the goal set forth in the Proposed Ruling.

A. Lack of State Statutes Similar to Those Described in the Proposed Ruling

Situation 1 described in the Proposed Ruling provides a safe harbor based on the assumption that the PTC is organized in a jurisdiction that has enacted the particular type of private trust company statute described above. To our knowledge, there is no state that has adopted such a statute. As a result, the safe harbor provided for in Situation 1 will have limited applicability unless and until one or more states actually enacts such a statute.

Similarly, Situation 2 assumes organization of the PTC in a state that permits a company to establish a set of governing documents with certain provisions that cannot be changed unless a committee of individuals, a majority of which are neither members of the family that controls the PTC nor related or subordinate to any of them (within the meaning of Code section 671) consents to the changes. It is not clear how many states would permit the owners of a company to limit their inherent authority as

owners in this manner. As a result, the safe harbor provided for in Situation 2 may be of limited applicability.

We recommend that the Proposed Ruling add a third fact pattern, Situation 3, which will, at the present time, have a broader range of applicability. Situation 3 would describe a private trust company formed under the laws of a state that has no statutory provisions similar to those described in Situation 1 and Situation 2. Instead, the trust instruments that govern the trusts of which the PTC serves as trustee will provide that if certain provisions of a PTC's by-laws (such as the ones described in Situation 1 and Situation 2) are amended, then the PTC no longer would be able to exercise tax-sensitive powers such as the powers to make discretionary distribution decisions or amend the trust agreement, and an independent trustee should be appointed to replace the PTC to exercise such powers. This would permit a PTC to satisfy the provisions of the safe harbors even if it was formed in a state that does not have the governing document provisions described in Situation 1 and Situation 2.

B. Closely-Held Company Shares

The Proposed Ruling does not deal with the issue of controlled corporation shares held by trusts in which a PTC is trustee. Code section 2036(b) provides that the retention of the right to vote, directly or indirectly, shares of stock of a "controlled corporation" that a decedent gratuitously transferred to a trust is a retention of the enjoyment of such stock for purposes of Code section 2036(a).⁷ This retention would cause inclusion of the value of those shares in the decedent's gross estate if the decedent retained the right to vote until death or until anytime within three years of death. We suggest that the Service consider including in Situation 1 and Situation 2 and in our proposed Situation 3 a requirement that the grantor or any other person who has transferred property to a trust be prohibited from voting the shares of a controlled corporation held in any trust in which the PTC is trustee, either individually or as a member of any committee that holds such power.

C. Ascertainable Standards

The Proposed Ruling defines discretionary distributions as "permissible distributions that are not mandated in the trust instrument or by applicable law." In both Situation 1 and Situation 2, the Distributions Committee must be given exclusive authority to make all decisions regarding discretionary distributions. The definition of "discretionary distribution" does not distinguish between distributions made pursuant to an ascertainable standard and those that may be made without reference to any standards. Except when the individual making discretionary distributions decisions has a legal obligation to support a beneficiary, the power to make distributions pursuant to an

⁷ Code section 2036(b) defines a "controlled corporation" as a corporation in which the decedent owned (with the application of the constructive ownership rules of Code section 318) or had the right to vote, either alone or in conjunction with any other person, stock possessing at least twenty (20%) percent of the total combined voting power of all classes of stock of the corporation.

ascertainable standard is not generally a tax-sensitive power.⁸ We suggest that the Service consider including a statement in the final ruling that it is not necessary that the Distributions Committee have the exclusive authority to make such distributions. All of the directors of the PTC (including a beneficiary) or a different trustee altogether (including a trustee who is a beneficiary), other than an individual who has a legal obligation to support a beneficiary, could be permitted to participate in decisions regarding such distributions without causing estate tax inclusion under Code sections 2036, 2038 or 2041 and without causing any gift to a trust of which the PTC is trustee to be incomplete.

D. Removal of Distributions Committee Members

The Proposed Ruling does not discuss whether the grantor or a beneficiary of a trust of which the PTC is a trustee may have the power to participate in the removal of a member of the Distributions Committee and the appointment of a successor Distributions Committee member in his or her place. The Service took the position in Revenue Ruling 79-353⁹ that a decedent who had the unqualified power to remove a trustee and to appoint a successor trustee (other than the decedent) will be deemed to hold the powers held by the trustee for purposes of Code section 2036. In Revenue Ruling 95-58, the Service modified its earlier position and ruled that a decedent's unqualified power to remove a trustee and to appoint a successor trustee who is not related or subordinate to him or her within the meaning of Code section 672(c) would not be treated as a reservation by the decedent of the trustee's powers for purposes of Code section 2036 or 2038.¹⁰ The same principle should apply to the power to remove or replace members of the Distributions Committee. This would bring the treatment of PTCs with respect to the removal of Distribution Committee members in line with current law regarding trusts and the removal of individual trustees.

In order to avoid confusion on this issue, we suggest that the final ruling require a PTC's governing documents to provide that, if a grantor or a beneficiary participates in any decision to remove and replace any member of the Distributions Committee, the replacement for the removed member must be a person who is not related or subordinate to the grantor or beneficiary within the meaning of Code section 672(c). Alternatively, the final ruling could provide that the power to appoint replacement Distribution Committee members be given exclusively to an unrelated third party, such as a protector.

E. Provisions Regarding Insurance

The Proposed Ruling does not discuss the consequences of trustee ownership of life insurance on the life of a family member. Code section 2042 provides

⁸ See Treas. Reg. sections 25.2511-2(c), 25.2511-1(g)(2), and 20.2041-1(c)(2).

⁹ Rev. Rul. 79-353, 1979-2 C.B. 325.

¹⁰ Rev. Rul. 95-58, 1995-2 C.B. 191.

that the value of a life insurance policy on the life of a decedent will be included in the decedent's gross estate if he or she possessed at death any incidents of ownership over the policy, exercisable either alone or in conjunction with any other person.

In order to make the final ruling as inclusive as possible, this subject should also be addressed. We recommend that the final ruling provide that incidents of ownership with respect to a life insurance policy owned by a trust of which a PTC is trustee will not be imputed to a family member whose life is insured if the PTC's governing documents prevent him or her from exercising any incidents of ownership over the policy, either in his individual capacity or as a member of the Distributions Committee or any other PTC committee charged with making decisions regarding the policy.

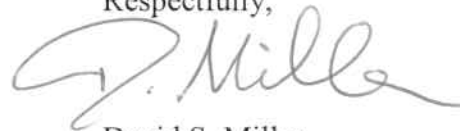
F. Violations of Provisions in Governing Documents

The Proposed Ruling describes several types of provisions that are required in order to benefit from the safe harbors of either Situation 1 or Situation 2, but does not describe the consequences of violations of the provisions. For example, assume that a PTC's by-laws contain the requisite prohibition against reciprocal arrangements. If this prohibition is actually violated by members of the family who are beneficiaries of different family trusts, presumably the Service could take the position that trust assets would be included in the beneficiaries' gross estates under Code section 2041.

In order to provide clarity, we recommend that the final ruling state that violation of the prohibitions required in both Situation 1 and in Situation 2 may cause the Service to impute certain tax-sensitive powers of the PTC to family members who participate in the governance and administration of the PTC. If the final ruling includes the Situation 3 we describe above, violation of the prohibitions would cause the PTC to lose its power to exercise tax-sensitive powers as trustee of the family trusts.

We appreciate your consideration of our comments. Please let us know if you would like to discuss this letter or if we can otherwise further assist you.

Respectfully,

A handwritten signature in black ink, appearing to read "D. Miller", written in a cursive style.

David S. Miller

Enclosure

cc: Michael J. Desmond
Tax Legislative Counsel
Department of the Treasury

Catherine V. Hughes
Attorney Advisor, Tax Legislative Counsel
Treasury Department

Karen Gilbreath Sowell
Deputy Assistant Secretary for Tax Policy
Department of the Treasury

James Hogan
Senior Technical Reviewer
Internal Revenue Service

Donald L. Korb
Chief Counsel
Internal Revenue Service

Ann K. Malone
Office of Chief Counsel
Internal Revenue Service

George L. Masnik
Branch Chief
(Passthroughs and Special Industries)
Internal Revenue Service

William P. O'Shea
Associate Chief Counsel
(Passthroughs and Special Industries)
Internal Revenue Service

Clarissa C. Potter
Deputy Chief Counsel-Technical
Internal Revenue Service

Lon B. Smith
National Counsel to the Chief Counsel
for Special Projects
Internal Revenue Service