

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-146799-01

Date:

JULY 25, 2002

Re:

LEGEND:

- Settlor =
- Spouse =
- Country =
- Area of Country =
- Business =

- Trust =

- Date =
- State =

Dear :

This is in response to your letter dated August 30, 2001, concerning the application of the income tax and estate tax to certain property held in trust.

Settlor, a citizen and national of Country, is a nonresident alien. He resides exclusively in Country with no intention of removing himself therefrom. Settlor is engaged in Business principally within Area of Country. He has no United States trade or business.

Settlor executed the Trust in Area of Country on Date. Settlor designated himself as the trustee. The Trust investments include American Depositary Receipts. Under Article 3, paragraph 3.1 of the Trust, Settlor may revoke the trust in whole or in part during his life. On revocation, the trustee is to deliver to Settlor all or the designated portion of the trust property. Under Article 7.24, the validity of the instrument and construction of its beneficial provisions are to be governed by the laws of State (a state in the United States).

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Under Article 2, paragraphs 2.1, 2.2, and 2.4, while Settlor is living, trust income is to be added to principal. The trustee is to pay to or for Settlor such amounts as the trustee deems appropriate for Settlor's care, support, comfort and welfare. On Settlor's death, if Spouse survives, the Trust property is to be held in further trust for her benefit. On Spouse's death, the Trust property is to be distributed in accordance with Spouse's exercise of a general power of appointment. If Spouse does not survive Settlor, certain items of property are to be distributed among Settlor's surviving children. The remaining trust property is to be distributed among Settlor's then living issue, by right of representation. Spouse and Settlor's children are citizens and residents of Country.

You have asked us to rule that:

(1) For income tax purposes, the Trust is a foreign grantor trust and Settlor is treated as the owner of the ADRs and ADSs; and

(2) For purposes of § 2104 of the Internal Revenue Code, the ADRs and ADSs will not be deemed assets situated within the United States at Settlor's death.

Ruling (1)

Section 671 of the Internal Revenue Code provides that where it is specified in subpart E of Part I of subchapter J (§§ 671-679) that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 672(f)(1) provides generally that the rules of §§ 671 through 679 shall apply to cause a person to be treated as the owner of a trust only to the extent such application results, directly or indirectly, in any income or other amounts being currently taken into account in computing the income of a citizen or resident of the United States or a domestic corporation.

Section 672(f)(2)(A)(i) of the Code and § 1.672(f)-3(a)(1) of the Income Tax Regulations provide an exception for any portion of a trust where the power to revest absolutely in the grantor title to the trust property to which such portion is attributable is exercisable solely by the grantor without the approval or consent of any other person.

Section 676(a) provides that the grantor is treated as the owner of any portion of a trust where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

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Section 7701(a)(30)(E) provides that the term “United States person” means any trust if (i) a court within the United States is able to exercise primary supervision over the administration of the trust, and (ii) one or more United States persons have the authority to control all substantial decisions of the trust.

Section 7701(a)(31)(B) provides that the term “foreign trust” means any trust other than a trust described in § 7701(a)(30)(E).

Section 301.7701-1(a) of the Procedure and Administration Regulations provides that the Internal Revenue Code prescribes the classification of various organizations for federal tax purposes. Whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law.

Section 301.7701-4(a) provides that, in general, the term “trust” as used in the Internal Revenue Code refers to an arrangement created either by will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules provided in chancery or probate courts. Usually the beneficiaries of a trust as described in § 301.7701-4(a) do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create the trust. A trust created by the beneficiaries will be recognized as a trust under the Internal Revenue Code, if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 301.7701-7(a)(1) provides that a trust is a United States person if: (i) a court within the United States is able to exercise primary supervision over the administration of the trust (court test); and (ii) one or more United States persons have the authority to control all substantial decisions of the trust (control test).

Section 301.7701-7(d)(1)(i) provides that for purposes of the control test the term *United States person* means a United States person within the meaning of § 7701(a)(30). For example, a domestic corporation is a United States person, regardless of whether its shareholders are United States persons.

Section 301.7701-7(d)(1)(ii) provides that the term *substantial decisions* means those decisions that persons are authorized or required to make under the terms of the

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trust instrument and applicable law and that are not ministerial. Decisions that are ministerial include decisions regarding details such as the bookkeeping, the collection of rents, and the execution of investment decisions.

Section 301.7701-7(b)(3)(iii) provides that the term *control* means having the power, by vote or otherwise, to make all of the substantial decisions of the trust, with no other person having the power to veto any of the substantial decisions. To determine whether United States persons have control, it is necessary to consider all persons who have authority to make a substantial decision of the trust, not only the trust fiduciaries.

Based on the facts and circumstances presented, the Trust is a trust for federal tax purposes under § 301.7701-4(a) because its primary purpose is protecting and preserving the trust property for the beneficiaries of the Trust. In addition, the Trust is a foreign trust for federal tax purposes under § 301.7701-7 because the Trust fails the control test of § 301.7701-7(a)(1)(ii). Under the terms of the Trust agreement, Settlor, a nonresident alien, controls the substantial decisions of the Trust. Therefore, one or more United States persons do not have the authority to control all substantial decisions of the Trust.

In this case, Settlor retained the absolute power to revest title to the trust corpus in himself. Accordingly, the exception to the general rule of section 672(f)(1) is applicable and the rules of §§ 671-679 may be applied to treat Settlor as the owner of the Trust. For federal income tax purposes, Settlor is treated as the owner of the entire Trust under § 676.

Ruling (2)

Section 2101 provides, in part, that a tax is imposed on the transfer of the taxable estate of every decedent nonresident not a citizen of the United States.

Section 2103 provides that the value of the gross estate of every decedent nonresident not a citizen of the United States shall be that part of the gross estate which at the time of death is situated in the United States.

Section 2104(a) provides that, for purposes of the estate tax, shares of stock owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States only if issued by a domestic corporation.

Section 2104(b) provides that any property of which the decedent has made a transfer, by trust or otherwise, within the meaning of §§ 2035 to 2038 shall be deemed to be situated in the United States, if so situated either at the time of the transfer or at the time of the decedent's death.

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Section 2038(a)(1) provides generally that the value of the gross estate shall include the value of all property transferred by the decedent during life, in trust otherwise, to the extent the decedent retained the power to alter, amend, revoke or terminate the transfer.

An American Depositary Receipt (“ADR”) is a negotiable certificate that is executed and sold by a United States bank. The United States bank certifies that the designated holder owns a certain number of American Depositary Shares (“ADSs”) representing the shares of a specified foreign corporation purchased by the holder which are on deposit with a bank in the foreign corporation’s home country. The bank in the foreign corporation’s home country is designated as the agent, or custodian, for the United States bank. The United States bank converts dividends, interest, and principal of the foreign security into United States dollars for the holder of the ADR. Rev. Rul. 65-218, 1965-2 C.B. 566; Rev. Rul. 72-271, 1972-1 C.B. 369.

Rev. Rul. 82-193, 1982-2 C.B. 219, considers a situation where D, a nonresident alien, established an irrevocable trust appointing a United States bank as trustee. The trustee invested the trust corpus in a certificate of deposit issued by the bank. On termination of the trust, the trust corpus was payable to D, or if D predeceased termination, to D’s estate. The revenue ruling holds that on D’s death prior to the termination of the trust, no portion of the trust corpus is includible in the gross estate, because no portion of the trust corpus is situated in the United States at the time of death. Specifically, under § 2105(b), the certificate of deposit held by the trust would be considered property without the United States if the certificate was owned by D directly. The interposition of the irrevocable trust does not affect the underlying character of the bank deposit, for purposes of § 2105(b). Accordingly, D’s interest in the trust is property situated outside the United States and, therefore, not included in the gross estate.

In the instant case, the Trust corpus would be subject to inclusion in Settlor’s gross estate under § 2038 to the extent the Trust corpus is situated in the United States. The situs of the assets held by the Trust, for estate tax purposes, is determined under the rules of §§ 2104 and 2105. The interposition of the Trust does not affect the determination of the situs of the property held by the Trust. Rev. Rul. 82-193, cited above. As discussed above, ADSs represent ownership rights in underlying shares of a foreign corporation. ADRs are certificates evidencing ownership of the ADSs. Accordingly, the ADRs and ADSs do not constitute shares of stock issued by a domestic corporation and, therefore, are not property within the United States under § 2104(a).

Accordingly, we conclude that, if the ADRs are held by the Trust on the date of Settlor’s death, these assets will not be considered property situated in the United States for purposes of § 2103, and will not be included in Settlor’s gross estate, assuming the assets are not otherwise treated as situated in the United States under § 2104(b).

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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 the 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. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to the Settlor.

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

Sincerely yours,

George L. Masnik
Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
copy for 6110 purposes