

INTERNAL REVENUE SERVICE
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October 27, 1998

Re:

LEGEND

Grantor =
Spouse =
Child 1 =
Child 2 =
Child 3 =
Child 4 =
Trust 1 =
Trust 2 =
Trust 3 =
Trust 4 =

Corporation =
State =

Dear

This is in response to a July 3, 1997 letter from your authorized representative requesting gift and estate tax rulings with respect to four trusts.

On December 31, 1991, Grantor and Spouse created four irrevocable trusts (Trust 1, Trust 2, Trust 3, and Trust 4) one for each of their four children, Child 1, Child 2, Child 3, and Child 4 and their respective issue. All of the children had reached age 21. Except for the primary beneficiary, each trust is substantially the same. Grantor and Spouse are trustees of each trust. In addition, each child is now a co-trustee (along with Grantor and Spouse) of the trust created for his or her benefit.

Paragraph 5 provides that the property shall be held and distributed for the benefit of the members of a class consisting of the child who is the primary beneficiary and that child's issue.

Subparagraph (a) of Paragraph 5 provides the trustees with the discretionary authority to distribute both income and principal for "the general welfare, education and the maintenance in health and reasonable comfort of the members of the class,

considering the needs, circumstances and the usual standard of living of each, using the guidelines set out in the following paragraphs. Subparagraph (a) further provides that the trustees shall have discretion to add undistributed income to principal.

Subparagraph (b) provides that, in making the discretionary distributions, the trustee may distribute more to, or for the use and benefit of, one member of the class than another.

Subparagraph (c) provides that, within the scope of the general purposes expressed in subparagraph (a), a discretionary distribution may be made for such specific purposes as, but not limited to: education, which shall include private and preparatory schools and undergraduate and graduate education; vocational, professional or business training; reasonable assistance to establish a trade, business or profession, to acquire and maintain a home, and to alleviate circumstances arising from adversity or misfortune.

Paragraph 6 provides that the trustee shall distribute principal during each calendar year to the child who is the primary beneficiary as the child directs in writing, in an amount not to exceed \$5,000. In addition, if the child so directs, and is living on the last day of the year, the trustees shall distribute additional principal, not to exceed five percent of the value of the trust as of the last day, less principal previously distributed during the year.

Paragraph 7 provides that the trust shall terminate upon the death of the child who is the primary beneficiary. Subject to the provisions of Paragraph 8, the trust principal shall be distributed, first, to the issue of the child who are then living, by representation. If the child has no living issue, the principal shall be distributed to Grantor's issue, then living, by representation.

Paragraph 8 provides that any principal required to be distributed under Paragraph 7 to a beneficiary under the age of 50 shall not be distributed outright, but instead shall be held in a separate trust for the benefit of the beneficiary.

Paragraph 10 states that "[w]henver there are two or more trustees, all actions taken by or required of the Trustees under [the] agreement shall require action by all of the trustees and all decisions shall require the consent of all of the trustees."

On December 31, 1991, Spouse transferred 5,112 shares of common stock of Corporation to each of the four trusts. The common stock of Corporation is the only class of stock outstanding, and after the transfer, Spouse and her children

continued to hold approximately 29 percent of Corporation's common stock.

Further, on December 31, 1991, Child 1 became a co-trustee of her trust. Child 2, Child 3, and Child 4 became the co-trustee of his or her respective trust in January 1992.

In November 1993, Grantor and Spouse made additional gifts to the trusts consisting of cash to Trust 4 and a combination of cash and insurance policies to each of the other three trusts.

In December 1995, Spouse transferred 1,373 shares of Corporation to each of the trusts.

Grantor, Spouse, and the beneficiaries of the trusts intend to petition the State to modify each of the trusts pursuant to § 72-33-407 of the State Code. Paragraph 10 of each trust instrument will be modified to prohibit Spouse from participating, as a trustee, in voting the shares in Corporation. Specifically, Paragraph 10 will be modified to state as follows:

All actions taken by or required of the Trustees under this agreement shall require action by all of the Trustees and all decisions shall require the consent of all of the Trustees, except that the right to vote shares of stock in a Controlled Corporation shall not be exercised by either Grantor [Grantor] or Grantor [Spouse], but instead shall be exercised only by all of the other Trustees. A Controlled Corporation shall mean any corporation in which either [Grantor] or [Spouse] own (with the application of Section 318 of the [Internal Revenue] Code) or had the right (either alone or in conjunction with any person) to vote stock possessing at least 20% of the total combined voting power of all classes of stock.

Spouse has represented that she has not and will not enter into either an expressed or implied agreement with the other trustees that would direct the manner in which the other trustees vote the stock.

Grantor and Spouse have requested the following rulings:

- 1) The transfers of stock in Corporation, cash, and insurance policies, to the trusts were completed gifts for purposes of the gift tax under Chapter 12 of the Internal Revenue Code.
- 2) The value of the corpus of trust will not be included in Grantor's or Spouse's gross estate under §§ 2036(a)(2) or

2038, by reason of the retained fiduciary power to distribute income and principal.

3) If the death of Spouse does not occur within three years of the proposed modification of each of the four trusts, the stock in Corporation that is held by the four trusts will not be included in Spouse's gross estate under §§ 2035(a) or 2036(b).

Gift Tax Issue

Section 2501 imposes a tax on the transfer of property by gift by any individual, resident or nonresident.

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

Section 25.2511-2(b) of the Gift Tax Regulations provides that the gift is complete as to any property, or part thereof or interest therein, where the donor has parted with dominion and control as to leave him with no power to change its disposition, whether for his own benefit or for the benefit of another.

Section 25.2511-2(c) provides that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed and ascertainable standard.

Section 25.2511-2(g) provides that if a donor transfers property to himself as trustee and retains no beneficial interest in the trust and no power over it except fiduciary powers, the exercise or nonexercise of which is limited by a fixed or ascertainable standard, the donor has made a completed gift.

In this case, Grantor and Spouse transferred shares of common stock of Corporation, cash, and/or insurance policies to each of the four trusts. Grantor and Spouse are trustees of each of the trusts and each trust instrument authorizes the trustees to distribute income and principal to the beneficiaries pursuant to a specified standard for certain purposes. We conclude that Grantor's and Spouse's fiduciary power to distribute income and

corpus with respect to each of the trusts is sufficiently limited by a fixed and ascertainable standard as described in § 25.2511-2(c) and (g). Therefore, we conclude that transfers by Grantor and Spouse to each of the trusts were completed gifts.

Estate Tax Issues

Section 2035(a) provides that, (1) if the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of the property (or an interest therein) would have been included in the decedent's gross estate under § 2036, 2037, 2038, and 2042 if the transferred interest or relinquished power had been retained by the decedent on the date of death, the value of the gross estate shall include the value of any property (or interest therein) that would have been so included.

Section 2036(a) provides that a decedent's gross estate includes 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 case of a bona fide sale for an adequate and full consideration in money or money's worth) by trust or otherwise, under which the decedent has retained, for life or for any period not ascertainable without reference to the decedent's death or any period that does not in fact end before his death, (1) the possession or enjoyment of, or the right to the income, from the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

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

Section 2036(b)(2) provides that, for purposes of § 2036(b)(1), a corporation shall be treated as a controlled corporation, if at any time after the transfer of the property and during the 3-year period ending on the date of the decedent's death, the decedent owned (with the application of § 318) or had the right (either alone or in conjunction with any person) to vote stock possessing at least 20 percent of the total combined voting power of all classes of stock.

Section 2036(b)(3) provides that, for purposes of applying

§ 2035, with respect to § 2036(b)(2), the relinquishment or cessation of voting rights shall be treated as a transfer of property made by the decedent.

Section 318(a)(1) provides that an individual shall be considered as owning the stock owned, directly or indirectly, by or for (i) his spouse, and (ii) his children, grandchildren, and parents.

In Rev. Rul. 80-346, 1980-2 C.B. 271, a decedent transferred shares of stock to a trust for the benefit of his children. The trust instrument provided that the trustee would have the sole authority to vote the shares. The trustee agreed, however, to consult with the decedent before voting the stock and to vote only with the decedent's consent. Thereafter, the trustee exercised the voting rights only after obtaining the decedent's approval. The revenue ruling holds that the decedent indirectly retained the voting rights to the stock and, therefore, the value of the shares was includible in the decedent's gross estate under § 2036(b).

Section 2038 provides that the value of the gross estate shall include the value of all property of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth) in trust or otherwise, where the enjoyment thereof was subject to a power in the decedent to alter, amend, revoke or terminate such interest or where any such power was relinquished during the 3-year period ending on the date of the decedent's death.

In situations where the decedent transferred property in trust and retained the discretionary power as trustee to make distributions, the Service has ruled that § 2038 will not apply to include the trust in the gross estate if the retained power to make distributions is limited by definite ascertainable standards. Rev. Rul. 73-143, 1973-1 C.B. 407.

In this case, Grantor and Spouse transferred shares of Corporation, cash, and/or insurance policies to each of the trusts established for their four children. Grantor and Spouse are trustees of each of the trusts and paragraph 5(a) of each trust instrument permits the trustees to distribute both income and principal for the benefit of the members of a class consisting of the child who is the beneficiary of a respective trust and that child's issue. However, the power to distribute income and principal is sufficiently limited for purposes of §§ 2036(a)(2) and 2038. Therefore, based on the facts submitted and the representations made, we conclude that the retained trustee powers of Grantor and Spouse to distribute income and principal will not cause the principal and accumulated income of the four

trusts to be included in Grantor's or Spouse's respective gross estate under §§ 2036(a)(2) or 2038.

Spouse transferred shares of Corporation to each of the trusts established for her four children and Spouse was designated as a co-trustee of each of the trusts. Corporation is a controlled corporation within the meaning of § 2036(b) because Spouse as trustee, with other members of her family, retained and continued to hold the right to vote stock that is at least 20 percent of the total combined voting power of all classes of stock. Spouse's retained right, as a fiduciary, to vote the stock constitutes the right to vote stock for purposes of § 2036(b).

Spouse proposes to relinquish her power to vote the stock in Corporation by judicially modifying each of the trusts in a manner that will prohibit her from participating, as trustee, in the right to vote each Trust's shares in Corporation. Spouse, has represented that she has not and will not enter into either an expressed or implied agreement with the other trustees that would enable her to direct or influence the manner in which the other trustees vote the stock. If Spouse retains the power to vote the shares in Corporation, the value of the shares would be includible in her gross estate under § 2036.

Based on the facts submitted and the representations made and assuming the State District Court approves the amendment of each trust in the manner described, we conclude that, if Spouse's death does not occur within three years of the effective date of the amendment to each of the four trusts, then the stock in Corporation that is held by the four trusts will not be included in Spouse's gross estate under § 2035(a) or § 2036(b).

Except as we have specifically ruled herein, we express no opinion on the Federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. We are expressly providing no opinion with respect to the Federal tax consequences under § 2042.

This ruling is directed only to the taxpayers who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

George Masnik
Chief, Branch 4

Office of the Assistant Chief
Counsel(Passthroughs & Special
Industries)

Enclosure
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