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VIA E-MAIL AND EXPRESS MAIL

Internal Revenue Service
Attn: CC:PA:LPD:PR (CC:PSI:4)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Notice.comments@*irscounsel.treas.gov*

Re: IR-2007-127: Chief Counsel Seeking Comment on Gift Tax Consequences of Trusts Employing Distribution Committee

Dear Madams and Sirs:

This letter responds on behalf of the Association of the Bar of the City of New York Estate and Gift Taxation Committee (the "New York City Bar") to the request in IR-2007-127 (the "Release") regarding the federal income, estate and gift tax consequences that result from trusts employing distribution committees.

We respond primarily to the inquiry as to whether certain private letter rulings ("PLRs") addressing, in part, the gift tax consequences under sections 2511 and 2514 of the Internal Revenue Code (the "Code")[1] of trusts that utilize a distribution committee consisting of trust beneficiaries who direct distributions of trust income and corpus are inconsistent with Rev. Rul. 76-503, 1976-2 C.B. 275, and Rev. Rul. 77-158, 1977-1 C.B. 285. In doing so, we focus in particular on the suggestion that the facts presented in the PLRs are distinguishable from the revenue rulings because in the PLRs, the grantor's gift to the trust is incomplete because the grantor retains a testamentary special power of

[1] All references to the "Code" are the Internal Revenue Code of 1986, as amended, and all references to Regulations are to the Treasury Regulations promulgated thereunder.

appointment.

For the reasons discussed below, we believe that where the grantor's gift to the trust is incomplete, no member of the distribution committee can possess a general power of appointment over the trust property. In that regard, although the PLRs hold the grantor's gift to the trust to be incomplete, that conclusion is not free from doubt. Finding the gift to be incomplete generally requires a determination that the interests of the members of the distribution committee are not substantial adverse interests with respect to the donor, a finding which is inconsistent with the holdings in the PLRs that the trusts are not grantor trusts.[2] Finally, to the extent it remains relevant, we believe the cited Revenue Rulings are correctly decided, and that the facts in the PLRs are not meaningfully distinguishable with respect to the gift tax consequences under Code §§2511 and 2514.

Example of Structure of Transactions in the Recent Private Letter Rulings

A model example of the transaction structure present in the series of PLRs[3] at issue is as follows: a donor (the "Donor") establishes an irrevocable trust (the "Trust") which provides that the trustee shall pay the income and principal in such amounts, including the whole thereof, at such times and in such manner as a distribution committee ("Distribution Committee") determines, in its sole and absolute discretion, to or for the benefit of one or more of the descendants of the Donor's parents then living and a qualified charity. The initial members of the Distribution Committee (each a "Distribution Committee Member") are two permissible beneficiaries of the Trust and the Trust agreement requires that at all times during the Donor's life the Distribution Committee be composed of two permissible beneficiaries of the Trust other than the Donor.

There are two ways that a Trust distribution can be made: (i) the Distribution Committee Members can, by unanimous consent, direct the trustee to make a distribution and (ii) either Distribution Committee Member, acting alone, can direct the trustee to make a distribution, provided the Donor consents to such distribution. In addition, the Donor retains a testamentary power to appoint the Trust property to such person or persons (other than the Donor, his or her estate, his or her creditors, or creditors of his or her estate) as the Donor appoints by will and to the extent not so appointed, the Trust provides that the property is to be paid to the issue, per stirpes, of the Donor.

The conclusions reached in the PLRs are: (i) the Donor's transfer to the Trust is not a completed gift under Code §2511 until Trust property is distributed to a beneficiary other than the Donor[4] or at such time, during the Donor's lifetime, as and when the Donor releases

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[2] We acknowledge that the retention of a testamentary power of appointment may render a gift incomplete. See Treas. Reg. §25.2511-2(b). However, as discussed below, we do not believe the retention of such a power by the donor in the PLRs rendered the gift incomplete.

[3] Private Letter Rulings 200247013, 200502014, 200612002, 200647001, 200715005, and 200731019. The first private letter ruling, PLR 200247013, did not request the third ruling requested in each of the later PLRs that the distribution of property from the trust to the Donor by the Distribution Committee would not be a gift because the Distribution Committee Member does not have a general power of appointment over the trust property under Code §2514.

[4] Upon a distribution, the Donor's gift is complete only to the extent of the amount of property actually distributed from the trust, and not as to the entire amount of the Donor's initial contribution (if greater).

his or her testamentary power of appointment; (ii) the Donor is not treated as the owner of the Trust property for federal income tax purposes under Code §671 (making the Trust a "non-grantor" trust) so long as the Distribution Committee is acting; and (iii) any distribution of property from the Trust to the Donor by the Distribution Committee is not a taxable gift because neither Distribution Committee Member has exercised a general power of appointment under Code §2514 by participating in such distribution.

A Taxpayer Cannot Hold A General Power of Appointment Over Property That Is Owned By Another.

A basic tenet of transfer tax law is that only one individual at a time is taxable with respect to ownership in specific property. Rev. Rul. 76-503 and Rev. Rul. 77-158 are distinguishable from the PLRs because the trust assets in the revenue rulings were the subject of completed gifts by the grantor for transfer tax purposes.[5] If a transfer is not considered complete for transfer tax purposes, as is the case in the PLRs, but each Distribution Committee Member is treated as having a general power of appointment, Trust property would be includible in the estates of two or more people simultaneously. Distributions from the Trust to the Donor would be taxed as a gift from Distribution Committee Members to the Donor, who for transfer tax purposes still owns the property. The transfer tax law should not tax as a gift property that is returned to an individual who, for gift and estate tax purposes, never parted with ownership of that property.

Tax law provisions.

The proposition that only one individual at a time is taxable with respect to ownership in specific property finds support in Code provisions relating to the estate tax, in the gift tax regulations, in the generation-skipping transfer tax provisions and in the grantor trust rules.

In the context of the estate tax, Code §2040 specifically provides that (i) a cotenant only includes in his or her gross estate for estate tax purposes the proportional interest that he or she has in the property; (ii) an individual does not have to include in his or her estate that portion of jointly owned property which may be shown to have originally belonged to the surviving joint tenant and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration; and (iii) in certain instances, including when property has been acquired by decedent and spouse as tenants by the entirety, only one-half of the property is taxable in the decedent's estate.

The gift tax regulations, in Treas. Reg. §25.2511-2(f), provide that no completed gift occurs with respect to property subject to a grantor's power to modify, alter or revoke unless it is distributed to a person "other than the donor." While, on its face, this regulation determines only whether the grantor would be deemed to make a gift if property were distributed to him, it also implies that no other taxpayer could be treated as having made a gift by distributing property to the grantor with respect to which the grantor's gift was incomplete.

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[5] The Release appears to assume that the gifts in the Revenue Rulings are complete although the Revenue Rulings do not discuss this issue.

Generation-skipping tax provisions specifically provide that only one person at a time may be considered the transferor of the same property for gift or estate tax purposes. Treas. Reg. §26.2652-1 defines the transferor of property for purposes of chapter 13 as "the individual with respect to whom property was most recently subject to federal estate or gift tax."

Other areas of the tax law support the concept that only one individual at a time is taxable with respect to ownership of the same property. For example, Code §678(b) provides that if the grantor of a trust is treated as the owner of trust property, a person other than the grantor is not treated as the owner of the trust property. Similarly, Code §682(a) shifts income from one spouse to another in the case of certain trusts created in connection with a divorce, so that both individuals are not taxable on the same trust income. In the most basic situations, where two individuals own a home as joint tenants with right of survivorship or a husband and wife own a home as tenants by the entirety, if that property is sold by the joint owners to a third party, each joint owner pays tax on only a portion of the property; both are not taxable on the full value at the same time with respect to the same transfer.

Contrary authorities distinguished.

The Release refers to Treas. Reg. §25.2514-1(e), example (1) and Rev. Rul. 67-370, 1967-2 C.B. 324, as possible authorities for the proposition that an incomplete gift may be subject to a taxable general power of appointment in someone other than the donor. These authorities do not stand for such proposition. Example (1) of Treas. Reg. §25.2514-1(e) addresses only the date on which a general power is deemed to have been created for purposes of the grandfathering rule of that section.

The scope of Rev. Rul. 67-370 is more problematic. It is the only authority we have found supporting the conclusion that the same property may be simultaneously includable in the estates of two different taxpayers before either of the taxpayers has made a completed gift for transfer tax purposes. However, it does not involve a general power of appointment, but rather a defeasible remainder interest in a trust subject to termination by another. By the terms of the trust in the Ruling, the decedent or his estate was to receive the trust principal upon the settlor's death, and the settlor reserved the right to modify, alter, or revoke the trust during her lifetime. The settlor modified the trust following the decedent's death by eliminating the estate's defeasible remainder interest. The IRS concluded that the fair market value of the defeasible interest surviving the decedent's death was includible in the decedent's gross estate. Insofar as this Ruling stands for the proposition that the same asset can simultaneously be includible in the taxable estates of two people, we believe it is incorrect.

Johnstone v. Commissioner, 76 F.2d 55 (9th Cir. 1935), also merits discussion in this regard. In *Johnstone*, the decedent's mother created a trust for her son, granted the son a testamentary general power of appointment, but retained the power to amend the trust before her son's death. Upon the son's death, the property over which he held a general power of appointment was included in his estate. This is clearly distinguishable from the PLRs, most significantly on the ground that the mother's ability to amend the trust and change the disposition of the trust property was removed at the son's death, and therefore, the gift was complete at that time.

Policy considerations.

Incongruous and inappropriate estate taxation results if two people are treated as owning the same property for estate tax purposes even though one person has never made a completed gift of the property to the other. For purposes of illustration, assume that the Donor and all Distribution Committee Members die in a simultaneous event. Under the rationale contained in the Revenue Rulings, the Donor would be subject to estate tax on 100% of the value of the Trust and each Distribution Committee Member would be subject to estate tax on one-half[6] of the value of the Trust. It is not fair, from a policy perspective, to require double taxation of the Trust property without providing for any concomitant credits or deductions.[7] The power of a Distribution Committee Member to direct the trustee to make a distribution is always predicated on the consent of another person; a Distribution Committee Member can never unilaterally control the disposition of the Trust property. The PLRs hold that the Donor has never made a completed gift of the Trust property, and the Donor can unilaterally appoint the Trust property albeit only upon his or her death. Accordingly, the more logical and correct result from a policy perspective is that all of the Trust property is includible in the Donor's estate and none of the Trust property is includible in the estate of a Distribution Committee Member.

Determination of Whether There is a Completed Gift.

The PLRs do not adequately describe the rationale for the IRS' conclusion that the Donor has not made a completed gift when he or she transfers property to the Trust. Certain of the PLRs cite Treas. Reg. §25.2511-2(c) and *Estate of Sanford v. Commissioner*, 308 U.S. 39 (1939), for the principle that a donor does not make a completed gift if he or she retains the power to name new beneficiaries or to change the interest of the beneficiaries as between themselves, and they refer to the Donor's retention of a limited testamentary power of appointment.[8] Certain of the PLRs also cite Treas. Reg. §25.2511-2(b).[9] Given that the Trust

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[6] Assuming there are two Distribution Committee Members; based on the Revenue Rulings, a different percentage would potentially be includible in each Distribution Committee Members estate if there are a different number of Distribution Committee Members.

[7] It is not clear that the credit for tax on prior transfers under Code §2013 would be applicable in this scenario.

[8] See, for example, PLR 200247013: "Thus, in *Estate of Sanford*, the Court inferentially found that, even though the taxpayer could not change the terms of the trust for his own benefit, the taxpayer nevertheless continued to possess dominion and control over the trust property by reason of his retained right to change the beneficiaries of the trust. In the present case, A [the Donor] proposes to make inter vivos transfers of property to an irrevocable Trust. Under Trust, A possesses a limited testamentary power to appoint Trust principal (and accumulated income) to persons other than A, her creditors, her estate, or the creditors of her estate. By reason of A's limited power of appointment, A will have the power to change the beneficiaries of Trust. Therefore, for purposes of the gift tax, A will continue to possess dominion and control over the property transferred to Trust and the inter vivos transfers of property to Trust will not be completed gifts. Treas. Reg. §25.2511-2(c). However, when the Distribution Committee distributes Trust property to a beneficiary other than A or if, during her lifetime, A releases her testamentary power to appoint the Trust property, the gifts will be complete. Treas. Reg. §25.2511-2(f)."

[9] PLRs 200637025, 200647002, 200731009 and 200715005 cite Treas. Reg. §25.2511-2(b), which discusses a testamentary power to appoint the remainder of a trust whose terms permitted the trustee, in the trustee's discretion, to distribute income to the donor or to accumulate the income. Because in the example contained in the

may be immediately distributed by the Distribution Committee, the reserved power rendering the transfer to the Trust incomplete must be found in the Donor's power, with the consent of one Distribution Committee Member, to direct a current distribution of income or principal, or both, to persons among a class which include the Distribution Committee Members.[10]

PLR 200612002 analyzes the Donor's jointly held power to direct current distributions as follows: "In this case, X has retained a limited testamentary power to appoint the Trust corpus and accumulated income to any persons (other than X's estate, etc.) In addition, X has retained a lifetime power to appoint the Trust corpus to X with the consent of either one of Y or Z, the members of the Power of Appointment Committee, individuals who would not have a substantial adverse interest in the disposition of the transferred property for purposes of §2511. See, Rev. Rul. 79-63, 1979-1 C.B. 302. In view of these retained powers, X's transfer of property to Trust will not be a completed gift subject to federal gift tax. See §25.2511-2(b); §25.2511-2(c); §25.2511-2(e). However, X will be treated as making a taxable gift at such time as trust corpus is distributed to a beneficiary other than X, or if, during X's lifetime, X releases the testamentary power to appoint the Trust property. §25.2511-2(f)."

The Donor's power to direct current dispositions with the consent of one Distribution Committee Member will render the gift to the trust incomplete if the Donor possesses the power to direct current distributions "in conjunction with any person not having a substantial adverse interest in the disposition of the Trust property or the income therefrom." Treas. Reg. §25.2511-2(e). *Camp v. Commissioner*, 195 F.2d 999 (1st Cir. 1952), provides a method of determining when a gift is incomplete if the donor's power to alter or revoke is exercisable with a third person. The case examines a trust established in 1932 to pay the income to the donor's wife for life; upon her death the principal was to be paid to donor's issue then living, per stirpes, or, if none, the trust income was payable to donor's mother, if living, and upon her death the principal was payable to the donor's half brother. The donor retained the right to revoke or alter the indenture with the consent of either his half brother or his mother. In 1937, the donor exercised the power to amend, with the consent of his half brother, to provide that the indenture could be amended only with the consent of his wife. In 1946 he relinquished all power to amend or revoke. The opinion states, in part, as follows:

> If the trust instrument reserves to the donor a general power to alter, amend or revoke, in whole or in part, and this power is to be exercised only in conjunction with a designated beneficiary who has received an interest in the corpus or income capable of monetary valuation, then the transfer in trust will be deemed

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regulation, no distributions could be made to a person other than the donor during the donor's life, the testamentary power of appointment does reserve to the donor control over the disposition of the trust property to any person other than the donor and renders the gift incomplete. While a testamentary power of appointment would render the remainder interest in the Trust incomplete, inasmuch as the Distribution Committee, acting without the Donor's consent, can distribute the entire Trust immediately upon funding, it would not appear to render the transfer to the Trust an incomplete gift. This conclusion is not free from doubt, and some of the PLRs suggest that the existence of the limited testamentary power of appointment is, by itself, sufficient to render the gift incomplete. If this is the position of the IRS, it should be made clear. See footnote 12, infra.

[10] Our analysis assumes that the Trust is created in a jurisdiction which does not allow the Donor's creditors to compel a distribution to satisfy claims against the Donor.

> to be a completed gift, for purposes of the gift tax, only as to the interest of such designated beneficiary having a veto over the exercise of the power. As to the interests of other beneficiaries, the gifts will be deemed to be incomplete, for as to such interests the donor reserves the power to take them away in conjunction with a person who has no interest in the trust adverse to such withdrawal. The gifts to the other beneficiaries have not been 'put beyond recall' by the donor; in such cases the regulation recognizes realistically that when the donor has reserved the power to withdraw any of the donated interests with the concurrence of some third person who has no interest in the trust adverse to such withdrawal, it is in substance the same as if the donor had reserved such power in himself alone. *Id.* at 1004-1005.

The court determined that the taxpayer had made a completed gift of the income interest in 1937 when the indenture was amended to require his wife's consent to any subsequent amendment and that he had made a completed gift of the value of the trust principal, less the value of the income interest and any completed gifts made when the trust was created, when he relinquished his power to amend or revoke in 1946. Although only dictum, the court's discussion of when a gift is incomplete if the donor may alter the beneficial interests with the consent of either of several beneficiaries is of interest to the analysis of the PLRs:

> In passing, we simply allude to a possible difficulty, in that the donor originally reserved a power to revoke or modify the trust in conjunction with either [his half brother] or [his mother]. [The half brother's] contingent remainder interest might have been revoked by the donor, in conjunction with [his mother], whose interest in the trust was not adverse to such revocation. [His mother's] contingent life estate could have been revoked by the donor in conjunction with [his half brother], whose interest in the trust was not adverse to such revocation. Where the veto power is thus lodged in the alternative, it may be that, for purposes of the gift tax, there is not a completed gift to either of such beneficiaries. *Id.* at 1005.

Examined under the *Camp* analysis, the transfer to the Trusts in the PLRs may indeed be an incomplete gift, although the conclusion is not free from doubt and the rationale for this conclusion in PLR 200612002 may warrant reconsideration. If the Distribution Committee Members would have reason to believe that, by cooperating with each other, they could distribute to themselves a pro rata share of the Trust property, they would be adverse to any distribution to the Donor[11] and to any person other than themselves. Each Distribution Committee Member would not, however, be adverse to a distribution to himself or herself. Thus, the Donor could be regarded as retaining, in the alternative, the power to distribute to Distribution Committee Member A, with A's consent, or the power to distribute to Distribution Committee Member B, with B's consent. The Donor has thus retained the power to "change the interests of the beneficiaries as between themselves" within the meaning of Treas. Reg. §25.2511-2(c) and §25.2511-2(e). If this analysis is correct, however, the conclusion reached

[11] Thus the transfer to the Trust would not be incomplete because the Donor had retained a right of revocation.

by the PLRs that the Trust is not a grantor trust under §674(a) may warrant reconsideration, as discussed below.

Nevertheless, the analysis of the Distribution Committee Members' collective financial interest could lead to the alternate conclusion: that rather than risk receiving nothing in the event one Distribution Committee Member collaborates with the Donor to receive all, or a disproportionate share, of the Trust, the Distribution Committee Members would rather agree among themselves to divide the trust pro rata and would agree not to consent to a proposal by the Donor to distribute to any one of them. In such case, the members' financial interest would render them adverse to any exercise of the distribution power held jointly with the Donor that is different from their collective distribution. Stated another way, the conferring of the general power in the Distribution Committee Members is itself a completed gift and takes precedence over the Donor's retained power to vary the beneficiaries' interest.[12]

Whether the mere creation of a general power can constitute a completed gift in the face of a donor's retained power to direct distributions is not without controversy and is discussed in Stephens, Maxfield, Lind, Calfee & Smith, *Federal Estate and Gift Taxation* (8th ed., 2002), as follows:

> A similar problem arises if the donor creates a trust with a right in himself to designate beneficiaries of income or corpus but, in addition, gives some third party a general power of appointment over the trust property. Under the *Sanford* principle, there is no gift to those to whom the donor may direct payments because, pro tempore, he has obviously retained control. If, under local law, he may still effect distributions to beneficiaries free and clear of the third party's power, he has made gifts to no one, for he still controls the entire trust property; but any distribution pursuant to his designation constitutes a gift by him. [citing Treas. Reg. §25.2511-2(f)] On the other hand, if, under local law, a donor can and does give another a general power of appointment over property that takes precedence over any interest in or control over the property by the donor, he has made a completed gift of the entire property. The only obstacle to this conclusion is the settled property and tax law principle that a power is not an interest in property. How then can the donor be said to have transferred "property" by creation of the power? The answer is that the effect of the transaction is a complete shift of dominion and control over the property actually owned by the donor to the one to whom the power is given, and it is immaterial that the

[12] To clarify this area, the IRS should consider establishing a "bright line" rule concerning when a gift is complete. Such a rule could provide that either (i) a gift is incomplete so long as the donor may participate with other parties in a power to control the disposition of the property, even if such other parties may, without the participation of the donor, also control the disposition of the property, or (ii) a gift is complete if the donor has given the power to control the disposition of the property to other parties, even if the donor has retained the power, together with any of those parties, to control the disposition of the property.

shift in actual ownership is couched in terms of a gift of the power. *Id.* at ¶10.01[9].

"Adverse Interest" Under The Gift and Income Tax Provisions

Conclusions with respect to both the gift[13] tax consequences of a jointly-held power of appointment (discussed above) and the grantor trust status of a Trust for income tax purposes hinge upon the determination of whether one joint holder of a distribution power over certain property has a "substantial interest" in such property that is "adverse to the exercise of the power in favor of" the other joint holder of such power. A Trust will be treated for income tax purposes as owned by its Donor (i.e., a "grantor trust") if the Donor has retained certain powers which he or she may exercise with the consent of a person possessing no substantial interest in the trust making him or her adverse to an exercise of the power in favor of the Donor. The rationale behind treating the Donor as the owner of such property for income tax purposes is the fact that the Donor has not imposed a substantive limitation on his or her ability to act unilaterally with respect to the property and, therefore, the requirement that a non-adverse party must consent to the exercise of a power should be ignored. Similarly, a Donor who has a joint power to appoint property among any member of a class that includes the Donor should be treated as though he or she holds the power individually if the joint-holder of such power has no substantial interest in the property which is adverse to the Donor's ability to exercise the power in favor of himself of herself.

With respect to the PLRs, the results arrived at suggest that the IRS applied the adverse interest rules under the income and gift tax provisions inconsistently. Addressing the same power of appointment, it concluded that the trust should not be treated as a grantor trust but that the transfer to the trust should be treated as an incomplete gift. Arriving at this conclusion would require the IRS to have reasoned that the interest of a Distribution Committee Member is adverse to that of the grantor for income tax purposes but not adverse for gift tax purposes. As discussed below, the Code and regulations provide the same test for adversity in determining whether a grantor should be treated as owner of the trust property for income and gift tax purposes. These rules should be consistently applied.

In determining whether a grantor has parted with dominion and control of his property for gift tax purposes, Treas. Reg. §25.2511-2(e) provides that a donor is considered to have retained a power that makes the gift incomplete if the power "is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom." As discussed above, concluding that the transfer by the Donor is an incomplete gift would appear to require a determination that the interest of a

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[13] In determining whether a power exercised by an individual is a general power of appointment, Treas. Reg. §25.2514-3(b)(2) provides that if a power of appointment is exercisable only in conjunction with another individual, such power "is not considered a general power of appointment if it is not exercisable by the possessor except with the consent or joinder of a person having a substantial interest in the property subject to the power which is adverse to the exercise of the power in favor of the possessor, his estate, his creditors, or the creditors of his estate."

Distribution Committee Member in the Trust is not a substantial adverse interest to such Member joining with the Donor to change the distribution of Trust property.

Property contributed to a Trust will be treated as owned by the Donor for federal income tax purposes (a "grantor trust") pursuant to Code §671 if any one of several powers with respect to the property are retained by the Donor. Two of the grantor trust provisions of the Code are relevant to our analysis: (i) Code §674(a) which provides that a "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" and (ii) Code §676(a) which provides that a "grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, 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." Code §672(a) defines an "adverse party" as "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." The conclusions in the PLRs that the Trusts are not grantor trusts turn on a finding that the Distribution Committee Members hold substantial adverse interests with respect to the Donor.

However, as discussed above, a determination that the Donor's gift to the Trust is incomplete rests, we believe, upon a finding that any Distribution Committee Member will not be adverse to a distribution to himself or herself. If any Distribution Committee Member whom the Donor approaches would cooperate with the Donor to authorize a distribution to himself or herself, then that Distribution Committee Member would not be regarded as an adverse party. As a consequence, the disposition of corpus and income would be subject to the Donor's power and the Donor would be treated as the owner of the trust under the general rule of §674. None of the exceptions in §674(b) or (c) apply to alter that conclusion.

It is difficult to reconcile these different determinations regarding substantial adversity between the Distribution Committee Members and the Donor for gift tax and income tax purposes, based on the same set of facts.

Analysis of General Powers of Appointment

If the IRS either (i) rejects our position that a Distribution Committee Member cannot hold a general power of appointment over property if there has not been a completed transfer of that property for gift or estate tax purposes or (ii) accepts that position but concludes that in the transactions described in the PLRs the gifts by the Donors were complete and the conclusions in the PLRs that the gifts were incomplete are not correct, then the determination of whether a Distribution Committee Member holds a general power of appointment, in light of the holdings of Rev. Rul. 76-503 and Rev. Rul. 77-158, becomes relevant.

In Rev. Rul. 76-503, three siblings, A, B and C, own equal interests in a family business which they transfer to a trust. Each grantor designates one of his adult children as one

of the three trustees of the trust. The trust directs that income be accumulated and added to principal until the trust terminates, twenty years after the death of the last descendant of A, B and C living at the date of creation of the trust. The trustees, acting unanimously, may distribute trust principal to whomever they select, including themselves. Each trustee may designate a relative to act as his successor if he ceases to act. In default of such designation, the oldest living descendant of the trustee ceasing to act is named as a successor.

The facts are the same in Rev. Rul. 77-158 except the trustees may act by majority vote. Both rulings conclude that each trustee holds a general power of appointment over a portion of the trust property. The analysis turns on the interpretation of the following language from §20.2041-3(c) of the estate tax Regulations, which is identical to the language in §25.2514-3(b) of the gift tax Regulations:

> "(2)*** A coholder of the power has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a coholder of a power is considered as having an adverse interest where he may possess the power after the decedent's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. Thus, for example, if X, Y, and Z held a power jointly to appoint among a group of persons which includes themselves and if on the death of X the power will pass to Y and Z jointly, then Y and Z are considered to have interests adverse to the exercise of the power in favor of X. Similarly, if on Y's death the power will pass to Z, Z is considered to have an interest adverse to the exercise of the power in favor of Y.***
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> (3) A power which is exercisable only in conjunction with another person, and which after application of the rules set forth in subparagraphs (1) and (2) of this paragraph constitutes a general power of appointment, will be treated as though the holders of the power who are permissible appointees of the property were joint owners of property subject to the power. The decedent, under this rule, will be treated as possessed of a general power of appointment over an aliquot share of the property to be determined with reference to the number of joint holders, including the decedent, who (or whose estates or creditors) are permissible appointees. Thus, for example, if X, Y, and Z hold an unlimited power jointly to appoint among a group of persons, including themselves, but on the death of X the power does not pass to Y and Z jointly, then Y and Z are not considered to have interests adverse to the exercise of the power in favor of X. In this case X is considered to possess a general power of appointment as to one-third of the property subject to the power."

Rev. Rul. 76-503 then provides the following analysis:

> "Where, however, as in the example in section 20.2041-3(c)(3) of the regulations, the surviving coholders of the power do not receive, at the

> death of the decedent, the entire power of appointment between themselves but must continue to share the power with the decedent's replacement, they would not necessarily be in a better economic position after the decedent's death than they are before the death. In such a situation, the fact that the coholders may survive the decedent does not mean that they stand to profit by refusing to exercise the power in favor of the decedent during the decedent's lifetime. Therefore, the coholders of the power do not have an interest that is adverse to exercise of the power in favor of the decedent for purposes of section 2041(b)(1)(c)(ii) of the Code.
>
> If the coholders of the power, who must share their power with the decedent's replacement upon the death or resignation of the decedent, have no interest in the subject property other than as coholders of, and permissible appointees under, the power, those facts alone cannot support the conclusion that they hold adverse interests. As a result, the decedent's power meets the definition of a 'general power of appointment' because the coholders of the power in actuality have no substantial interest in the subject property, which is adverse to the exercise of the power in favor of the decedent."

We believe that the holdings in both Revenue Rulings are consistent with the Regulations cited above, and that the Revenue Rulings are correctly decided. The question then becomes whether the interests in the trusts described in the PLRs held by the Distribution Committee Members are sufficiently different from the interests held by the trustees in the Revenue Rulings, so that the PLRs may be distinguished from the Revenue Rulings and the interests of the Distribution Committee Members found to be substantially adverse to each other. Although the conclusion is not free from doubt, for the reasons discussed below, we believe that the differences between the PLRs and the Revenue Rulings are not sufficient to justify a different result.

There are three principal differences between the interests held by a Distribution Committee Member in the PLRs and the interests held by a trustee in the Revenue Rulings. They are:

1. a Distribution Committee Member does not have the power to appoint his or her own successor;

2. a Distribution Committee Member may be a taker in default of the exercise by the grantor of his or her limited testamentary power of appointment; and

3. a Distribution Committee Member may, with the consent of the grantor, distribute property to himself or herself.

As to the first difference, the significant point is that a successor Distribution Committee Member must be appointed, not who appoints the successor. This is illustrated by

the examples quoted above from the estate tax and gift tax Regulations. That the trustees in the Revenue Ruling have the power to name their own successors arguably gives them a greater interest than the Distribution Committee Members, but still not an interest that is substantially adverse to the other trustees.

As to the second difference, each Distribution Committee Member stands in the same position as the others, and there is no economic improvement that occurs when one Distribution Committee Member dies without the power of distribution having been exercised, if he is replaced by another individual with similar economic interests in the trust. Stated differently, while this difference may make a Distribution Committee Member adverse to the exercise of the power of appointment by the grantor, it does not appear to make him adverse to the other Distribution Committee Member (or Members).

The impact of the third difference is the most difficult to evaluate. It appears, however, to be analogous to the situation in Rev. Rul. 77-158, in that a single Distribution Committee Member may join with one other person, in this case, the grantor, to effect a distribution. It is difficult to see how the existence of that power creates a substantial interest in the Trust property that is adverse to a Distribution Committee Member joining with another Distribution Committee Member to exercise the power. Rather, as in Rev. Rul. 77-158, "the surviving [Distribution Committee members] are in no better position to exercise the power after [one member's] death than before the death...." Hence, we suggest that, as in the Revenue Rulings, the conclusion in the PLRs should be that the interests of the Distribution Committee Members are not adverse to the exercise of the power in favor of each of them.[14]

Recommendations

The income and transfer tax consequences of the transactions described in the PLRs are complex and should be clarified in a consistent manner. As discussed above, we believe that if the transfer of property by the Donor to the Trust does not constitute a completed gift, the Distribution Committee Members should not be treated as holding general powers of appointment. In that regard, we recommend that the IRS repeal Rev. Rul. 67-370, which we believe is incorrect. Further, if the IRS reaffirms that the transfer of property by the Donor to the Trust does not constitute a completed gift, the IRS should reexamine the conclusions in the PLRs that the Trusts are not grantor trusts. In that regard, the determination of what constitutes a substantial adverse interest should be made consistently for income tax and transfer tax purposes.

[14] If the interest of a Distribution Committee Member in cooperating with the Donor concerning a distribution is sufficient to render the gift incomplete, there is no general power as discussed in the first part of this letter. In that event, the interests of the Distribution Committee Members would be viewed and adverse, since they would have separate interests in cooperating with the Donor. Alternatively, if the separate interests of the Distribution Committee Members in cooperating with each other is viewed as outweighing their interest in cooperating with the Donor, then the gift would be complete and, as discussed above, they would be treated as having a general power.

We recommend the IRS publish a ruling clarifying the issues discussed, effective prospectively under Code §7805(b).

Respectfully submitted,

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