

NEW YORK  
CITY BAR

COMMITTEE ON  
ESTATE AND GIFT TAXATION

---

MICHAEL I. FRANKEL  
CHAIR  
2 WALL STREET  
NEW YORK, NY 10005  
Phone: (212) 238-8802  
Fax: (212) 732-3232  
frankel@clm.com

November 4, 2008

KAREN T. SCHIELE  
SECRETARY  
2 WALL STREET  
NEW YORK, NY 10005  
Phone: (212) 238-8667  
Fax: (212) 732-3232  
schiele@clm.com

*Via Electronic Submission and Express Mail*  
*Notice.Comments@irs.counsel.treas.gov*  
*Re: Notice 2008-63*

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

Re: Comments to Notice 2008-63

Dear Ladies and Gentlemen:

This letter sets forth the comments of the Association of the Bar of the City of New York Estate and Gift Taxation Committee to Notice 2008-63 (the "Notice"). The Notice contains proposed guidance in the form of a proposed revenue ruling regarding the estate, gift, generation-skipping transfer ("GST") and income tax issues that are associated with the establishment and administration of trust companies that are family-owned or controlled ("private trust companies," or "PTCs").

We believe that the Service's objective of confirming "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"<sup>1</sup> can be best attained if the Service's guidance is limited to transfer tax issues, and if certain additional points are clarified. Our specific recommendations are set forth below.

---

<sup>1</sup> Notice at 1.

**1. The Service’s Guidance Should Not Address The Grantor Trust Rules Because They Are Often Inconsistent With The Transfer Tax Rules That May Apply To Private Trust Companies**

As an overriding consideration, we believe that the Service’s guidance should only address transfer tax issues, and do not believe that it is necessary or desirable for the Service to consolidate its guidance on transfer tax issues with guidance on the grantor trust rules of Sections 671 through 679 of the Internal Revenue Code. Substantial inconsistencies exist between these two sets of rules, and the Service’s attempt to propose a framework that will not run afoul of either regime fails in the transfer tax arena to achieve the Service’s objective of confirming tax consequences “that are not more restrictive than the consequences that could have been achieved by a taxpayer directly.”

This inconsistency is demonstrated by the Notice’s prohibiting a member of the Discretionary Distribution Committee (the “DDC”) from participating “in the activities of the DDC with regard to any trust of which that DDC member *or his or her spouse* is a grantor, or any trust of which that DDC member *or his or her spouse* is a beneficiary.” (emphasis added) For transfer tax purposes, the status of a person’s *spouse* as a grantor or beneficiary generally will not trigger any adverse estate, gift, or GST tax consequences.<sup>2</sup> This contrasts with the “spousal unity rule” of Section 672(e) that applies for grantor trust purposes, under which the status of a person’s spouse as a grantor or beneficiary of a trust may trigger grantor trust status.

Moreover, as a practical matter, guidance on the application of the grantor trust rules to private trust companies is less relevant than guidance on the transfer tax rules. This is so because in many instances (i) the person who has established a trust for which a private trust company would serve as trustee is deceased (thereby precluding the application of the grantor trust rules, except to the extent that Section 678 may apply) and (ii) grantor trust treatment will be desired and planned for. Consequently, we believe that the grantor trust aspects of the Notice should be eliminated.<sup>3</sup>

**2. A Member Of The DDC Should Not Be Precluded From Participating In The Activities Of The DDC With Regard To A Trust Merely Because The DDC Member’s Spouse Is A Grantor Of The Trust, Or The DDC Member’s Spouse Is A Beneficiary**

The status of a DDC member’s spouse as a grantor or a beneficiary of a trust generally does not, of itself, produce adverse estate, gift or GST tax consequences.

---

<sup>2</sup> One circumstance where the status of a person’s spouse as a beneficiary could potentially matter for transfer tax purposes is with respect to the estate tax inclusion period (“ETIP”) rules under Section 2642(f)(4) concerning the allocation of GST exemption. The ETIP rules could apply if the spouse holds a general power of appointment in excess of the *de minimis* exception under Section 2514(e). This narrow circumstance (which can be planned for in the PTC’s governing documents, or alternatively could be addressed narrowly in the Service’s guidance) does not justify excluding a DDC member from participating in the activities of the DDC with regard to any trust of which that DDC member’s spouse is a beneficiary.

<sup>3</sup> Alternatively, there could be two versions of the Service’s guidance: (i) one version that does not address the grantor trust rules, and (ii) a second version that attempts to harmonize the transfer tax rules with the grantor trust rules.

Accordingly, there should not be a prohibition imposed on a DDC member participating in the activities of the DDC with regard to a trust merely because the DDC member's spouse is a grantor or a beneficiary of such trust.

**3. A Member Of The DDC Should Not Be Precluded From Participating In The Activities Of The DDC With Respect To Any Trust That Has A Beneficiary To Whom That DDC Member's Spouse Owes A Legal Obligation Of Support**

The fact that a DDC member's spouse owes a legal obligation of support to a beneficiary does not, of itself, produce adverse estate, gift or GST tax consequences. Accordingly, there should not be any prohibition imposed on a DDC member participating in the activities of the DDC with regard to a trust merely because the DDC member's spouse owes a beneficiary a legal obligation of support.

**4. The IRS Should Clarify That The Safe Harbor Of Rev. Rul. 95-58 Has No Application For Estate, Gift And GST Tax Purposes With Respect To The Removal And Replacement Of Officers, Directors And Members Of The DDC**

One significant non-tax benefit of using a private trust company is to encourage family members to participate in trust governance within a framework that establishes appropriate checks and balances, yet is sufficiently flexible to adjust as may be warranted over several generations. Consistent with this objective, the Notice does not make any reference to the safe harbor of Rev. Rul. 95-58, which would require that the successor to a fiduciary who has been removed from office not be a related or subordinate party within the meaning of Section 672(c) to any person who has participated in the removal decision. It would be helpful if this were expressly stated. Accordingly, the Service should clarify that no adverse transfer tax consequences will be produced if a successor to an officer, director or member of the DDC who has been removed from office is a related or subordinate party within the meaning of IRC Section 672(c) to any person who has participated in the removal decision.

**5. The Prohibition On Participating In Decisions Of The DDC Should Be Confined To The Current Beneficiaries And Presumptive Remaindermen Of A Given Trust**

The Notice would prevent a member of the DDC from participating in activities of the DDC with regard to any trust of which that DDC member (or his or her spouse) is a beneficiary. How broad is the definition of a "beneficiary" for this purpose? For example, should a contingent beneficiary who will only receive trust property if all of the descendants of the grantor's parents are predeceased be considered a beneficiary for this purpose? How should a potential appointee of a power of appointment that may be exercised in favor of anyone other than the powerholder, his or her estate, his or her creditors or the creditors of his or her estate be treated? The universe of such potential appointees would be nearly unlimited.

We believe that the prohibition on participating in decisions of the DDC should be limited to current beneficiaries and presumptive remaindermen of the trust. Accordingly, remainder beneficiaries who are not presumptive remaindermen should be eligible to participate in discretionary distribution decisions. In addition, permissible appointees under a power of appointment should not be rendered ineligible by virtue of such status.

**6. Members Of The DDC Should Not Be Excluded From Participating In Distribution Decisions That The Governing Instrument Requires To Be Made In Accordance With An Ascertainable Standard Relating To A Beneficiary's Health, Education, Maintenance Or Support**

The Notice does not expressly allow members of the DDC to participate in decisions on distributions that are required to be made under the governing instrument in accordance with an ascertainable standard relating to a beneficiary's health, education, maintenance or support.<sup>4</sup> The law is clear, however, that a beneficiary-trustee who may exercise a discretionary power in favor of himself or herself that is limited by an ascertainable standard will not be deemed to possess a general power of appointment;<sup>5</sup> and that a transferor's reservation of a power as trustee to make distributions to beneficiaries pursuant to an ascertainable standard will not render a transfer to a trust incomplete for gift tax purposes<sup>6</sup> or cause estate tax inclusion in the transferor's gross estate.<sup>7</sup> Accordingly, the Service should clarify that DDC members need not be excluded from participating in decisions on distributions that are required under the governing instrument to be made in accordance with an ascertainable standard relating to a beneficiary's health, education, maintenance or support.

**7. The IRS Should Clarify Why Participation In PTC Personnel Decisions Such As Hiring, Firing, Promotion And Compensation Of Employees Is Limited To Officers And Managers Of The PTC, And Whether Members Of The DDC Are Deemed To Be Employees For This Purpose**

The proposed ruling would require "that only officers and managers of the PTC may participate in decisions regarding personnel of the PTC (including the hiring, discharge, promotion and compensation of employees)." The purpose of this requirement is unclear.

---

<sup>4</sup> The Notice, at page 16, states that "[t]he conclusions regarding the tax consequences of PTC as trustee of the Family trusts would not change even if . . . any of the discretionary distributions are made pursuant to a reasonably definite external standard provided in the trust instrument." The phrase "reasonably definite external standard" is taken from the grantor trust rules – specifically, Section 674(d). Although this language should be synonymous with an ascertainable standard for transfer tax purposes, the Service should clarify its intention.

<sup>5</sup> See I.R.C. §§ 2041(b)(1), 2514(c)(1).

<sup>6</sup> See Treas. Reg. § 25.2511-2(c).

<sup>7</sup> See *Jennings v. Smith*, 161 F.2d 74 (2d Cir. 1947).

Moreover, it is unclear whether members of the DDC are deemed to be employees for this purpose. Accordingly, the Service should clarify these points.

**8. The Service Should Clarify That Section 2036(b) Will Not Be Implicated Provided That The Transferor Is Prohibited Either By The State PTC Statute Or By The PTC's Governing Documents From Participating In Voting Shares Of Stock Of A Controlled Corporation**

The Notice requests comments on whether additional guidance is necessary where trust assets include stock in a controlled corporation.<sup>8</sup> We believe that such guidance is warranted, and that the Service should clarify that Section 2036(b) will not be implicated so long as the transferor is prohibited either by the state PTC statute or by the PTC's governing documents from participating in voting shares of stock of a controlled corporation. The revenue ruling should further provide that, in such case, the transferor shall *not* be deemed to have retained indirectly the right to vote shares of stock of a controlled corporation for purposes of Section 2036(b).

**9. The Service Should Clarify That Excluding The Insured From All Incidents Of Ownership With Respect To Life Insurance Will Avoid Estate Tax Inclusion Under Section 2042**

The Notice also requests comments on whether additional guidance is necessary where trust assets include life insurance.<sup>9</sup> We request the Service to provide that estate tax inclusion under Section 2042 will be avoided if the insured is prohibited either by the state PTC statute or by the PTC's governing documents from participating in any decision or the exercise of any power that would constitute an incident of ownership over life insurance for purposes of Section 2042.

**10. The IRS Should Clarify That The Principles Announced In The Notice Apply Not Only To Corporations, But Also To Other Entities, Including Limited Liability Companies**

The Notice assumes that the PTC will be formed as a corporation. However, PTCs may be formed not as corporations, but as other types of entities, including limited liability companies ("LLCs"). The IRS should clarify that the principles announced in its guidance will apply not only to corporations, but also to other entities, including LLCs.

**11. The IRS Should Clarify That The Presence Of Nonresident Aliens On The DDC, Or Their Acting In Other Capacities (e.g., As Officers, Directors Or Managers Of The PTC), Will Not, Of Itself,**

---

<sup>8</sup> See Notice at 17.

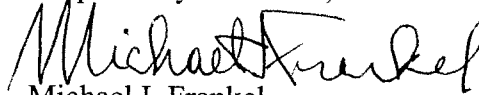
<sup>9</sup> See Notice at 17.

**Cause The Trust To Fail The “Control Test” As A U.S. Domestic Trust Under Section 7701(a)(30) Where The PTC Is Itself A Domestic Entity**

Finally, the Notice does not address whether the presence of nonresident aliens on the DDC, or their acting in other capacities (including as officers, directors or managers of the PTC), may have any effect upon whether a trust will satisfy the “control test” to be a U.S. trust under Section 7701(a)(30). The status of the PTC as a domestic entity should be dispositive, without regard to whether the PTC’s fiduciaries are comprised in whole or in part of non-U.S. persons. This approach would be consistent with the bright-line rule that Section 7701(a)(30) establishes for determining whether a trust is a domestic trust or a foreign trust for U.S. tax purposes. We request the Service to clarify that a PTC’s status as a U.S. domestic entity will be the inquiry under Section 7701(a)(30) without regard to the U.S. person or nonresident alien status of the PTC’s fiduciaries.

We recommend that any guidance published by the Service concerning PTCs clarify the issues as discussed above.

Respectfully submitted,



Michael I. Frankel

Chair, Estate and Gift Taxation Committee

*Contributing members:*

Kevin Matz

Jane Tse

Ronnie Ringel

Merrie J. Webel