

LEVIN SCHREDER & CAREY LTD

120 North LaSalle Street 38th Floor Chicago Illinois 60602  
TEL 312 332 6300 FAX 312 332 6393 www.levinschreder.com

November 17, 2008

Email: notice.comments@irs.counsel.treas.gov  
Internal Revenue Service  
Office of the Associates Chief Counsel  
(Passthroughs and Special Industries), CC:PSI  
Attn: Mary Berman, Room 5300  
1111 Constitution Avenue, NW  
Washington, DC 20224

Re: Notice 2008-63

Dear Ms. Berman:

We are providing comments to Notice 2008-63 (the "Notice") with respect to the tax consequences of participation by family members who are grantors and/or beneficiaries of trusts of which a private trust company ("PTC") will act as the trustee. We will not summarize the law and facts from the Notice. Unless otherwise provided herein, any capitalized terms used or other terms defined in the Notice have the same meanings herein. References herein to the "Code" mean the Internal Revenue Code.

1. Definition of Discretionary Distributions

The Notice describes the trustee's distribution authority under the trust agreements as "discretionary authority to distribute income and/or principal", and defines "discretionary distributions" as those that "are not mandated in the trust instrument or by applicable law." As an initial matter, the Notice does not state whether distributions under the trust agreements are the same as "discretionary distributions". Further, the Notice never states whether distributions subject to an ascertainable standard but exercisable in the discretion of the trustee are mandated by the trust instrument or are discretionary. Therefore, we suggest that a "discretionary distribution" be defined as a distribution which is not directed (as in, that all income be distributed) or is not limited by an ascertainable standard.

2. Limit on Trust Term

We do not think that there is a tax reason to limit the term of the trusts to the rule against perpetuities. Given that there are numerous jurisdictions which have extended or

abolished this rule, we suggest that this fact should either be eliminated or the Notice should describe why this fact is relevant to a specific tax issue.

3. GST Issue

It would be clearer for GST purposes to indicate the date that the original trusts were created. It seems that the trusts had to have been created before September 25, 1985 for the grandfathering issue to be raised, but that is not stated.

Although the Notice indicates that no trust's inclusion ratio is changed by the PTC acting as trustee, it would be helpful if the facts stated that A (who created the 2008 Trusts) allocated some or all of his or her GST exemption to such trusts.

4. Form of Entity for a PTC

Many states allow a PTC to be formed as a corporation or a limited liability company, and there does not appear to be any tax reason for limiting the treatment in the Notice to a corporation (except as described below with respect to the Amendment Committee). Therefore, we recommend that the Notice should either expand the description of the facts to include limited liability companies or clarify that comparable rules apply to other forms of entities.

5. Discretionary Distribution Committee and Amendment Committee

By delegating the power to make decisions on "discretionary distributions" to the DDC and the authority to modify the Tax Sensitive Provisions to an Amendment Committee, the Notice presumably seeks to replicate provisions which would limit the powers of a grantor or beneficiary acting as an individual trustee, but we believe the Notice does not completely accomplish this goal.

a) *Discretionary Distribution Committee*

Although the Notice provides that "discretionary distributions" are handled by the DDC and defines "discretionary distributions" as those that "are not mandated in the trust instrument or by applicable law", the Notice does not indicate whether distributions which are discretionary but limited by an ascertainable standard are handled by the DDC, the governing board or employees. Even if distributions are limited by an ascertainable standard, if a grantor acts as trustee or has the power to remove and replace the trustee with himself or a "Related Party" (which has the meaning provided under Code Section 672(c)) to the grantor, the trust will be includible in that person's estate under Code Section 2036 (see also, Rev. Rul. 95-58), and, depending on other terms of the trust, it may be a grantor

Internal Revenue Service  
Ms. Mary Berman  
November 4, 2008  
Page 3

trust for income tax purposes. The only limitations described in the Notice apply to persons serving on the DDC, but, in order to avoid inclusion of a trust in a grantor's estate, the Notice should provide that a person cannot participate in any distribution decisions involving trustee discretion from trusts created by that person, whether or not limited by an ascertainable standard. In order to avoid grantor trust status, although the rules are somewhat more complicated, they should apply in the same fashion as if an individual was acting as a trustee.

The definition of "discretionary distributions" also needs to be clarified for beneficiaries. Certainly a beneficiary can serve as individual trustee of a trust created by another person without causing the trust to be included in the beneficiary's estate under Code Section 2041 or a gift to occur under Code Section 2514 by making a distribution to another person, as long as the discretion is limited by an ascertainable standard. Therefore, beneficiaries should be able to participate in distribution decisions if the distribution standard is so limited.

Further, the Notice indicates that the governing documents of the PTC prohibit the Family from entering into reciprocal agreements regarding "discretionary distributions". This is certainly intended to comply with current law regarding reciprocal trusts. However, trusts can be considered "reciprocal" and included in a grantor's estate, regardless of whether the distributions from such trusts are limited by an ascertainable standard. In addition to such an agreement, grantors should be prohibited from participating in any distribution decisions from trusts created by that person and other trusts which could be considered reciprocal under current law.

The Notice does not appropriately address removal and replacement of members of the DDC. To avoid estate inclusion for a grantor or beneficiary (but only, as to a beneficiary, if distributions are not limited by an ascertainable standard), the grantor or beneficiary cannot remove and replace an existing trustee with a person who is a Related Party to the remover. Although the Notice provides that no grantor or beneficiary can participate in "discretionary distribution" decisions to herself, her spouse or persons dependent upon her for support, there are no other limitations on who can serve on the DDC. To address this, the Notice should also limit the manner in which DDC members are elected or removed. For example, the governing documents could provide that the DDC is elected by the non-Family members who serve on the board or that, if family members elect the members of the DDC, they do not have the power to remove them.

Finally, the Family members are prohibited from "participating in the activities of the DDC" rather than "participating in the discretionary distribution decisions of the DDC".

Internal Revenue Service  
Ms. Mary Berman  
November 4, 2008  
Page 4

By using “activities”, the question is whether this means not participating in discussions or not attending meetings at which a discussion occurs or something else. The use of “activities” is too vague and could lead to inadvertent violations. This reference should be clarified, and we recommend that it be changed to “distribution decisions not directed or limited by an ascertainable standard” because that would be more consistent with the same function that an individual trustee would serve. An individual trustee might have discussions about a distribution with numerous people, including the beneficiary and the beneficiary’s family, but the trustee would make the decision (assuming that there is no pre-arrangement with the trustee).

*b) Amendment Committee*

It is almost certain that no State law allows delegation of authority to modify the governing documents of an entity to persons who are not the owners of the PTC or members of the board. Although most states allow the board of directors of a corporation to have the authority to amend the bylaws, the shareholders can change that; and the operating agreement of a limited liability company can only be modified by the members. Unless options are provided, this provision could be practically unattainable.

One alternative is that the owners of the PTC agree not to change the Tax Sensitive Provisions in a manner that is inconsistent with those limitations except by unanimous agreement; the trust agreements could support this requirement if they contain provisions that are intended to reach the same tax results. Another option for a PTC operating as a corporation is that the by-laws require third parties to be included on the board and the governing documents provide that either (a) members of the family and Related Parties to the owners of the PTC who are board members cannot vote on changes to the Tax Sensitive Provisions or (b) any such changes may only be adopted if the third parties constitute a majority of the board members who vote in favor of such changes; of course, for a PTC formed as a limited liability company, this option would be unavailable. A third alternative, which would apply to either a corporation or limited liability company, is for the grantors and beneficiaries to adopt the Tax Sensitive Provisions as part of a family agreement related to the operations of the PTC; such agreement could only be changed by unanimous consent of the living grantors and beneficiaries and, if it is changed, the negative tax consequences are triggered.

An alternative to an Amendment Committee is for the owners of the PTC to be someone other than the family. For example, an irrevocable trust could be created for the benefit of any members of the Family, of which a person who is not a Family member is the trustee, to own the PTC (an “Owner Trust”). As long as the trustee of the Owner Trust

could never be a member of the Family or, if the Family could remove the trustee, they could only replace him or her with a corporate trustee or a person who was not a Related Party to any Family members, a separate Amendment Committee would be unnecessary because, by definition, the Family would not effectively control changes to the Tax Sensitive Provisions. Moreover, the trustee of the Owner Trust could be a Related Party to a Family member if the Family was not concerned about the grantor trust provisions of the Code or as long as no member of the Family had the power to remove and replace the trustee of the Owner Trust with another Related Party.

#### 6. Personnel Decisions

The Notice is confusing with respect to officers and managers of the PTC who have authority over “personnel decisions”. Although the Notice defines personnel decisions as including hiring, discharge, promotion and compensation of employees, it does not describe what actions employees can take. In particular, if employees do not have authority with respect to distribution decisions or do not serve on the DDC, control over employees is irrelevant for estate tax purposes.

If “personnel decisions” are intended to include deciding who would serve on the DDC, the Notice does not clearly state that. Even if that limitation was intended, the Notice allows Family members who are officers and managers to participate in personnel decisions, which would allow them to potentially remove and replace the persons who make distribution decisions without any limitation. In ruling on the grantor trust issue, the Notice provides that control over employees of the corporate trustee is significant under Code Section 672(c)(2) if the employees make “discretionary distribution decisions on behalf of the corporation”. While that is certainly true, the Notice does not state that employees are so involved. We suggest that the facts in the Notice provide that either employees are not involved in “discretionary distribution” decisions (whether limited by an ascertainable standard or not) or that grantors who want to avoid grantor trust treatment are not involved in personnel decisions.

#### 7. Former Spouses

It is unclear why former spouses are included in the definition of “Family”. Except in the limited situation where a former spouse has a legal obligation to support children or the other former spouse, there is no specific tax reason for prohibiting a former spouse from participating in discretionary distribution decisions. Former spouses are not included in the definition of a Related Party under Code Section 672, nor are there any provisions under Code Sections 2036, 2038 or 2041 which would cause inclusion of a trust in a person’s estate because a former spouse was acting as trustee. Therefore, although it might be

Internal Revenue Service  
Ms. Mary Berman  
November 4, 2008  
Page 6

unusual for a former spouse to be included on the board or the DDC of a PTC and there might be practical reasons for not including a former spouse, there is no tax reason for doing so.

8. Provisions Not Covered

There are a few provisions in the Code which are not addressed in the Notice. Examples are:

- i. In order to avoid inclusion of stock transferred by a person to a trust of which a PTC is acting as trustee in such transferor's gross estate under Code Section 2036(b), any such transferor serving on the board or in any other capacity within the PTC should be prohibited from participating in any decision with respect to such stock, if the corporation is a controlled corporation as to the transferor.
- ii. In order to avoid inclusion of a life insurance policy owned by a trust on the life of the transferor of such policy in his or her gross estate under Code Section 2042, any officer of a PTC should be prohibited from exercising any investment powers or other decisions which would constitute "incidents of ownership" under Code Section 2042 over any policies on his or her life.

For these and similar provisions, the Notice should provide a similar "look-through" rule for officers and employees of the PTC and members of the DDC as described for the grantor trust rules so that persons cannot hold powers that they could not hold as an individual trustee without causing estate tax inclusion.

9. Conclusion

We believe that the Notice has made substantial progress over the private letter rulings issues issued on the PTC topic. We respectfully request that the Service review these comments and take them into consideration in finalizing the Notice.

Very truly yours,

Levin Schreder & Carey Ltd.

By Carleen L. Schreder