

801.1(c)(3); 801.1(b); 801.1(c)(1)

May 6, 1999

Via Facsimile

Mr. Richard Smith
Premerger Notification Office
Bureau of Competition, Room 303
Federal Trade Commission
Sixth Street and Pennsylvania Avenue NW
Washington, D.C. 20580

Re: HSR Issue

Dear Mr. Smith:

Following up on our discussion yesterday, I wanted to set forth the facts and the issue that those facts present. In essence, the question is whether a irrevocable trust in which the settlor has no reversionary interest is nonetheless included within the settlor's "person" by reason of a limited power to appoint trustees.

An individual formerly held more than 50% of the voting securities of Corporation A. For estate planning purposes, the individual created a trust and transferred to that trust a sufficient number of shares to bring the individual's own holdings below the 50% mark. As a result, the individual holds approximately 49% of the voting securities of Corporation A. The trust holds approximately 21%. (The individual's spouse does not own any shares, and the couple's children are all adults.)

The trust is irrevocable, and the individual (whom I will now refer to as Settlor) has no power to modify or amend the trust. The Settlor has no reversionary interest in the trust. The Settlor is precluded from ever having any beneficial interest in the trust. The Settlor's spouse is the sole beneficiary during her lifetime; thereafter, the couple's children are the beneficiaries. The trust has three trustees, one of whom is the Settlor's spouse; the Settlor himself is not and legally cannot be a trustee. The Settlor does have, however, the power to appoint successor

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trustees (where an incumbent ceases to act or to qualify) and to remove trustees and appoint successors. The appointment power, however, is expressly limited. The trust document provides:

[Settlor] shall have the power at any time and from time to time to appoint a successor to any trustee who fails to qualify and ceases to serve and to remove any trustee then acting, but I shall have the duty to appoint a successor to any trustee that I remove. I shall not appoint, however, a trustee under this Paragraph who is a "related or subordinate party" to me within the meaning of Section 672(c) of the Internal Revenue Code.

Under Section 672(c) of the Internal Revenue Code, a "related or subordinate party" is defined as a "nonadverse party" who is not

- (a) the grantor's spouse if living with the grantor;
- (b) any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

26 U.S.C. § 672(c) (1997).¹¹

Thus, although the trust document grants a limited trust-appointment power, the Settlor's ability to control the trust through the trustee-appointment power is severely circumscribed. The Settlor can only appoint persons who fall outside a class of persons whose conduct the Settlor would be able to influence or control -- that is to say, the Settlor cannot appoint persons who are family members, direct employees, employees of corporations in which either the Settlor or the

¹¹ A "nonadverse party" is defined as anyone who is not an "adverse party," and an "adverse party" is a person who has "a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses with respect to the trust." It is not clear that anyone would qualify as an adverse party for purposes of appointment as trustee, but if there is such a person, by definition that adverse party has a "substantial" interest to protect and therefore presumably will act to protect that interest, regardless of the Settlor's wishes.

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trust have significant holdings, or a subordinate in a company in which the Settlor is an executive.²

The purpose for the transfer to the trust is to ensure that the transferred securities are not included within the Settlor's estate, and to ensure that the Settlor's estate does not control Corporation A (so that the shares held by Settlor's estate will be treated as a minority interest). To achieve these purposes, the trust must be administered for the benefit of current and future beneficiaries, and not for the benefit of Settlor. Likewise, the purpose of the limitation on the trust-appointment power is to ensure that the Settlor is deemed not to control the trust. If the Settlor were deemed to control the trust, then, for tax purposes, the trust would be ignored, with significant adverse estate tax consequences for the Settlor's estate and family.

It seems clear under 801.1(c)(2) that the trust "holds" voting securities of Corporation A, because the trust is irrevocable and the Settlor has no reversionary interest. That leaves open the possibility, however, that the Settlor is deemed to "control" the trust under 801.1(b)(2) if the limited appointment power is considered to be a "contractual power presently to designate 50% or more of the directors of a corporation, or in the case of unincorporated entities, of individuals exercising similar functions."

The Statement of Basis and Purpose notes that a trust is an "entity" and will also be a "person" under 801.1(a) "unless the trust is controlled by another entity." SBP, reprinted in 2 S. Axinn et al., Acquisitions under the Hart-Scott-Rodino Antitrust Improvements Act at p. B-29 (rev. ed. 1996). The SBP also states that since a trust does not issue voting securities, it can be controlled by another entity "only if the [other entity] has a contractual power, under the trust indenture, to designate the trustee or, if there is more than one, a majority of the trustees." *Id.* The commentary portion of Interpretation No. 82 in the ABA Premerger Notification Manual is to the same effect. The commentary notes that "the settlor's power to designate the trustee in establishing the trust does not confer control." The commentary also notes that "any third party having the power to designate or replace half or more of the trustees will control" (emphasis added).

² Indeed, the trust document actually limits the appointment power more than the statute requires. For some purposes, a "related or subordinate party" may act as trustee without adverse tax consequences, if it can be established by a preponderance of the evidence that such person is not "subservient" to the grantor. This trust document does not permit that kind of appointment.

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But the interpretation itself makes clear that a settlor is not deemed to "control" the trust even if he is currently serving as trustee -- and it would seem anomalous that a settlor who has a limited appointment power but is legally precluded from serving as trustee would be deemed to "control," whereas a settlor actually serving as trustee is deemed not to control. It is particularly anomalous here, where the purpose of the limitation is to ensure that the settlor does not "control" the trust (or Corporation A), albeit for purposes of a different statutory regime.

I understand that you wanted to reflect upon this issue before responding. I appreciate your assistance, and I look forward to speaking with you further.

Very truly yours,
[Redacted]

5/7/99 Called writer and advised that Premier
Office can and will only look at settlor's power to remove and
replace trustees of a trust. ~~and~~ Settlor has that power here and, thus,
controls trust and holds what trust holds. The IRS may say
settlor does not control if only certain types or trustees are (or are
not) appointed, but such position is not binding on the Premier
Office. (PS, NU, HO and TH agree in conclusion reached)

RR Smith