

Internal Revenue Service

Department of the Treasury

Index Number: 2055.09-01

Washington, DC 20224

Number: **200032010**
Release Date: 8/11/2000

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4-PLR-101030-00
Date:
May 5, 2000

Re:

Legend

Decedent =

State X =

Date 1 =

Date 2 =

Date 3 =

B =

Will =

Codicil =

Trust =

Trust Amendment =

Trustees =

Compromise Agreement =

Charity A =

Property M =

Property N =

y =

PLR-101030-00

- z =
- Cite 1 =
- Cite 2 =
- Cite 3 =
- Cite 4 =
- Cite 5 =
- Cite 6 =
- Cite 7 =
- Cite 8 =

Dear :

This is in response to your letter dated December 20, 1999, and subsequent correspondence, requesting a ruling that transfers of property to Charity A and other charitable organizations pursuant to a Compromise Agreement qualify for the estate tax charitable deduction under § 2055 of the Internal Revenue Code.

Facts

Decedent, a resident of State X, died testate on Date 1. Decedent’s brother, B, survived him and was designated the executor of his estate. Pursuant to Article Fifth, Section A of his will, Decedent bequeathed Property M to Charity A. After the satisfaction of numerous other specific bequests, Article Eight of Decedent’s will provides that the residue of Decedent’s estate passes to Trust, a revocable trust established by Decedent prior to his death, to be distributed in accordance with the terms of the Trust agreement.

Article Second of the Trust agreement directs the Trustees to distribute portions of the Trust property to various beneficiaries upon Decedent’s death. Pursuant to Article Second, Section E, after the satisfaction of these specific bequests the balance of Trust is to be divided among eleven charities, including a bequest of y percent of the Trust residue to Charity A.

After executing his will and the Trust agreement, Decedent became dissatisfied with Charity A and its management. On Date 2, Decedent asked the principal officer of his family corporation (who is not a lawyer) to draft a codicil to the will (Codicil) and amend Trust (Trust Amendment) to eliminate Charity A as a beneficiary.

PLR-101030-00

The Codicil made two important changes. First, Article Fifth, Section A of Codicil eliminated the gift of Property M to Charity A. Instead, Property M was devised “to my brother, B.” The Codicil provided no direction regarding the disposition of Property M in the event that B predeceased Decedent. Second, Article Fifth, Section C of Codicil devised Property N “to my brother, B, if he survives me, and in the event he does not survive me, then to the issue of my brother. . . .” Under the terms of the original will, Property N was not specifically bequeathed to any particular beneficiary and would have passed as part of the residuary to Trust, to be divided among the charities according to the percentages set forth in the Trust agreement.

The Trust Amendment made one important change. Article Eighth, Section E of the Trust Amendment eliminated Charity A’s y percent share of the Trust residue. Instead, this share was bequeathed to Decedent’s brother, B, or if Decedent’s brother did not survive Decedent, to B’s issue in equal shares.

Shortly after executing the Codicil and the Trust Amendment, Decedent died. Subsequent to his death, various issues have arisen with respect to the validity and interpretation of the Codicil and the Trust Amendment. With regard to the Codicil, the charitable residuary beneficiaries, including Charity A, contend that the provision governing the disposition of Property M should not be interpreted as giving beneficial ownership of Property M to B. Rather, the provision should be construed as a bequest to B, as executor, to designate the charitable recipient or recipients of such property. In support of this contention, Charity A notes that the language used by Decedent when he intended to make a beneficial gift to B always included words to the effect that if B did not survive Decedent, the gift was to pass to B’s children or issue. Article Fifth, Section A of Codicil did not include such language, but merely stated that Decedent devised Property M “to B.” The Codicil, however, also did not contain the general language utilized in the will when the Decedent desired B, as executor, to designate the beneficiaries of certain charitable bequests (e.g., “to the executor of Decedent’s estate, to be distributed as the executor may in his absolute discretion select”).

The estate has submitted an affidavit from the drafter of the Codicil supporting Charity A’s interpretation. The draftsman states that, based on his discussions with Decedent on Date 2, it was his understanding that Decedent intended Property M to pass to B, in his capacity as executor, to be distributed to the charitable recipient or recipients selected by B. Decedent did not intend that the property pass to B, outright, as the beneficial owner of such property. The affiant acknowledged that the language he used in the Codicil may not clearly reflect this intent.

Charity A has also contested the validity of the Trust Amendment. Charity A contends that the Trust agreement provides that Trust may only be amended by an instrument in writing delivered to the Trustees. In this case, the Trust Amendment was not delivered to the Trustees prior to the Decedent’s death, and the Trustees had no knowledge of the existence of the Trust Amendment prior to Decedent’s death. Additionally, the Trust Amendment incorrectly referenced an inoperative provision, a provision superseded by an earlier Trust amendment, as authority for Decedent’s power

PLR-101030-00

to amend Trust.

On Date 3, in an attempt to avoid expensive litigation and negative publicity, Charity A, the other residual charitable beneficiaries, and B executed a Compromise Agreement, conditioned upon a favorable ruling by the Internal Revenue Service, to settle the dispute. Under the terms of the Compromise Agreement, the Trust Amendment is declared invalid. Charity A will receive its original y percent share of the Trust residue. Charity A agrees, in a separate agreement referenced by the Compromise Agreement, to place the y percent residuary Trust share into an endowment account which limits Charity A's use of the Trust share to certain specific charitable purposes. In addition, the Compromise Agreement upholds the validity of the Codicil. However, Article Fifth, Section A of Codicil will be interpreted such that B does not receive beneficial ownership of Property M, but will designate, in his capacity as executor, the charitable recipient or recipients of Property M. Finally, B will receive Property N outright.

Law and Analysis

Section 2055(a) provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all transfers for charitable purposes.

Section 20.2056(c)-2(d)(2) of the Estate Tax Regulations provides that, if as a result of the controversy involving the decedent's will, or involving any bequest or devise thereunder, a property interest is assigned or surrendered to the surviving spouse, the interest so acquired will be regarded as having "passed from the decedent to the surviving spouse" only if the assignment or surrender was a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate. If the assignment or surrender was pursuant to an agreement not to contest the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse. This regulation is equally applicable for purposes of the charitable deduction.

In Ahmanson Foundation v. United States, 674 F.2d 761 (9th Cir. 1981), the court considered whether a marital deduction was allowable for property distributed to the decedent's spouse pursuant to a settlement agreement. Relying on Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the court concluded that a good faith settlement must be based upon an enforceable right under state law properly interpreted in order to qualify the property distribution as "passing" from the decedent for purposes of the federal estate tax marital deduction.

In the present case, in accordance with § 20.2056(c)-2(d)(2) and Ahmanson Foundation, a deduction is allowable under § 2055(a) to the Decedent's estate for the amounts paid to Charity A and other designated charities pursuant to the Compromise Agreement if:

(1) the Compromise Agreement was negotiated and is in settlement of a bona fide dispute;

PLR-101030-00

(2) the Compromise Agreement is the product of arm's length negotiations and is within the range of reasonable outcomes under the governing instrument and applicable state law; and

(3) the payments received by Charity A and the other designated charities as a result of the Compromise Agreement do not exceed what Charity A and the other designated charities would have been entitled to if their rights had been pursued in litigation.

Under State X law, when construing a will, the court must "ascertain the intent of the testator from the whole instrument, attributing due weight to all its language, and then give effect to that intent unless prevented by some positive rule of law. . . ." Cite 1. State X courts have also held that it is permissible to look at all the material circumstances in the light of which the will was executed in order to comprehend the sense and purpose of the language employed. Cite 2. See also, Cite 3 (where oral evidence was admitted for the purpose of showing that testator intended the remainder interest in a trust created under her will to pass to her three grandchildren); Cite 4 (where, in determining the identity of a legatee, extrinsic evidence of the conduct and declarations of the testator was admissible to show the testator's relation to, and state of feeling towards, any of the respective claimants of a legacy, so that the purpose and intention of the testator could be determined from the language of the will taken in connection with all the surrounding and attendant circumstances).

Under State X law, a valid trust once created cannot be revoked or altered except by the exercise (in strict conformity with the terms of such trust) of a reserved power to do so. Cite 5. In Cite 5, the trust settlor reserved the right to amend the trust by an instrument in writing acknowledged and delivered to the trustees. In that case, the amendments executed by the settlor were not acknowledged by the settlor before a public officer authorized by law to take acknowledgments, but were delivered and accepted by the trustees. The court held that the acknowledgment required under the terms of the trust could not be waived and the purported amendments were invalid. Cite 6. See also, Cite 7 (holding that where a trust instrument explicitly provides for a power and method of modification, that power must be exercised in strict conformity to its terms).

In the present case, we believe that State X law supports Charity A's objection that the Trust Amendment is invalid because it was not delivered to the Trustees as prescribed by the terms of the Trust agreement. Cite 8.

Regarding the proper construction of the Codicil, the language used to bequeath Property M to B neither clearly vested beneficial title in B, nor directed B, as executor, to designate the charitable recipient or recipients of Property M. However, affidavits submitted by the draftsman and B state that the Decedent intended Property M to pass to B, as executor, to designate the charitable recipient or recipients of such property. Further, Decedent's history of charitable giving (approximately z acres donated to Charity A by Decedent and B) supports such an interpretation. Accordingly, in view of

PLR-101030-00

State X law admitting extrinsic evidence when construing an instrument, we believe that a court could reasonably view the Codicil as passing Property M to B, as executor, to designate the charitable recipient or recipients of such property.

Based on the facts submitted and the representations made, we believe that the Compromise Agreement was negotiated in settlement of a bona fide contest regarding the validity and interpretation of the Codicil and the Trust Amendment. We also believe that the Compromise Agreement satisfies the requirements articulated in § 20.2056(c)-2(d)(2) and Ahmanson Foundation. Therefore, the y percent share of the Trust residue passing to Charity A and Property M passing to the charitable recipient or recipients selected by B qualify for the estate tax charitable deduction under § 2055.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed regarding whether the terms of the Compromised Agreement result in an act of self-dealing under § 4941.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the executor of Decedent's estate and an additional authorized representative.

Sincerely,
Assistant Chief Counsel
(Passthroughs and Special Industries)
By: Robert Honigman
Acting Assistant Branch Chief, Branch 4

Enclosure (1)
Copy for 6110 purposes