Internal Revenue Service **Department of the Treasury**

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Person to Contact:

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Refer Reply To:
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November 28, 2000

Legend: Taxpayer:
SSN:
$X:
Charity 1:
Charity 2:
Son:
Spouse:

Dear

We received the April 15, 2000, letter on behalf of Taxpayer requesting rulings concerning the federal income, gift, and estate tax consequences of the creation of a proposed charitable lead annuity trust. This letter responds to that request.

The facts and representations submitted are as follows. Taxpayer proposes to create Trust, an irrevocable trust intended to qualify as a charitable lead annuity trust. Trust will continue for a period of twenty (20) years from the date of the trust agreement, or, if later, until the death of the survivor of Taxpayer and Taxpayer's wife.

During the term of Trust, it will distribute a fixed annual annuity in the amount of $X, in the following proportions: one-sixth (1/6) to Charity 1 and five-sixths (5/6) to Charity 2.

Article 4.01 (01) of Trust provides that the trustee is to pay one-sixth of $X to Charity 1 and five-sixths of $X to Charity 2, in equal semiannual installments payable on the last day of June and December of each such taxable year.

Article 4.2 of Trust provides that when Trust terminates, all remaining assets are to be allocated as follows:

(01) Eighty percent (80%) is to be allocated to Taxpayer's then living children and to the then living issue of any child of Taxpayer who is then deceased, by right of representation. Further, each share allocated to a then living child of Taxpayer is to be paid over and distributed to that child, outright and free of trust. Each share allocated to a grandchild or more remote issue of Taxpayer is to be held as a separate trust named for the grandchild or other issue of the

Taxpayer for whose benefit it is so allocated, to be administered and distributed as provided in accordance with Article V of Trust.

(02) Twenty percent (20%) (or all if none of the persons described in subsection 4.02(01) are then living) is to be allocated to Taxpayer's wife's then living children and to the then living issue of any child of Taxpayer's wife who is then deceased, by right of representation; provided, however, that if Taxpayer's wife's son, Son, is not then living but his present wife, Spouse, is then living and was married to Son at the time of his death, the share of the remaining assets of Trust that would have been allocated to Son had he been living is to instead be allocated to Spouse and she is to be deemed to be a child of Taxpayer's wife for purposes of Section 4.2 and 5.1 of Trust; and, provided further that if a share is so allocated to Spouse, no share is to be allocated, by right of representation, to any then living issue of Son. Each share so allocated is to be held as a separate trust named for the child or other issue of Taxpayer's wife for whose benefit it is so allocated, to be administered and distributed as provided in Article V.

The trustee is an individual unrelated to Taxpayer and Taxpayer's spouse. Taxpayer has no authority to remove a trustee, but can appoint a successor trustee. Neither Taxpayer nor Taxpayer's spouse may serve as trustee.

The trust agreement contains the following relevant provisions:

Article 1.1 of Trust provides that other than the property being transferred upon the execution of Trust, no additions may be made to the trust.

Article 2.1 of Trust provides that Taxpayer is to have no reversionary interest in either the principal or the income from any trust established under the trust agreement.

Article 2.2 of Trust provides that the agreement and the trusts created under it are irrevocable, and neither the Taxpayer nor any other person will have the power to revoke, modify or amend the agreement or any trust created under it in any respect.

Article 4.01 (02) of Trust provides that notwithstanding anything in the agreement to the contrary, while the trust exists, no income or principal will be distributed (other than for good and valuable consideration) to or for the benefit of any person or entity other than an organization described in each of §§ 170(c), 2055(a), and 2522(a). If Charity 1 or Charity 2 fails to qualify as an organization described under any of said sections when any annual annuity is to be distributed to such organization, the trustee is to distribute such annual annuity to one or more organizations described in each of said sections. The selection of such one or more organizations, and the share of such annual annuity which any such organization is to receive, is to be in the trustee's sole and absolute discretion.

Article 4.1 (04) of Trust provides that each payment of the annual annuity is to be made first from income. To the extent that income of Trust is not sufficient, payment of the annual annuity is to be made from principal. The income of the trust distributed in satisfaction of the

annual annuity is to consist of the same proportion of each class of income of the trust as the total of each class of income bears to the total of all classes of income of the trust for such taxable year Any income of the trust for any taxable year in excess of the annual annuity for such year is to be added to the principal of the trust estate.

Article 7.1 of Trust provides that notwithstanding anything within the agreement to the contrary, nothing within the agreement is to be construed or interpreted in a manner that, during the Taxpayer's lifetime, will cause the trust income to be considered the Taxpayer's income for federal income tax purposes or that, on Taxpayer's death, will cause any of the trust assets to be included in the gross estate for federal estate tax purposes.

Article 7.1(01) provides that neither the Taxpayer nor any other person, including the Trustee, will have the power to dispose of the beneficial enjoyment of the principal of a trust or the income therefrom, except as specifically provided in the agreement.

Article 7.1(02) provides that neither the Taxpayer nor any other person may purchase, exchange, or otherwise deal with or dispose of any part of the principal of a trust under the agreement or any income from the trust for less than adequate consideration in money or money's worth.

Article 7.1(03) provides that neither the principal nor the income of a trust under the agreement will be loaned to the Taxpayer or the Taxpayer's spouse, directly or indirectly, without adequate interest or adequate security.

Article 7.1(04) provides that no part of the income of a trust may be: (a) distributed to the Taxpayer or the Taxpayer's spouse; (b) held or accumulated for future distribution to the Taxpayer or the Taxpayer's spouse; or, (c) applied to the payment of premiums on policies of insurance on the life of the Taxpayer or the Taxpayer's spouse.

Article 8.8 provides that if at any time while the Taxpayer is living the office of trustee of any trust under the agreement is vacant, and no successor trustee has been appointed as provided in the agreement, the Taxpayer will appoint an individual(s) (other than the Taxpayer or the Taxpayer's spouse), bank or trust company, or any combination thereof, as the successor trustee of such trust.

Article 8.9 prohibits the trustee from any act of self-dealing (as defined in § 4941(d)), prohibits the trustee from making any taxable expenditures as provided in § 4945(d), prohibits the trustee from making, acquiring, or retaining any investments which jeopardize the charitable purpose of Trust as defined in § 4944, and prohibits the trustee from retaining any excess business holdings within the meaning of § 4943. The trustee will make distributions in such time and manner so as not to subject the trust to tax under § 4942.

Taxpayer is a member of the board of directors of Charity 1, and is presently serving as Vice-Chair of Charity 1. In addition, Taxpayer is president and serves as a member of the board of directors of Charity 2.

It is represented that prior to establishing Trust, the bylaws of Charity 1 and Charity 2 will be amended to provide that any funds received from Taxpayer will be segregated and held in a separate fund. The separate fund will be administered and distributed by a separate fund committee consisting of one or more members of the board of directors, other than Taxpayer. The members of the board of directors serving on such separate fund committee will be selected by the board of directors, other than the Taxpayer. Taxpayer will have no right to vote or otherwise participate in any decisions relating to the composition of the separate fund committee, the administration of the separate fund, or the use or distribution of any of the principal of or income from such fund. In addition, Taxpayer will have no right to participate in any decision relating to amendments to the governing instruments of the organization which would alter the changes described above or otherwise affect the separate fund or the separate fund committee.

The following rulings are requested:

(1) Trust will qualify as a charitable lead trust, the funding of which will result in a completed gift for gift tax purposes under §§ 2501 and 2511 of the Code and will entitle Taxpayer to a gift tax charitable deduction under § 2522 of the Code based on the actuarial value of the guaranteed annual annuity payable from the Trust;

(2) No portion of the principal of Trust will be included in Taxpayer's gross estate for federal estate tax purposes under §§ 2035, 2036, or 2038 of the Code upon Taxpayer's death;

(3) Trust will not be treated as a grantor trust for income tax purposes under §§ 671 through 677 of the Code and no portion of the income of Trust will be taxable to Taxpayer; and,

(4) Trust will be allowed a deduction under § 642(c) for amounts of gross income paid to Charity 1, Charity 2, or such other charitable beneficiaries described in § 170(c) of the Code during the taxable year.

LAW AND ANALYSIS

Ruling Request 1:

Section 2501 imposes a tax on the transfer of property by gift by any individual. Section 25.2511-1(a) of the Gift Tax Regulations provides that the gift tax applies to every kind of transfer by way of gift, whether direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(a) provides that the gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee at the time of the transfer. The tax is a primary and personal liability of the donor, is an excise upon the act of making the transfer, is measured by the value of the property passing from the donor, and attaches at the time the property passes, regardless of the fact that the identity of

the donee may not then be known or ascertainable.

Under § 25.2511-2(b), a gift is complete and subject to the gift tax when the donor has so parted with dominion and control over the property transferred as to leave in the donor no power to change its disposition, whether for the donor's own benefit or for the benefit of another.

Section 25.2511-2(c) provides that a gift is incomplete to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries.

Under § 25.2511-2(e), a donor is considered to have a power if it is exercisable by the donor in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property, such as a trustee.

Section 2522(a) provides that, in computing the taxable gift each year, there is allowed a deduction for: 1) all gifts to or for the use of federal or other government entities for exclusively public purposes, 2) all gifts to or for the use of a corporation or trust operated exclusively for religious, charitable, scientific, literary, or educational purposes, or 3) certain transfers to fraternal or veterans organizations.

Section 2522(c)(2)(B) provides that, where a transfer is made to both a charitable and noncharitable person or entity, no deduction shall be allowed for the charitable portion of the gift, in the case of any interest other than a remainder trust, unless the interest is in the form of a guaranteed annuity or is a fixed percentage distributed annually of the fair market value of the property determined on an annual basis.

Section 25.2522(c)-3(c)(2)(vi) provides that the term "guaranteed annuity interest" means an irrevocable right, pursuant to the instrument of transfer, to receive a guaranteed annuity. A guaranteed annuity is an arrangement under which a determinable amount is paid periodically (but not less often than annually) for a specified term or for the life or lives of a named individual or individuals, each of whom must be living at the date of the gift and can be ascertained at such date. An amount is determinable if the exact amount which must be paid under the conditions specified in the instrument of transfer can be ascertained as of the date of the gift.

Section 25.2522(c)-3(c)(2)(vi)(e) contains a further requirement for a guaranteed annuity interest in trust if the present value on the date of gift of all the income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all amounts in the trust. Under these circumstances, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument prohibits both the acquisition and the retention of assets which would give rise to a tax under § 4944 if the trustee had acquired the assets.

Under § 25.2522(c)-3(c)(2)(vi), the amount of the deduction for a guaranteed annuity interest in trust is limited to the fair market value of the guaranteed annuity interest as determined under § 25.2522(c)-3(d)(2)(iv). Under § 25.2522(c)-3(d)(1), the fair market value of an annuity is its present value, and, under § 25.2522(c)-3(d)(2)(iv), the present value of a guaranteed annuity

interest in trust is to be determined under § 25.2512-5.

In the present case, for purposes of § 25.2511-2(b), the Taxpayer will retain no power over the property he contributes to Trust. The Taxpayer retains no interest or reversion in the trust and no right to alter, amend, or revoke Trust. Neither the Taxpayer nor the Taxpayer's spouse can serve as trustee of the trust. In addition, the Taxpayer holds no general power of appointment over the property of the trust. Further, although the Taxpayer is a member of the board of directors and Vice-chair of Charity 1 and is president and a member of the board of directors of Charity 2, the by-laws of Charities 1 and 2 will be revised so that any funds received from the trust will be segregated and held in a separate fund. This separate fund will be administered and distributed by a separate fund committee, and the Taxpayer will have no power over the separate fund or the separate fund committee. Accordingly, we conclude that, provided the by-laws of Charities 1 and 2 are amended prior to the funding of Trust, the funding of Trust will result in a completed gift for federal gift tax purposes under §§ 2501 and 2511.

The annuity payable under the proposed terms of Trust satisfies the requirements of § 25.2522(c)-3(c)(2)(vi) and, therefore, will be a guaranteed annuity for purposes of § 2522(c)(2)(B).

Accordingly, based on the facts submitted and the representations made, we conclude that Trust will qualify as a charitable lead trust, the funding of which will result in a completed gift for federal estate tax purposes under §§ 2501 and 2511 and will entitle the Taxpayer to a gift tax charitable deduction under § 2522, based on the actuarial value of the guaranteed annuity payable to Charities 1 and 2 from Trust.

Ruling Request 2:

Section 2033 provides for the inclusion in the gross estate of any property in which the decedent had an interest at the time of his death.

Section 2035(a)(2) provides that only transfers of property that would have been included under §§ 2036, 2037, 2038, or 2042 are includible in the gross estate if these transfers are made within three years of death. Other transfers made within three years of death are not includible in the gross estate. Sections 2036, 2037, and 2038 provide for the inclusion in the gross estate of the property of which the decedent has made a transfer and in which the decedent has either retained an interest in the property or a power over the property. Section 2042 provides for the inclusion in the gross estate of the proceeds of life insurance over which the decedent has retained any incidents of ownership.

In the present case, the Taxpayer proposes to create an irrevocable charitable lead annuity trust. A fixed amount will be distributed annually from Trust to qualified charitable organizations during the trust term. Thereafter, the corpus and remaining income will be divided among the Taxpayer's then-living issue and Taxpayer’s Wife’s then-living issue, by right of representation. The Taxpayer retains no interest or reversion in the trust and no right to alter, amend, or revoke the trust. The Taxpayer cannot serve as trustee of the trust. In addition, the Taxpayer holds no

general power of appointment over the property in the trust.

Accordingly, based on the facts submitted and the representations made, no portion of the principal of Trust will be included in the Taxpayer's gross estate for federal estate tax purposes under §§ 2035, 2036, or 2038, at the Taxpayer's death.

Ruling Requests 3 and 4:

Section 671 provides, in general, that if the grantor is treated as the owner of any portion of a trust, his taxable income and credits shall include the income, deductions, and credits of the trust attributable to that portion of the trust to the extent that these items are considered in computing the taxable income or credits of an individual.

Sections 673 through 677 specify the circumstances under which the grantor will be regarded as the owner of a portion of a trust. Our examination of the trust agreement reveals none of the circumstances that would cause the Taxpayer to be treated as the owner of any portion of the Trust under §§ 673, 674, 676, or 677.

Under § 675 and the applicable regulations, the grantor is treated as the owner of any portion of a trust if under the terms of the trust agreement or circumstances attendant on its operation, administrative control is exercised primarily for the benefit of the grantor rather than the beneficiary of the trust.

Regarding § 675, our examination of the proposed trust agreement reveals none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the Taxpayer. Thus, the circumstances attendant on the operation of the Trust will determine whether the Taxpayer will be treated as the owner of any portion of the Trust under § 675. This is a question of fact, the determination of which must be made by the Internal Revenue Service office having examination jurisdiction over the parties' tax returns.

The proposed Trust agreement provides for the payment of specified annuity amounts to two corporations qualifying as charitable organizations under §§ 170(c), 2055(a), and 2522(a). In the event either corporation ceases to exist or no longer qualifies as a charitable organization under the Code, the trustee shall distribute the annuity amount payable to that corporation to one or more other qualifying charitable organizations selected by the trustee in his sole discretion. The income of the Trust distributed as annuity amounts shall consist of the same proportion of each class of income of the Trust as the total of each class of income bears to the total of all classes of income of the Trust for that tax year.

Section 642(c)(1) provides in the case of an estate or trust that there is allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170(a), relating to the deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the tax year, paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)). If a charitable contribution is paid after the close of that tax year and on or before the final day of the

tax year following the close of that tax year, then the trustee or administrator may elect to treat the contribution as paid during that tax year.

Section 1.642(c)-3(b)(2) of the Income Tax Regulations provides that, in determining whether the amounts of income so paid, permanently set aside, or used for a purpose specified in § 642(c)(1), (2), or (3) include particular items of income of an estate or trust not included in gross income, the specific provision controls if the governing instrument specifically provides as to the source out of which amounts are to be paid, permanently set aside, or used for such purpose. In the absence of specific provisions in the governing instrument, an amount to which § 642(c)(1), (2), or (3) applies is deemed to consist of the same proportion of each class of the items of income of the estate or trust as the total of each class bears to the total of all classes.

Section 681 provides that, in computing the deduction allowable under § 642(c) to a trust, no amount otherwise allowable under § 642(c) as a deduction shall be allowed as a deduction with respect to income of the tax year which is allocable to its unrelated business income for that year. For purposes of the preceding sentence, the term "unrelated business income" means an amount equal to the amount which, if the trust were exempt from tax under § 501(a) by reason of § 501(c)(3), would be computed as its unrelated business taxable income under § 512 (relating to income derived from certain business activities and from certain property acquired with borrowed funds).

Except to the extent that the trust has unrelated business income within the meaning of § 681, the trust will be allowed deductions under § 642(c)(1) for amounts of gross income paid out to charitable beneficiaries described in § 170(c) during the tax year, or by the close of the following tax year if the trustee so elects under § 1.642(c)-1(b). Because the deduction under § 642(c)(1) is limited to amounts of gross income, no deduction will be allowed for a distribution of an amount of trust principal except to the extent that the amount distributed has been included in the trust's gross income and provided no deduction was allowed for any previous tax year for the amount distributed.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
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50-14362R

Enclosures:
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