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Department of the Treasury

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Washington, DC 20224

Person to Contact:

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Refer Reply To:  
CC:PSI:2 - PLR-122437-00  
Date:  
October 23, 2001

Trust =

Spouse =

Donor =

Charity A =

Charity B =

D1 =

D2 =

D3 =

x =

y =

z =

w =

Dear :

This responds to your letter dated October 19, 2000, and subsequent correspondence, submitted on behalf of Trust and Donor, requesting rulings under §§ 170, 2522, and 664 of the Internal Revenue Code on the income and gift tax consequences of the contribution of a portion of an interest in a trust (Trust) to a charitable remainder beneficiary of Trust.

The information submitted states that on D1, Spouse created what is represented to be a charitable remainder unitrust (CRUT) as described in § 664(d)(2) and (d)(3). Annually, Trust is to pay to Spouse during his life and then to Donor, if the Donor survives, for her life, a unitrust payment equal to the lesser of: (1) x percent of the net fair market value of the assets of Trust valued annually, (unitrust amount); or (2) the net income of Trust during that year. In any year that Trust has net income that

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exceeds the x percent unitrust amount, the excess income will be distributed to the unitrust beneficiary to the extent that the aggregate amounts paid to the beneficiary in prior years is less than the aggregate unitrust amounts prescribed for those years. Any income that exceeds the payments to the beneficiary will be added to principal.

Upon the death of the survivor of Spouse and Donor, Trust will terminate and the principal and income is to be distributed as follows: (1) y to Charity A; (2) z to Charity B; and (3) z to such one or more organizations described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) as may be selected.

Spouse died on D2. On D3, Charity B asked Donor for help with its immediate funding needs. To accommodate this request, Donor proposes to transfer to Charity B (not in trust) an undivided w portion of her unitrust interest. Donor will transfer all right, title, and interest in and to a w fractional share of the unitrust payments from Trust. This undivided portion consists of a fraction of each and every substantial right owned by Donor in the unitrust interest and will extend over the entire period of time that Donor's interest extends. Charity A, the other fixed charitable remainder beneficiary of Trust, will consent to the transfer.

Donor represents that under local law, the undivided w portion that Donor proposes to transfer to Charity B (not in trust) will merge with w of Charity B's remainder interest in Trust. Donor and Charity B will consent to the termination of w of Trust, and a w interest in Trust assets will be distributed to Charity B.

Donor represents that when Spouse created Trust, Spouse did not intend to divide the income and remainder interests in order to avoid the rule against contribution of partial interests under § 170(f).

In connection with the proposed transaction described above, Donor requests a ruling that she will be entitled to deductions under §§ 170 and 2522 for the value of the undivided w interest in the unitrust payment transferred to Charity B. In addition, Donor requests a ruling as to the value of the gift under §§ 170 and 2522. Trust requests a ruling that Donor's gift of the undivided w interest in Trust will not cause Trust to cease to be a CRUT under § 664(d)(2).

Section 170(a)(1) provides that there shall be allowed as a deduction any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year.

Section 170(f)(3)(A) provides that a contribution (not made by a transfer in trust) of less than the taxpayer's entire interest in property is not allowed as a charitable contribution deduction except to the extent such contribution would have been allowed as a deduction had it been transferred in trust.

Section 170A-7(a)(2)(i) of the Income Tax Regulations provides that a deduction

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is allowed for a contribution of a partial interest in property if such interest is the taxpayer's entire interest in the property, such as an income interest or a remainder interest. If, however, the property in which such partial interest exists was divided in order to create such interest and thus to avoid § 170(f)(3)(A), the deduction will not be allowed.

Section 170(f)(3)(B)(ii) provides that § 170(f)(3)(A) does not apply to a contribution of an undivided portion of the taxpayer's entire interest in property. Section 1.170A-7(b)(1) provides that an undivided portion of a taxpayer's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the taxpayer in the property and must extend over the entire term of the taxpayer's interest in the property.

In Rev. Rul. 86-60, 1986-1 C.B. 302, the Service considered whether donations of an annuity interest in a charitable remainder annuity trust (CRAT) to the remainder beneficiary of the CRAT qualify for charitable contribution deductions under §§ 170 and 2522. In Situation 1 of the ruling, the grantor, A, created a CRAT described in § 664(d)(1), and retained the annuity interest for life. The remainder beneficiary was a charitable organization described in §§ 170(c) and 2522. Four years later, A transferred the annuity interest in the CRAT to the remainder beneficiary. Rev. Rul. 86-60 concludes, *inter alia*, based partly on § 1.170-7(a)(2)(i), that the gift by A to the charity of A's annuity interest in the CRAT qualifies for a charitable contribution deduction under § 170.

The present case is analogous to Rev. Rul. 86-60. Here, Spouse retained a unitrust interest when he created Trust. Spouse did not divide his interest in the property to avoid the rule against contribution of partial interests. Upon Spouse's death, Donor became entitled during her lifetime to the unitrust interest. Although the present case involves a contribution (not in trust) of an undivided portion of a unitrust interest instead of all of the unitrust interest, §§ 170(f)(3)(B)(ii) and 1.170A-7(b)(1)(i), allow a charitable contribution deduction for such a contribution (not in trust). Accordingly, based solely on the facts submitted and representations made, including the representation that under local law, Donor's undivided w portion of her unitrust interest transferred (not in trust) to Charity B merges with w of Charity B's remainder interest, we conclude that Donor's transfer of an undivided portion of the unitrust interest will qualify for a charitable contribution deduction under § 170.

Section 2522(a) provides that, in computing taxable gifts for the calendar 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 25.2522(c)-3(c)(1)(i) of the Gift Tax Regulations provides that if, after July 31, 1969, a taxpayer transfers an interest in property for charitable purposes and

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either retains or transfers an interest in the same property for private purposes, no deduction is allowed under § 2522 for the value of the interest which is transferred for a charitable purposes unless the interest in property is a “deductible interest” described in § 25.2522(c)-3(c)(2).

Section 25.2522(c)-3(c)(2)(i) states, in part, that a deductible interest is a charitable interest interest in property that is:

[A]n undivided portion, not in trust, of the donor’s entire interest in the property. An undivided portion of the donor’s entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in such property and must extend over the entire term of the donor’s interest in such property and in other property into which such property is converted. For example, if the donor gave a life estate in an office building to his wife for her life and retained a reversionary interest in the office building, the gift by the donor of one-half of that reversionary interest to charity while his wife is still alive will not be considered the transfer of a deductible interest; because an interest in the same property has already passed from the donor for private purposes, the reversionary interest will not be considered the entire interest in the property. If, on the other hand, the donor had been given a life estate in Blackacre for the life of his wife and the donor had no other interest in Blackacre on or before the time of the gift, the gift by the donor of one-half of that life estate to charity would be considered the transfer of a deductible interest; because the life estate would be considered the donor’s’s entire interest in the property, the gift would be an undivided portion of such entire interest.

In Rev. Rul. 79-295, 1979-2 C.B. 349, A created an intervivos trust, the terms of which provided for the trust income to be paid to B for B’s life, and upon B’s death, the remainder was to be paid to C. The remainder interest was the only interest that C ever possessed in the trust property. C subsequently conveyed one-half of the remainder interest to a qualified charitable organization. The ruling concludes that the transfer to the charitable organization by C of an undivided portion of C’s entire interest that was not made in further trust, qualified for a charitable deduction, because C’s only interest in the trust property was the remainder interest given to C by A and C had no other interest in the trust property on or before the time of the gift.

In Situation 2 of Rev. Rul. 86-60, supra, A created a CRAT, retaining the annuity interest for life. Upon A’s death, the annuity interest was to be paid to B, and upon the death of the survivor of A and B, the remainder would pass to a qualified charitable organization. A and B subsequently assigned their interests to the charitable remainder beneficiary. The ruling concludes, inter alia, that B’s transfer to the charitable remainder beneficiary qualifies for the gift tax charitable deduction under § 2522 because, following the transfer, B did not retain any interest in the trust and, at no time,

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had B made a transfer of an interest in the trust for a private purpose.

In the present case, Spouse established Trust. Donor's only interest in Trust has been that of a successor beneficiary of the unitrust interest on Spouse's death. Donor has never had any other interest in Trust and at no time has Donor made a transfer of an interest in trust property for a private purpose. In addition, Donor's proposed transfer is not a transfer in further trust. Rev. Rul. 79-295, supra. Accordingly, Donor's proposed transfer of all right, title, and interest that she owns in w of the unitrust interest is a transfer (not in trust) of an undivided portion of Donor's entire interest in the property under § 25.2522(3)-3(c)(2)(i). Therefore, based solely on the facts submitted and representations made, including the representation that Trust qualifies as a CRUT, as described in § 664(d)(2) and (d)(3), we conclude that the present value of the undivided w interest in the unitrust payment transferred by Donor to Charity B will qualify for a charitable deduction under § 2522, for federal gift tax purposes.

Section 25.2522(c)-3(d)(1) provides that the amount of deduction in the case of a contribution of a partial interest in property is the fair market value of the partial interest on the date of the gift.

Section 1.170A-7(c) provides in part that the amount of the deduction under § 170 in the case of a charitable contribution (not in trust) of a partial interest in property to which § 1.170A-7(b) applies is the fair market value of the partial interest at the time of the contribution. See § 1.170A-1(c). Section 1.170A-7(b)(1) pertains to a gift of an undivided portion of a donor's entire interest. Section 1.170A-7(c) further provides that the fair market value of such a partial interest must be determined in accordance with § 20.2031-7 of the Estate Tax Regulations.

The valuation methodology set forth under § 20.2031-7(d) is the same methodology described under § 664 for valuing unitrust interests for income tax purposes and under § 2512 for valuing income interests for gift tax purposes.

In the present case, Donor is entitled to receive the lesser of: (1) x percent of the fair market value of the trust corpus, determined annually; or (2) the net income of Trust for that year, paid annually. Donor will transfer an undivided w portion of this interest to Charity A. Thus, the income and gift tax charitable deduction allowable is w of the lesser of: (1) the present value, as of the date of transfer, of the right of Donor to receive annually for life an amount equal to x percent of the net fair market value, determined annually, of the trust corpus, determined in accordance with § 25.2522(c)-3(d)(2)(v) and § 1.664-4(e) of the Income Tax Regulations; or (2) the present value, as of the date of the transfer, of the right to receive trust income for Donor's life, determined in accordance with § 25.2512-5(d)(2)(iii).

Section 1.664-3(a)(4) provides that the governing instrument may provide that any amount other than the unitrust amount shall be paid (or may be paid in the discretion of the trustee) to an organization described in § 170(c) provided that, in the case of distributions in kind, the adjusted basis of the property distributed is fairly

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representative of the adjusted basis of the property available for payment on the date of the payment.

The regulations thus authorize the current distribution of unitrust assets to a charitable organization. In this case, it is represented that under local law, upon Donor's transfer of an undivided w portion of her unitrust payment to Charity B, Charity B's interest in the unitrust payment and w of its interest in the remainder of the unitrust will merge. Although a partial termination of Trust will occur, Trust will continue to be in the form of, and will function as a CRUT within the meaning of § 664(d)(2). Accordingly, based solely on the facts submitted and representations made, we conclude that the gift of the undivided partial interest in the unitrust will not cause Trust to cease to be a trust described in § 664(d)(2).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the proposed transaction described above under any other provision of the Code. In particular, we express no opinion as to whether local law requirements for merger will be satisfied. We also express no opinion as to whether Trust qualifies as a CRUT. A copy of this ruling should be attached to Donor's federal income and gift returns for the tax years affected.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Donor and Trust.

Sincerely yours,  
Shannon Cohen  
Assistant to the Branch Chief, Branch 2  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2  
Copy of this letter  
Copy for § 6110 purposes