Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B04- PLR-100156-01
Date:
MAY 17, 2002

Re:

LEGEND:

Decedent	=
Trust	=
Successor Co-Trustees	=
Beneficiary 1	=
Beneficiary 2	=
Beneficiary 3	=
Charity 1	=
Charity 2	=
Date 1	=
Date 2	=
Date 3	=
State	=
Court	=

Dear :

This letter is in response to your letter of December 18, 2001, requesting the following rulings regarding a proposed reformation of a charitable trust agreement:

1. The proposed reformation will constitute a “qualified reformation” within the meaning of section 2055(e)(3)(B) of the Internal Revenue Code.

2. The separate reformed trusts for Beneficiary 1 and Beneficiary 2, as reformed, will each meet the requirements of a charitable remainder unitrust under section 664(d)(2).

3. A federal estate tax charitable deduction will be allowed under section 2055(a) based upon the present value of the charitable remainder interests provided for under the Beneficiary 1 and Beneficiary 2 unitrusts, as reformed.

4. A federal estate tax charitable deduction will be allowed under section 2055(a) equal to the full value of the property passing to the separate trusts for Charity 1 and Charity

2, as reformed.

FACTS:

Decedent died testate on Date 1. The Trust Agreement, as amended, contains the following provisions:

> Article III C 1 – Upon the Settlor's death, the Trustee shall pay to, or apply for the benefit of her nieces, Beneficiary 1, Beneficiary 2 and Beneficiary 3, and two charities, Charity 1 and Charity 2, in equal shares, all the net income of the residue, payable no less often than annually. Upon the death of any individual beneficiary, the income payments shall be made in equal shares to the surviving named beneficiaries.
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> Article III C 2 – On the death of the last to survive of Beneficiary 1, Beneficiary 2 and Beneficiary 3, the Trust shall terminate and be distributed, in equal shares, to Charity 1 and Charity 2.
>
> Article III C 3 – If prior to distribution of the residue, either Charity 1 or Charity 2 cease to exist or cease to qualify as a tax exempt charitable organization with the Internal Revenue Service, all income to that organization shall immediately cease and the income shall be divided, pro rata, between the remaining beneficiaries. On the death of the last to survive of Beneficiary 1, Beneficiary 2 and Beneficiary 3, the residue shall be distributed solely to the organization that is existing and qualifying as a tax-exempt charitable organization. If both charities cease to exist or cease to qualify as a tax-exempt charitable organization with the Internal Revenue Service, the residue shall be distributed to another organization with similar purposes in State provided such organization is operated exclusively for charitable purposes and exempt from tax under sections 501(c)(3), 170(b)(1)(A) and 170(c).

Beneficiary 3 died on Date 2, and her estate disclaimed any rights it had in Trust. It is represented that the disclaimer was a qualified disclaimer under section 2518. Trust, as presently drafted, does not fully qualify for the federal estate tax charitable deduction. The Successor Co-Trustees filed a petition with Court to divide and reform the Trust. As reformed, Trust would establish four equal trusts, one for each of the income beneficiaries.

Two of the new trusts would each directly benefit one of the two charitable organizations and maintain the basic Trust terms that provide for each charitable beneficiary to receive the net income of its separate trust. A provision was added to ensure that these two trusts satisfied the requirements of sections 4941, 4942, 4943 and 4944. At the time of death of the last surviving individual beneficiary, such trust will be distributed outright to that charitable organization. If, prior to distribution of any

income or principal to the charitable organization, the organization ceases to exist or qualify as a tax-exempt charitable organization, all income (as well as the balance of the Trust upon the death of the survivor of the individual beneficiaries of the other trusts) shall be paid to the remaining charitable organization. If both organizations cease to exist or cease to qualify as a tax-exempt charitable organization, all income of the trust and the balance of the trust corpus upon the death of the survivor of the beneficiaries shall be distributed to another organization with similar purposes in State, selected in the discretion of the Successor Co-Trustees, provided that such organization is operated exclusively for charitable purposes and is then described in all of sections 501(c)(3), 170(b)(A) and 170(c).

The remaining two trusts would each be reformed into a qualified charitable remainder unitrust and directly benefit one of the two remaining individual beneficiaries with unitrust payments for life. Beneficiary 1 and Beneficiary 2 would each receive unitrust payments of seven percent (7%) annually. Upon the first beneficiary's death, that beneficiary's trust would continue to make the unitrust payments in equal shares to the surviving individual beneficiary and to the two charitable organizations. Upon the death of the surviving individual beneficiary, these two trusts would terminate and both trust estates would be distributed in equal shares to the two charitable organizations. The provisions regarding the disqualification of either or both organizations as qualified charitable organizations shall apply to their interests in the charitable remainder unitrusts. The reformation would be effective retroactively to the date of Decedent's death.

On Date 3, Court granted the petition filed by Decedent's estate to reform Trust effective retroactively to the date of Decedent's death.

LAW AND ANALYSIS:

Ruling Requests 1 and 3

Section 2055(a) provides in part that, for estate tax purposes, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to or for the use of any corporation organized and operated exclusively for religious, charitable, educational and certain other purposes.

Section 2055(e)(2) disallows the estate tax charitable deduction where an interest in property (other than an interest described in section 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in section 2055(a), and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed for less than adequate and full consideration in money or money's worth from the decedent to a person, or for a use, not described in section 2055(a) unless–

(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5)), or

(B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined annually).

Section 2055(e)(3)(A) provides that a deduction shall be allowed under section 2055(a) in respect of any "qualified reformation."

Section 2055(e)(3)(B) provides that the term "qualified reformation" means a change of a governing instrument by reformation, amendment, construction, or otherwise which changes a reformable interest into a qualified interest, but only if–

(i) any difference between (a) the actuarial value of the qualified interest determined as of the date of decedent's death, and (b) the actuarial value (as so determined) of the reformable interest, does not exceed 5 percent of the actuarial value (as so determined) of the reformable interest,

(ii) in the case of (a) a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) terminates at the same time, or (b) any other interest, the reformable interest and the qualified interest are for the same period, and

(iii) such change is effective as of the date of decedent's death.

Section 2055(e)(3)(C)(i) defines the term "reformable interest" to mean any interest for which a deduction would be allowable under section 2055(a) at the time of the decedent's death but for section 2055(e)(2).

Section 2055(e)(3)(C)(ii) provides that the term "reformable interest" does not include any interest unless, before the remainder vests in possession, all payments to persons other than an organization described in section 2055(a) are expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property.

Section 2055(e)(3)(C)(iii)(I) provides, however, that section 2055(e)(3)(C)(ii) shall not apply to any interest if a judicial proceeding is commenced to change such interest into a qualified interest not later than the 90th day after the last date (including extensions) for filing an estate tax return, if an estate tax return is required to be filed.

Section 2055(e)(3)(D) defines a "qualified interest" as an interest for which a deduction is allowable under section 2055(a).

Section 20.2055-2(a) of the Estate Tax Regulations provides that, if a trust is created for both charitable and private purposes, a deduction may be taken for the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

Section 20.2055-2(b)(1) provides that, if an interest has passed to charity at the time of a decedent's death and the interest would be defeated by the subsequent performance of some act, the possibility of occurrence of which appeared at the time of the decedent's death to be so remote as to be negligible, the deduction is allowable. If the trustee is empowered to divert the property, in whole or in part, to a use which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed by the decedent, the deduction will be limited to that portion of the property which is exempt from an exercise of the power.

In the present case, an estate tax deduction would have been allowable under section 2055(a) for the value of the interest, but for the requirements of section 2055(e)(2). The interests passing to Beneficiary 1 and Beneficiary 2 were not expressed in terms of either specified dollar amounts or a fixed percentage of the fair market value of the property as required by section 2055(e)(3)(C)(ii). However, that requirement is not applicable under section 2055(e)(3)(C)(iii)(I), since the reformation proceeding was commenced within the time prescribed by that section. Accordingly, the charitable remainder interest provided for in each reformed trust constitutes a reformable interest under section 2055(e)(3)(C)(i).

The reformation is a qualified reformation within the meaning of section 2055(e)(3)(B) because: (1) based on the discount rate under section 7520 applicable for the month of Decedent's death, the actuarial value of the charitable remainders as reformed will not differ by more than five percent from the actuarial value of the charitable reminder interest prior to reformation; (2) the pre-reformation and post-reformation noncharitable interests will each terminate at the death of the last individual beneficiary; and (3) the reformation will be effective as of the Decedent's date of death.

Accordingly, we rule that the reformation is a qualified reformation within the meaning of section 2055(e)(3)(B). Therefore, an estate tax charitable deduction is allowable under section 2055(a) for the present value of the charitable remainder interests provided for under the Beneficiary 1 and Beneficiary 2 trusts, as reformed, determined in accordance with section 20.2055-2(f)(2)(ii).

Ruling Request 2

Section 1.664-1(a)(1)(iii)(a) provides that the term "charitable remainder trust" means a trust with respect to which a deduction is allowable under section 170, 2055, 2016 or 2522 and which meets the definition of charitable remainder annuity trust or a charitable remainder unitrust.

Section 1.664-1(a)(4) provides, in part, that in order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Solely for purposes of section 664 and the regulations thereunder, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under subpart E, part 1, subchapter J, chapter 1, subtitle A (relating to grantors and others treated as substantial owners), but in no event prior to the time the property is first transferred to the trust.

Section 664(d)(2) provides that for the purposes of section 664, a charitable remainder unitrust (CRUT) is a trust-

> (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,
>
> (B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 170(c),
>
> (C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use,
>
> (D) with respect to each contribution of property to the trust, the value (determined under section 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Section 1.664-3(a)(1)(i)(a) provides that, in general, the governing instrument of a CRUT must provide that the trust will pay not less often than annually a fixed percentage of the net fair market value of the trust assets determined not less often than annually to a person described in section 1.664-3(a)(3) for each taxable year of the period described in section 1.664-3(a)(5).

Section 1.664-3(a)(3)(ii) provides that a trust is not a charitable remainder unitrust if any person has the power to alter the amount to be paid to any named person other than an organization described in section 170(c) if such power would cause any person to be treated as the owner of the trust, or any portion thereof, if subpart E, part

1, subchapter J, chapter 1, subtitle A were applicable to such trust.

Section 1.664-3(a)(4) provides that the trust may not be subject to a power to invade, alter, amend or revoke for the beneficial use of a person other than an organization described in section 170(c). Notwithstanding the preceding sentence, the grantor may retain the power exercisable only by will to revoke or terminate the interest of any recipient other than an organization described in section 170(c).

Based solely on the facts and representation submitted by the taxpayer, we conclude that the reformation will not violate any provisions of sections 664, 1.664-1(a), 1.664-3(a)(3)(ii), 1.664-3(a)(4), or the remaining regulations thereunder. Accordingly, we conclude that the reformation will not adversely affect Trust's qualification as a charitable remainder unitrust if it otherwise meets the requirements of section 664 and the applicable regulations.

Ruling Request 4

Section 2055(a)(2) provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests to charitable organizations. Under the new charitable trusts, two separate trusts will be established–one for Charity 1, and one for Charity 2. The terms of the reformed trusts provide that all income from the trust assets will be paid in equal shares to these two charitable organizations, and upon the death of Beneficiary 1 and Beneficiary 2, the proceeds of the trust assets will be distributed outright to the two charities.

Furthermore, in the event that either charity fails to qualify as a tax-exempt entity, the income and remainder will be paid to the other charitable organization, so long as it continues to qualify as a tax-exempt entity. If both charities cease or fail to qualify as tax-exempt, the trustee will select a similar organization that qualifies as a tax-exempt entity. A charitable organization that qualifies under sections 170(c) and 2055(a) will receive all of the income and all of the principal from the reformed trusts. Accordingly, we rule that an estate tax charitable deduction will be allowed under section 2055(a) equal to the full value of the two separate trusts for the two charitable organizations, as reformed.

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 your authorized representative. A copy of this letter must be attached to any income tax return to which it is relevant.

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.

Sincerely,
Lorraine E. Gardner
Assistant to the Branch Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes