

Internal Revenue Service

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Person To Contact: _____, ID No.

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LEGEND

- Date 1 =
- Taxpayer =
- Trust =
- x =
- Foundation =
- Month 1 =
- Month 2 =
- Date 2 =
- State =
- State Court =

- Date 3 =
- Date 4 =
- State Statute 1 =
- State Statute 2 =
- Case 1 =

Dear _____ :

This is in response to your letter, dated January 11, 2007, in which you requested rulings regarding the proposed reformation of a charitable remainder unitrust (CRUT).

The facts presented and representations made are as follows: On Date 1, Taxpayer created Trust. By its terms, Trust is an irrevocable net income with makeup charitable remainder unitrust (NIMCRUT).

Article 2.1 of Trust provides that in each taxable year of the trust until Taxpayer's death, the trustee shall pay the unitrust amount to Taxpayer. After Taxpayer's death, the unitrust amount is to be paid to Taxpayer's children for a term of ten years, or until the death of the last surviving term recipient if that occurs sooner than the expiration of the ten year term. The unitrust amount is defined as the lesser of (i) the trust income for the taxable year (as defined in § 643(b)) and (ii) x percent of the net fair market value of the trust assets, valued as of the first day of each taxable year of the trust.

Article 2.2 provides that in each taxable year of the trust, a deficiency payable amount shall be computed. The deficiency payable amount is equal to the lesser of (i) the amount by which the income of the trust for such year exceeds the fixed percentage amount for such taxable year, and (ii) the deficiency computed as of such taxable year. In each taxable year in which the income of the trust exceeds the fixed percentage amount, the deficiency payable amount plus the fixed percentage for such taxable year shall be paid to the unitrust recipient for the taxable year.

Article 3.1 provides that upon termination of the noncharitable interests, the trustee shall distribute all of the remaining principal and income of the trust to Foundation.

Article 3.3 provides for the selection of alternate charitable beneficiaries in the event Foundation is not an organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) upon the termination of the noncharitable interests.

Trust was created as a result of a planned giving solicitation by Foundation, the trustee and remainder beneficiary of Trust. Trust was drafted by counsel for Foundation.

From the creation of Trust through Month 1, Foundation, in its capacity as trustee, made unitrust payments to Taxpayer in the amount of x percent of the net fair market value of Trust, determined annually.

Trust was created by Taxpayer with the assistance of Foundation's planned giving officer (PGO). PGO also managed the operation of Trust until he vacated the position.

In Month 2, a new planned giving officer (PGO) was hired to fill the position vacated by the PGO. Shortly after taking the position, the new PGO was asked to review planned gifts in place at that time. During the review process, the PGO discovered that although the trust instrument of Trust created a NIMCRUT, the trust had been treated as a standard payment unitrust since its inception. Foundation's legal counsel advised Foundation that it would have to recapture the excess payments to Taxpayer in order to keep the trust in compliance with the requirements of § 664.

The vice president of Foundation and the PGO later discussed this issue with Taxpayer. Taxpayer expressed surprise that there had been excess distributions from Trust and contended that he was entitled to an annual distribution of x percent of the net fair market value of the trust assets. Taxpayer further contended that Foundation had provided him with information that specifically referred to distributions of x percent, and that he was not advised prior to the execution of Trust that the distribution would be the lesser of the trust's income for the year and x percent of the net fair market value of the trust assets.

Foundation and Taxpayer entered into discussions regarding the repayment of the excess payments made to Taxpayer, but the parties reached an impasse. In order to avoid protracted litigation, the parties entered into a settlement agreement in which they agreed to seek a judicial reformation of Trust from a NIMCRUT into a standard CRUT with an x percent payout. The settlement agreement was conditioned on the following: (i) that the attorney general of State approve or waive any objection to the reformation of Trust; (ii) that State Court approve the requested reformation; and (iii) that the Internal Revenue Service (Service) issue a favorable private letter ruling that Trust will retain its qualification as a charitable remainder unitrust under § 664(d) following the reformation.

On Date 2, Foundation filed a petition in State Court seeking to reform Trust from a NIMCRUT into a standard x percent CRUT. All of the trust beneficiaries consented to the proposed reformation.

On Date 3, the attorney general of State waived any objection to the reformation.

On Date 4, State Court issued an order approving the reformation of Trust based upon a mistake at the time the trust was executed. The order was conditioned upon the parties obtaining of a favorable private letter ruling from the Service that the reformation would not disqualify Trust as a CRUT under § 664(d).

The evidence provided in support of the reformation includes, but is not limited to, the following items that were prepared for Taxpayer by Foundation prior to the creation of Trust: (i) promotional materials and charts describing a standard x percent CRUT; (ii) computations for the value of the remainder interest in Trust, based on an x percent annual unitrust payment; (iii) projected rates of return for Taxpayer, based on an x percent annual unitrust payment.

You now request the following rulings:

1. The judicial reformation of Trust, ab initio, does not violate § 664.
2. The continuing qualification of Trust under § 664 is not adversely affected by the judicial reformation.

3. The judicial reformation of Trust does not result in an act of self-dealing.

Rulings 1 and 2

Section 664(d)(2) provides that for purposes of § 664, a charitable remainder unitrust is a trust – (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent of the initial net fair market value of all property placed in trust) is to be paid, not less frequently than annually, to one or more persons (at least one of which is not an organization described in § 170(c) and, in the case of individuals, only to an individual who is living at the time of 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 § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c); (C) following termination of the payments described in § 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in § 664(g)(4)), all or a part of such securities are to be transferred to an employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined in § 664(g)); and (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of the remainder interest passing to charity is at least 10 percent of the initial net fair market value of all property placed in the trust.

Section 664(d)(3) provides that notwithstanding the provisions of § 664(d)(2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year – (A) the amount of the trust income, if such amount is less than the amount required to be distributed under § 664(d)(2)(A), and (B) any amount of the trust income which is in excess of the trust amount required to be distributed under § 664(d)(2)(A), to the extent that (by reason of § 664(d)(3)(A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

Section 1.664-3(a)(4) of the Income Tax Regulations provides, in part, that a charitable remainder 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 § 170(c).

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it

finds to be state law after giving “proper regard” to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

State Statute 1 provides that if all beneficiaries to an irrevocable trust consent, they may compel modification or termination of the trust upon petition to the court.

State Statute 2 provides that when, through fraud or a mutual mistake of the parties, or a mistake of one party, which the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised, on the application of a party aggrieved, so as to express that intention, so far as it can be done without prejudice to rights acquired by third persons, in good faith and for value.

Under State law, trial courts have the power to reform a trust agreement based on mistake, but may not create a new trust instrument under the theory of reformation. Case 1.

A modification or reformation of a charitable remainder trust does not violate § 664 if the modification or reformation is necessary to conform the trust instrument to the grantor's intent. In this case, an examination of the trust instrument and the other evidence presented indicates that the provisions of Trust, as originally drafted, are contrary to the intent of Taxpayer.

Based on an analysis of the facts submitted and the representations made, we have determined that State Court's Date 4 reformation of Trust is consistent with applicable state law, as it would be applied by the highest court of the state. We therefore conclude that the judicial reformation of Trust from a NIMCRUT into a standard x percent CRUT does not violate § 664. Further, the judicial reformation of Trust will not adversely affect Trust's qualification as a valid CRUT under § 664.

Ruling 3

Section 4941(a) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) provides that the term “self dealing” means any direct or indirect transfer to, or for the use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a) provides the term “disqualified person” with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), the foundation manager (including a trustee) and the members of the family of those individuals.

Section 4946(a) provides that the term "disqualified person," with respect to a private foundation, includes a substantial contributor to the foundation (including the creator of a trust), the foundation manager (including a trustee), and a member of the family of any such individual.

Section 4947(a)(2) provides, in pertinent part, that in the case of a trust which is not exempt from tax under § 501(a), not all of the unexpired interests in which are devoted to charitable purposes, and which has amounts in trust for which a charitable deduction was allowed, § 4941 applies as if such trust were a private foundation.

Section 4947(a)(2)(A) provides that § 4947(a)(2) shall not apply with respect to any amounts payable under the terms of such trust to noncharitable income beneficiaries.

Section 53.4947-1(c)(2)(ii) of the Foundation and Similar Excise Taxes Regulations provides, in essence, that payments of income by a CRUT to its individual income beneficiaries do not result in any tax on self-dealing under § 4947.

Trust is a split-interest trust described in §§ 4947(a)(2). As such, Trust is subject to the provisions of § 4941 and certain other provisions, as if it were a private foundation. The income beneficiary, Taxpayer, is a disqualified person with respect to Trust within the meaning of § 4946(a)(1)(A) by virtue of Taxpayer being the creator of Trust. Section 507(d)(2) defines the term "substantial contributor" to include the creator of the trust.

We find that there is no self-dealing resulting from the state court reformation of the trust document by virtue of State Court's finding of a mistake at the time of the execution of the trust, and based on the "no position" pleading to the litigation by the attorney general of State.

Accordingly, we rule that the judicial reformation of Trust does not result in an act of self-dealing within the meaning of § 4941.

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.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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.

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,

James F. Hogan
Senior Technician Reviewer, Branch 4
(Passthroughs & Special Industries)

Enclosures

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