

[4830-01-P]

Published July 23, 2002

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 20, and 25

[REG-115781-01]

RIN 1545-A031

Definition of Guaranteed Annuity and Lead Unitrust Interests

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations conforming the income, gift, and estate tax regulations to the Tax Court's decision in Estate of Boeshore v.

Commissioner, 78 T.C. 523 (1982), acq. in result, 1987-2 C.B. 1, holding portions of §20.2055-2(e)(2)(vi)(e) of the Estate Tax Regulations invalid.

DATES: Written or electronic comments and requests to speak at the public hearing scheduled for October 16, must be received by September 25, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-115781-01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D C 20044. Submission of comments may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG-115781-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet directly to the IRS Internet site at www.irs.gov/regs.

The public hearing will be held in Room 4718,

Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Susan Hurwitz (202) 622-3090); concerning submissions of comments, Sonya Cruse (202) 622-7180.

SUPPLEMENTARY INFORMATION

Background

In general, if interests in the same property are transferred for both charitable and noncharitable purposes, the charitable interest will qualify for the charitable deduction for federal income, gift, and estate tax purposes only if the interest is in one of certain prescribed forms. If the charitable interest is not a remainder interest, sections 170(f), 2522(c)(2), and 2055(e)(2) of the Internal Revenue Code (Code) require that the charitable interest be in the form of either a guaranteed annuity or a fixed percentage of the annual net fair market value of the property (unitrust interest).

A guaranteed annuity is defined in the regulations under sections 170, 2522, and 2055 as an arrangement pursuant to which a specified sum is paid not less often than annually, for a specified term of years or for the life or lives of certain named individuals. A unitrust interest is defined as a right to receive not less often than annually a fixed percentage of the net fair market value, determined annually, of the property funding the unitrust interest, payable for a specified term of years or for the life of certain named individuals. The income, estate, and gift tax regulations also provide that if guaranteed annuity or unitrust interests are payable for private and charitable purposes from a trust and the private interest is payable before the expiration of the charitable interest, then in order for the charitable guaranteed annuity interest or unitrust interest to be deductible,

among other requirements, the charitable interest must begin either before, or at the same time as, the private interest. See, for example, §20.2055-2(e)(2)(vii)(e) regarding the estate tax provision applicable to unitrust interests. See also, Rev. Rul. 76-225 (1976-1 C.B. 281).

In Estate of Boeshore v. Commissioner, the decedent devised the residue of her estate to a charitable remainder unitrust described in section 664 of the Code. Under the terms of the trust, a 6 percent unitrust amount was to be paid annually from the trust. During the life of the decedent's surviving spouse, 70 percent of the distribution was to be paid to the surviving spouse and the remaining 30 percent to the decedent's daughter and two grandchildren. Upon the surviving spouse's death, 58 percent of the unitrust amount was to be paid to the decedent's daughter and two grandchildren for their lives, and the remaining 42 percent was to be paid to a qualifying charity. Upon the death of the last to die of the four individual beneficiaries, the remainder interest was to be paid to charity. The decedent's estate claimed an estate tax charitable deduction for the present values of the charitable remainder interest and the charitable unitrust interest that was to begin upon the spouse's death.

Under the authority of §20.2055-2(e)(2)(vi)(e) (currently §20.2055-2(e)(2)(vii)(e)), the IRS disallowed the deduction for the present value of the charitable unitrust interest, because it was preceded by a noncharitable unitrust interest.

The court noted that the rules contained in section 2055(e)(2) ensure that the value of the charitable interest is not subject to manipulation through trustee investment practices and that the actual benefit charity receives bears a reasonable relationship to the

deduction allowed for the value of the charitable interest. Since all the nonremainder interests in the Boeshore trust, both charitable and noncharitable, were in the form of unitrust interests, any incentives to manipulate the income interest were removed. Estate of Boeshore v. Commissioner, 78 T.C. at 529. Under these circumstances, the court was unable to find any congressional intent to preclude a charitable deduction for an otherwise qualified charitable unitrust interest. Accordingly, the court held §20.2055-2(e)(2)(vi)(e) invalid insofar as the regulation disallowed a deduction for the charitable unitrust interest under the facts presented.

Explanation of Provisions

The proposed regulations amend the existing regulations under sections 170, 2055, and 2522 governing charitable guaranteed annuity interests and unitrust interests to eliminate the requirement that the charitable interest can not be preceded in point of time by a noncharitable interest that is in the form of a guaranteed annuity or unitrust interest. The regulations will continue to require that any amounts payable for a private purpose before the expiration of the charitable annuity or unitrust interest either must be in the form of a guaranteed annuity or unitrust interest or must be payable from a separate group of assets devoted exclusively to private purposes.

Effective Date

The regulations are applicable as of the date these regulations are published in the **Federal Register** as final regulations.

Effect on Other Documents

The following publication is revoked as of the date these regulations are published in the **Federal Register** as final regulations.

Rev. Rul. 76-225 (1976-1 C.B. 281)

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 5) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies, if written) or electronic comments that are submitted timely (in the manner described in the ADDRESSES portion of this preamble) to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 16, 2002, at 10:00 a.m., Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to

building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit comments and an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by September 25, 2002.

A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Susan Hurwitz of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of the IRS and the Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

26 CFR Part 25

Gift taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.170A-6 is amended as follows:

1. Paragraph (c)(2)(i)(E) is revised and the example following paragraph (c)(2)(i)(E) is removed.

2. Paragraph (c)(2)(ii)(D) is revised.

The revision reads as follows:

§ 1.170A-6 Charitable contributions in trust.

* * * * *

(c) * * *

(2) * * *

(i) * * *

(E) Where a charitable interest in the form of a guaranteed annuity interest is transferred after May 21, 1972, the charitable interest generally is not a guaranteed annuity interest if any amount may be paid by the trust for a private purpose before the expiration

of all the charitable annuity interests. There are two exceptions to this general rule. First, the charitable interest is a guaranteed annuity interest if the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. Second, the charitable interest is a guaranteed annuity interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(i)(E), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947-1(c) of this chapter (Foundation and Similar Excise Tax Regulations) for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust. * * * * *

(ii) * * *

(D) Where a charitable interest is in the form of a unitrust interest, the charitable interest generally is not a unitrust interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable unitrust interests. There are two exceptions to this general rule. First, the charitable interest is a unitrust interest if the amount payable for a private purpose is in the form of a unitrust interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private unitrust interest as opposed to the charitable unitrust interest. Second, the charitable interest is a unitrust interest if under the trust's governing instrument the amount

that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(ii)(D), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947-1(c) of this chapter (Foundation and Similar Excise Tax Regulations) for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

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PART 20--ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 3. The authority citation for part 20 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * * *

Par. 4. Section 20.2055-2 is amended as follows:

1. Paragraph (e)(2)(vi)(f) is revised.
2. Paragraph (e)(2)(vii)(e) is revised.
3. In paragraph (f)(2)(iv) Example (4) is removed.

The revisions read as follows:

§20.2055-2 Transfers not exclusively for charitable purposes.

* * * * *

(e) * * *

(2) * * *

(vi) * * *

(f) Where a charitable interest in the form of a guaranteed annuity interest is in trust, the charitable interest generally is not a guaranteed annuity interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable annuity interests. There are two exceptions to this general rule. First, the charitable interest is a guaranteed annuity interest if the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. Second, the charitable interest is a guaranteed annuity interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (e)(2)(vi)(f), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947-1(c) of this chapter (Foundation and Similar Excise Tax Regulations) for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

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(vii) * * *

(e) Where a charitable interest in the form of a unitrust interest is in trust, the charitable interest generally is not a unitrust interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable unitrust interests. There are two exceptions to this general rule. First, the charitable interest is a unitrust interest if the amount payable for a private purpose is in the form of a unitrust interest and the trust's

governing instrument does not provide for any preference or priority in the payment of the private unitrust interest as opposed to the charitable unitrust interest. Second, the charitable interest is a unitrust interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (e)(2)(vii)(e), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947-1(c) of this chapter (Foundation and Similar Excise Tax Regulations) for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

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PART 25--GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. The authority for part 25 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 6. Section 25.2522(c)-3 is amended as follows:

1. Paragraph (c)(2)(vi)(f) is revised.
2. Paragraph (c)(2)(vii)(e) is revised.
3. In paragraph (d)(2)(iv), Example 4, is removed.

The revisions read as follows:

§25.2522(c)-3 Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

* * * * *

(c) * * *

(2) * * *

(vi) * * *

(f) Where a charitable interest in the form of a guaranteed annuity interest is in trust, and the gift of such interest is made after May 21, 1972, the charitable interest generally is not a guaranteed annuity interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable annuity interests. There are two exceptions to this general rule. First, the charitable interest is a guaranteed annuity interest if the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. Second, the charitable interest is a guaranteed annuity interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(vi)(f), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947-1(c) of this chapter (Foundation and Similar Excise Tax Regulations) for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

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(vii) * * *

(e) Where a charitable interest in the form of a unitrust interest is in trust, the charitable interest generally is not a unitrust interest if any amount may be paid by the trust for a private purpose before the expiration of all the charitable unitrust interests.

There are two exceptions to this general rule. First, the charitable interest is a unitrust interest if the amount payable for a private purpose is in the form of a unitrust interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private unitrust interest as opposed to the charitable unitrust interest. Second, the charitable interest is a unitrust interest if under the trust's governing instrument the amount that may be paid for a private purpose is payable only from a group of assets that are devoted exclusively to private purposes and to which section 4947(a)(2) is inapplicable by reason of section 4947(a)(2)(B). For purposes of this paragraph (c)(2)(vii)(e), an amount is not paid for a private purpose if it is paid for an adequate and full consideration in money or money's worth. See §53.4947-1(c) of this chapter (Foundation and Similar Excise Tax Regulations) for rules relating to the inapplicability of section 4947(a)(2) to segregated amounts in a split-interest trust.

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Deputy Commissioner of Internal Revenue.