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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 20, and 25

[TD 8923]

RIN 1545-AX74

Lifetime Charitable Lead Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the definitions of a guaranteed annuity interest and a unitrust interest for purposes of the income, gift, and estate tax charitable deductions. The regulations affect taxpayers who make transfers to charitable lead trusts. The regulations restrict the permissible terms for charitable lead trusts and are necessary to ensure that the amount the taxpayer claims as a charitable deduction reasonably correlates to the amount ultimately passing to the charitable organization.

DATES: Effective Dates: These regulations are effective January 5, 2001.

Applicability Dates: For dates of applicability of these regulations, see §§1.170A-6(e), 20.2055-2(e)(3)(iii), and 25.2522(c)-3(e).

FOR FURTHER INFORMATION CONTACT: Scott S. Landes at 202-622-3090.

SUPPLEMENTARY INFORMATION:

Background

On April 5, 2000, the IRS published in the **Federal Register** (65 FR 17835) a notice of proposed rulemaking (REG-100291-00) relating to the permissible terms for charitable guaranteed annuity interests and unitrust interests. This document adopts final regulations with respect to the notice of proposed rulemaking. Written comments were received with

respect to the proposed regulations, but no public hearing was requested or held. A summary of the principal comments received is provided below.

In general, in order to qualify as a guaranteed annuity interest or unitrust interest for purposes of the income, estate, and gift tax charitable deductions under sections 170(c), 2055(e)(2), and 2522(c)(2), respectively, the permissible term for the charitable lead interest must be either a specified term of years, or the life or lives of individuals living at the date of the transfer. The proposed regulations limit the individuals who may be used as measuring lives to the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. This proposed limitation is intended to eliminate abusive schemes utilizing seriously ill individuals, who are unrelated to the grantor or the remainder beneficiaries, as measuring lives for charitable lead trusts.

Commentators argued that by limiting the class of individuals who can be used as measuring lives in a charitable lead trust, the regulations preclude the use of these trusts in certain nonabusive situations. In response to these comments, several changes were made to the final regulations to provide a greater degree of flexibility for selecting a measuring life.

The final regulations expand the class of permissible measuring lives to include an individual who, with respect to all noncharitable remainder beneficiaries, is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. Thus, remainder beneficiaries can include step-children and step-grandchildren of the individual who is the measuring life, and charitable organizations (described in section 170, 2055, or 2522).

The final regulations also provide that a trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that

individuals who are not lineal descendants will receive any trust corpus. This probability must be computed at the date of transfer to the trust taking into consideration the interests of all individuals living at that time. This change will afford drafters the flexibility to provide for alternative remainder beneficiaries in the event the primary remainder beneficiary and his or her descendants predecease the individual who is the measuring life for the term of the charitable interest.

The application of the probability test may be illustrated by assuming a grantor establishes a charitable lead annuity trust (CLAT) that provides for the annuity to be paid to a charity for the life of A who is age 75 on the date the CLAT is created. On A's death, the corpus is to pass to A's only child, B, age 50 on the date the CLAT is created. If B predeceases A, the corpus is to pass to B's issue then living and if B has no living issue at that time, then to A's heirs at law (which class could include A's siblings, uncles, aunts, nieces and nephews). B has no living children on the date the CLAT is created. Based on the current applicable Life Table contained in §20.2031-7 of the Estate Tax Regulations (Life Table 90CM), the probability that B will predecease A, and the trust will pass to individuals who are not lineal descendants of A is 10.462%, taking into account the interests of remainder beneficiaries living at the time the trust was created. Since the probability that any trust corpus will pass to beneficiaries who are not lineal descendants of A is less than 15%, the CLAT will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of A or A's spouse.

Several commentators identified hypothetical situations where an individual who is either unrelated to the remainder beneficiaries, or a remote family member, could be used as a measuring life to achieve an estate planning objective. The commentators suggested three

alternative standards that would expand the class of permissible measuring lives. None of these suggestions has been adopted.

First, one commentator suggested that the regulations allow a charitable lead trust to use as a measuring life an ancestor of any remainder beneficiary rather than an ancestor of all remainder beneficiaries. Under the suggested standard, the charitable lead trust could provide a nominal remainder interest for descendants of the measuring life, with the balance passing to the grantor's family members. Thus, the standard would do little to prevent the abuse the regulations are intended to address.

Second, one commentator suggested that the regulations provide that an individual is a permissible measuring life if all remainder beneficiaries are natural objects of the individual's bounty. However, the determination of whether a person is the natural object of one's bounty requires an inquiry into facts that may be difficult to ascertain or verify. Such a subjective standard would create uncertainty and would be difficult to administer.

Third, one commentator suggested that if the charitable interest is payable for the life of an individual, then the trust must require that, in the event the individual fails to survive to a normal life expectancy, a guaranteed lump sum will be paid to charity (determined actuarially), that will make up for the shortfall in the charitable annuity. A provision requiring such a payment in the event of the premature death of the measuring life would be complex and inconsistent with the valuation rules of section 7520. In addition, this requirement would in substance convert a life interest to a term of years interest and in some cases allow that term interest to be commuted. Thus, such a requirement may conflict with other rules prohibiting commutation or prepayment of the charitable lead interest.

In summary, the Treasury Department and the IRS acknowledge that there may be

situations in which the grantor, for a valid estate planning objective, may desire to use an individual as a measuring life who does not satisfy the criteria in the regulations (for example, where a remainder beneficiary is dependent on a nonfamily member for support and the trust corpus is intended to provide that support after the death of the nonfamily member). However, the Treasury Department and the IRS believe that in these situations the grantor's objectives can be satisfied through the use of other permissible estate planning techniques. In situations where a charitable lead trust is utilized, the Treasury Department and the IRS believe that the final regulations allow adequate flexibility for achieving legitimate estate planning objectives while providing reasonable safeguards to preclude abusive arrangements.

Special Analyses

It has been determined that this Treasury decision 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 Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Scott S. Landes, Office of the Chief Counsel, IRS. Other personnel from the IRS and the Treasury Department participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, and 25 are amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.170A-6 also issued under 26 U.S.C. 170(f)(4); 26 U.S.C. 642(c)(5). * * *

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

1. Paragraph (c)(2)(i)(A) is amended as follows:

- a. In the first sentence, the comma is removed.
- b. In the second sentence, the language "of years" is added after the word "term", the language "an individual or individuals" is removed, and "certain individuals" is added in its place.
- c. The third sentence is removed, and six new sentences are added in its place.
- d. In the penultimate sentence, the language "of years" is added after the word "term", the language "an individual" is removed, and "the donor" is added in its place.

2. Paragraph (c)(2)(ii)(A) is amended as follows:

- a. In the fifth sentence, the language "of years" is added after the word "term", "an individual or individuals" is removed, and "certain individuals" is added in its place.
- b. The last sentence is removed, and six new sentences are added in its place.

3. Paragraph (e) is amended by adding four sentences to the end of the paragraph.

4. The authority citation at the end of the section is removed.

The additions read as follows:

§1.170A-6 Charitable contributions in trust.

* * * * *

(c) * * *

(2) * * *

(i) * * * (A) * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. * * *

* * * * *

(ii) * * * (A) * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or

2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664.

* * * * *

(e) Effective date. * * * In addition, the rule in paragraphs (c)(2)(i)(A) and (ii)(A) of this section that guaranteed annuity interests and unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals applies to transfers made on or after April 4, 2000. If a transfer is made to a trust on or after April 4, 2000 that uses an individual other than one permitted in paragraphs (c)(2)(i)(A) and (ii)(A) of this section, the trust may be reformed to satisfy this rule. As an alternative to reformation, rescission may be available for a transfer made on or before March 6, 2001. See §25.2522(c)-3(e) of this chapter for the requirements concerning reformation or possible rescission of these

interests.

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) (a) is amended as follows:

a. In the third sentence, the language "of years" is added after the word "term", the language "an individual or individuals" is removed, and "certain individuals" is added in its place.

b. The fourth sentence is removed, and six new sentences are added in its place.

c. In the penultimate sentence, the language "of years" is added after the word "term", the language "an individual" is removed, and "the decedent's spouse" is added in its place.

2. Paragraph (e)(2)(vii)(a) is amended as follows:

a. In the sixth sentence, the language "of years" is added after the word "term", the language "of an individual or individuals" is removed, and "of certain individuals" is added in its place.

b. The last sentence is removed, and six new sentences are added in its place.

3. Paragraph (e)(3) is amended as follows:

a. The period at the end of paragraph (e)(3)(ii)(c) is removed, a comma is added and the word "and" is added after the comma.

b. A new paragraph (e)(3)(iii) is added.

The additions read as follows:

§20.2055-2 Transfers not exclusively for charitable purposes.

* * * * *

(e) * * *

(2) * * *

(vi) * * * (a) * * * Only one or more of the following individuals may be used as measuring lives: the decedent's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, as of the date of the decedent's death taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. * * *

* * * * *

(vii) * * * (a) * * * Only one or more of the following individuals may be used as measuring lives: the decedent's spouse, and an individual who, with respect to all remainder

beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, as of the date of the decedent's death taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664.

* * * * *

(3) * * *

(iii) The rule in paragraphs (e)(2)(vi)(a) and (vii)(a) of this section that guaranteed annuity interests or unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals is generally effective in the case of transfers pursuant to wills and revocable trusts where the decedent dies on or after April 4, 2000. Two exceptions from the application of this rule in paragraphs (e)(2)(vi)(a) and (vii)(a) of this section are provided in the case of transfers pursuant to a will or revocable trust executed

on or before April 4, 2000. One exception is for a decedent who dies on or before July 3, 2001 without having republished the will (or amended the trust) by codicil or otherwise. The other exception is for a decedent who was on April 4, 2000, under a mental disability to change the disposition of the decedent's property, and either does not regain competence to dispose of such property before the date of death, or dies prior to the later of: 90 days after the date on which the decedent first regains competence, or July 3, 2001 without having republished the will (or amended the trust) by codicil or otherwise. If a guaranteed annuity interest or unitrust interest created pursuant to a will or revocable trust where the decedent dies on or after April 4, 2000, uses an individual other than one permitted in paragraphs (e)(2)(vi)(a) and (vii)(a) of this section, and the interest does not qualify for this transitional relief, the interest may be reformed into a lead interest payable for a specified term of years. The term of years is determined by taking the factor for valuing the annuity or unitrust interest for the named individual measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term of years factor for an annuity or unitrust interest. For example, in the case of an annuity interest payable for the life of an individual age 40 at the time of the transfer, assuming an interest rate of 7.4% under section 7520, the annuity factor from column 1 of Table S(7.4), contained in IRS Publication 1457, Book Aleph, for the life of an individual age 40 is 12.0587 (Publication 1457 is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402). Based on Table B(7.4), contained in Publication 1457, Book Aleph, the factor 12.0587 corresponds to a term of years between 31 and 32 years. Accordingly, the annuity interest must be reformed into an interest payable for a term of 32 years. A judicial reformation must be commenced prior to the later of July 3, 2001, or the date prescribed by section 2055(e)(3)(C)(iii). Any judicial

reformation must be completed within a reasonable time after it is commenced. A non-judicial reformation is permitted if effective under state law, provided it is completed by the date on which a judicial reformation must be commenced. In the alternative, if a court, in a proceeding that is commenced on or before July 3, 2001, declares any transfer made pursuant to a will or revocable trust where the decedent dies on or after April 4, 2000, and on or before March 6, 2001, null and void ab initio, the Internal Revenue Service will treat such transfers in a manner similar to that described in section 2055(e)(3)(J).

* * * * *

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

Par. 5. The authority citation 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)(a) is amended as follows:

a. In the third sentence, the language "of years" is added after the word "term", the language "a named individual or individuals" is removed, and "certain individuals" is added in its place.

b. The fourth sentence is removed, and six new sentences are added in its place.

c. In the sentence beginning "For example, the amount", the language "of years" is added after the word "term", the language "an individual" is removed, and "the donor" is added in its place.

2. Paragraph (c)(2)(vii)(a) is amended as follows:

a. In the sixth sentence, the language "of years" is added after the word "term", the language "an individual or individuals" is removed, and "certain individuals" is added in its place.

b. The last sentence is removed, and six new sentences are added in its place.

3. Paragraph (e) is amended by adding nine new sentences to the end of the paragraph.

The additions 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) * * * (a) * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even

if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only certain specified individuals does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. * * *

* * * * *

(vii) * * * (a) * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in section 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that all noncharitable remainder beneficiaries are lineal descendants of the individual who is the measuring life, or that individual's spouse, if there is less than a 15% probability that individuals who are not lineal descendants will receive any trust corpus. This probability must be computed, based on the current applicable Life Table contained in §20.2031-7, at the time property is transferred to the trust taking into account the interests of all primary and contingent remainder beneficiaries who are living at that time. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. The rule in this paragraph that a charitable interest may be payable for the life or lives of only

certain specified individuals does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664.

* * * * *

(e) Effective date. * * * In addition, the rule in paragraphs (c)(2)(vi)(a) and (vii)(a) of this section that guaranteed annuity interests or unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals applies to transfers made on or after April 4, 2000. If a transfer is made on or after April 4, 2000, that uses an individual other than one permitted in paragraphs (c)(2)(vi)(a) and (vii)(a) of this section, the interest may be reformed into a lead interest payable for a specified term of years. The term of years is determined by taking the factor for valuing the annuity or unitrust interest for the named individual measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term of years factor for an annuity or unitrust interest. For example, in the case of an annuity interest payable for the life of an individual age 40 at the time of the transfer, assuming an interest rate of 7.4% under section 7520, the annuity factor from column 1 of Table S(7.4), contained in IRS Publication 1457, Book Aleph, for the life of an individual age 40 is 12.0587 (Publication 1457 is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402). Based on Table B(7.4), contained in Publication 1457, Book Aleph, the factor 12.0587 corresponds to a term of years between 31 and 32 years. Accordingly, the annuity interest must be reformed into an interest payable for a term of 32 years. A judicial reformation must be commenced prior to October 15th of the year following the year in which the transfer is made and must be completed within a reasonable time after it is commenced. A non-judicial reformation is permitted if effective

under state law, provided it is completed by the date on which a judicial reformation must be commenced. In the alternative, if a court, in a proceeding that is commenced on or before July 3, 2001, declares any transfer, made on or after April 4, 2000, and on or before March 6, 2001, null and void ab initio, the Internal Revenue Service will treat such transfers in a manner similar to that described in section 2055(e)(3)(J).

Robert E. Wenzel
Deputy Commissioner of Internal Revenue.

Approved: 12/20/00

Jonathan Talisman
Acting Assistant Secretary of the Treasury.