

Internal Revenue Service

Department of the Treasury

Number: **200227015**
Release Date: 7/5/2002
Index Number: 2055.03-03

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B09-PLR-126203-01
Date:
March 29, 2002

LEGEND:

- Decedent =
- Revocable Trust =
- Brother's Trust =
- Charitable Trust =
- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- Brother =
- Brother's Spouse =
- Co-Trustee =
- Court =
- State =

Dear _____ :

This is in response to your letter dated May 8, 2001, in which you requested rulings under § 2055 of the Internal Revenue Code.

The facts submitted and representations made are as follows: On Date 1, Decedent established a revocable trust agreement (Revocable Trust) which he amended on three occasions prior to his death. Decedent died on Date 2, at which time the trust became irrevocable.

As finally amended, the dispositive provisions of the Revocable Trust provide, inter alia, that at Decedent's death a trust be created for the benefit of Decedent's

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brother (Brother) and Decedent's brother's wife (Brother's Spouse). The terms of this trust (Brother's Trust) provide that the trustee shall pay all of the net income quarter-annually to Brother for his life. At Brother's death, if Brother's Spouse survives him, the trustee is to pay her \$3,000 per month for the duration of her life. No discretionary distributions of principal from Brother's Trust are authorized. At the death of the survivor of Brother and Brother's Spouse, the trust is to terminate and be distributed to Charitable Trust.

Brother's Trust does not qualify as a charitable remainder trust under § 664 and, therefore, does not satisfy the requirements of § 2055(e)(2) for the estate tax charitable deduction for the actuarial value of the remainder interest that will pass to Charitable Trust upon the death of the survivor of Brother and Brother's Spouse.

Decedent's federal estate tax return was timely filed on extension on Date 3. On Date 4, which is within 90 days after the filing of the return, the Co-trustee of Revocable Trust filed a petition in Court requesting the court to reform Brother's Trust in order to qualify the trust as a charitable remainder annuity trust. Under the proposed reformation, Brother's Trust will be governed and administered under the following terms:

1. In each taxable year (which shall be the calendar year) of Brother's Trust, the trustees shall pay to Brother, during his lifetime, and after his death, to Brother's Spouse, for such time as she survives, the annuity amount. The annuity amount is that amount which is equal to 6.9579% of the initial net fair market value of the trust's assets, as finally determined for federal estate tax purposes.

2. The annuity amount for each taxable year shall be paid (a) in equal monthly payments on the first business day of each month of each taxable year, and (b) from the income of Brother's Trust, and from the principal only to the extent that the trust income is not sufficient to make such payments.

3. Income generated during a taxable year that exceeds the annuity amount required to be distributed currently shall be accumulated and added to the principal of Brother's Trust.

4. In the case of a taxable year that is for a period of less than 12 months, the annuity amount that must be distributed shall be the annuity amount multiplied by a fraction. The numerator of the fraction shall be the number of days in the taxable year of Brother's Trust, and the denominator shall be 365 (or 366 if February 29 is a day included in the numerator). In the case of the taxable year in which the annuity interest terminates, the annuity amount that must be distributed shall be the annuity amount multiplied by a fraction. The numerator of the fraction shall be the number of days in the period beginning on the first day of such taxable year and ending on the day the annuity interest terminates, and the denominator of the fraction shall be 365 (or 366 if February 29 is included in the numerator). Notwithstanding the foregoing, the obligation of the trustees to pay the annuity amount shall terminate with the payment next preceding the survivor recipient's death.

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5. The obligation to pay the annuity amount commences with the date of Decedent's death, but the payment of the annuity amount may be deferred from such date until the end of the taxable year of Brother's Trust in which occurs the complete funding of the trust. Within a reasonable time after the end of the taxable year in which the complete funding of the trust occurs, the trustees must pay to the recipients (in the case of an underpayment) or receive from the recipients (in the case of an overpayment) the difference between (1) any annuity amounts actually paid, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under § 664 prescribe for such computation for such period, and (2) the annuity amounts payable, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under § 664 prescribe for such computation for such period.

6. If the initial net fair market value of the assets constituting Brother's Trust is incorrectly determined, then within a reasonable period after the final determination of the correct value, the trustees shall pay to the recipients, in the case of an undervaluation, or recover from the recipients, in the case of an overvaluation, an amount equal to the difference between the amount properly payable and the amount actually paid.

7. No additional contributions may be made to Brother's Trust after it is funded. The initial contribution, however, shall be deemed to consist of all property passing to the trust by reason of Decedent's death.

8. Nothing in the trust instrument shall be construed to restrict the trustees from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of net income or gain from the sale or disposition of trust assets.

9. Except for the payment of the annuity amount, in the management, investment, and distribution of the trust, the trustees shall not (i) engage in any act of self-dealing as defined in § 4941(d), (ii) retain any excess business holdings as defined in § 4943(c) which would subject the trust to tax under § 4943, (iii) make any investments which would subject the trust to tax under § 4944, or (iv) make any taxable expenditures as defined in § 4945(d). To the extent required, the trustees shall distribute the net income, and, to the extent the net income is not sufficient, the principal of the trust, at such times and in such manner so as not to subject the trust to tax under § 4942.

10. Upon the death of the survivor recipient, the trustees shall distribute all of the then principal and income of Brother's Trust (other than any amount due to either of the recipients) to Charitable Trust. If Charitable Trust is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time when any principal or income of the trust is to be distributed to it, the trustees shall instead distribute such principal and accrued income to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the trustees may select in their sole discretion.

11. The trustees shall have the power, upon written notice to and with the

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written consent of the Attorney General's Office of State, to amend Brother's Trust in any manner required for the sole purpose of ensuring that the trust qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of § 664(d)(1).

12. The operation of Brother's Trust shall be governed by the laws of State. The trustees, however, are prohibited from exercising any power or discretion granted under State laws that would be inconsistent with the qualification of the trust under § 664(d)(1) and the corresponding regulations.

You have requested the following rulings:

1. The interest passing to Charitable Trust under Brother's Trust is a "reformable interest" under § 2055(e)(3)(C).
2. The petition for reformation, if granted, will result in a "qualified reformation" as defined in § 2055(e)(3)(B).
3. A federal estate tax charitable deduction will be allowed under § 2055(a) for the present value of the remainder interest of Brother's Trust, as reformed.

LAW AND ANALYSIS

Section 2055(a) provides that for purposes of the federal estate tax, 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, scientific, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

Section 2055(e)(2) disallows the estate tax charitable deduction where an interest in property (other than an interest described in § 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in § 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 an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in § 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 § 664) or a pooled income fund (described in § 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 yearly).

The charitable split interest rules of § 2055(e)(2) were enacted by the Tax Reform Act of 1969 and are applicable, with exceptions not relevant here, to estates of decedents dying after December 31, 1969.

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Section 2055(e)(3) provides for reformations of interests to comply with the requirements of § 2055(e)(2).

Section 2055(e)(3)(A) provides that a deduction shall be allowed under § 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 (I) the actuarial value (determined as of the date of the decedent's death) of the qualified interest, and (II) the actuarial value (as so determined) of the reformable interest, does not exceed five percent of the actuarial value (as so determined) of the reformable interest,

(ii) in the case of (I) a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) terminated at the same time, or (II) 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 the 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 § 2055(a) at the time of the decedent's death but for the split-interest rules of § 2055(e)(2).

Under § 2055(e)(3)(C)(ii) 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 § 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) provides, however, that § 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 § 2055(a).

Under the relevant provisions of § 664(d)(1), a trust will be a charitable remainder annuity trust if it is a trust --

(A) from which a sum certain (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 often 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 the creation of the trust) for a

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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) may be paid to or for the use of any person other than an organization described in § 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 § 170(c), and

(D) the value (determined under § 7520) of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in the trust.

In this case, the interest passing to Charitable Trust under Brother's Trust is a reformable interest within the meaning of § 2055(e)(3)(C)(i) because the value of the charitable interest at the date of Decedent's death was ascertainable and, hence, severable from the non-charitable interest. Prior to the enactment of the "split-interest" rules of § 2055(e)(2), such an interest would have been deductible under § 2055(a) pursuant to § 20.2055-2(a) of the Estate Tax Regulations. Although the payments to the individual beneficiaries were not expressed in specified dollar amounts or a fixed percentage of the fair market value of the property as required by § 2055(e)(3)(C)(ii), a judicial proceeding was commenced, as provided under § 2055(e)(3)(C)(iii), before the 90th day after the last date (including extensions) for filing Decedent's estate tax return.

The reformation is a qualified reformation within the meaning of § 2055(e)(3)(B) because (1) the difference between the actuarial value (determined as of the date of Decedent's death) of the qualified interest and 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; (2) the nonremainder interest terminates at the same time both before and after the qualified reformation; and (3) the reformation is effective as of the date of Decedent's death. Additionally, the value (as determined under § 7520) of the remainder interest is at least 10 percent of the initial net fair market value of all the property placed in the trust as required by § 664(d)(1)(D).

Accordingly, provided that the judicial reformation of Brother's Trust conforms with the provisions of the proposed reformation, as stated above, and provided that the trust, as judicially reformed, is a valid trust under applicable State law, we conclude that, based on the facts submitted and representations made:

1. The interest passing to Charitable Trust under Brother's Trust is a "reformable interest" as defined in § 2055(e)(3)(C).
2. The petition for reformation, if granted, will result in a "qualified reformation" as defined in § 2055(e)(3)(B).
3. A federal estate tax charitable deduction will be allowed under § 2055(a) for the date of death present value of the remainder interest of Brother's Trust, as

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reformed.

Except as we have specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

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.

Sincerely,
Katherine A. Mellody
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

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