

Internal Revenue Service

Department of the Treasury

Number: **200230022**

Release Date: 7/26/2002

Index Number: 2055.12-07; 2055.12-10;
2518.02-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-114643-02

Date:

APRIL 23, 2002

Re:

Legend

Decedent =

Trust =

Brother =

Charity =

City =

State =

\$x =

Date 1 =

Date 2 =

Court =

State Statutes =

Cite =

Dear :

We received a letter dated March 6, 2002, from your authorized representative requesting rulings under §§ 2055 and 2518 of the Internal Revenue Code with respect

to the proposed reformation of Trust and a disclaimer of certain interests in Trust. This letter responds to that request.

Decedent died testate on Date 1. Prior to her death, Decedent had established Trust, a revocable trust that became irrevocable on Decedent's death. Article Second of Decedent's will, executed on Date 2, provides that the residue of Decedent's estate is to be distributed to Trust. Section 2 of Trust provides that, upon Decedent's death, the balance of Trust corpus is to be divided into two equal trusts. Under Section 2, Paragraph (2) one of the trusts is to be administered as follows:

Fifty (50) percent of the balance thereof shall continue in trust and shall be administered as follows:

(a) All the net income shall be paid to or for the benefit of my brother, [Brother], at least semi-annually.

(b) Trustee may pay to or for the benefit of my brother as much of the principal of the trust as the trustee may deem proper for his welfare, comfort and support.

(c) On the death of my brother, the trustee shall pay over the then remaining principal, together with all income accrued and unpaid to the date of his death:

(1) To the trust...established for the benefit of my aunt, ... and my aunt... .

(2) In the event my aunts, or the survivor of them, dies before the time for setting apart their trust share...what remains of their share shall be distributed by the trustee as follows:

(i) To [Charity][City, State] to be used in such manner as the Board of Trustees shall determine from time to time.

Section 2, Paragraph (3) provides for the administration of the second trust, as follows:

Fifty (50) percent of the balance thereof shall continue in trust and shall be administered as follows:

(a) All of the net income shall be paid to or for the benefit of my aunt..., and my aunt..., or the survivor, at least semi-annually.

(b) Trustee may pay to or for the benefit of my aunts, or the survivor of them, as much of the principal of the trust as the trustee may deem proper for their welfare, comfort and support.

(c) On the death of my surviving aunt, the Trustee shall pay over the then remaining principal, together with all income accrued and unpaid to the date of her death:

(1) To the trust hereinbefore established for the benefit of my brother, [Brother], to add the same to the trust estate thereof and hold and distribute the same as if it had been a part thereof immediately prior to the death of my aunt.

(2) In the event my brother dies before the time for setting

apart his trust share, or if he dies after his trust share has been set apart but before his entire share has been exhausted, what remains of his share shall be distributed by the Trustee as follows:

(i) To [Charity], [City, State] to be used in such manner as the Board of Trustees shall determine from time to time.

Both of Decedent's aunts referenced in Section 2, Paragraphs (2) and (3) predeceased Decedent. Accordingly, 100 percent of the Trust residue passes to the Section 2, Paragraph (2) trust. Brother proposes to disclaim the following interests in the Section 2, Paragraph (2) trust: (1) his right to receive discretionary distributions of trust principal under Section 2, Paragraph (2)(b); and (2) a fractional share of his income interest in the trust, the numerator of which is \$x and the denominator of which is the value of the trust as finally determined for estate tax purposes. The laws of State authorize the disclaimer of an interest passing in trust if the disclaimer is in writing and delivered to the trustee. The disclaimer relates back for all purposes to the date of the death of the decedent. Unless the testator has provided otherwise, the disclaimed property passes as if the disclaimant died before the decedent. State Statutes. Further, it is represented that under State law, the disclaimer of a life interest causes the acceleration of the remainder interest. Cite.

In conjunction with the execution of Brother's disclaimer, Trustee proposes to initiate proceedings for the judicial reformation of the Section 2, Paragraph (2) trust in accordance with § 2055(e)(3), in order to qualify the trust as a charitable remainder annuity trust under § 664(d)(1) .

As reformed, the trust will provide for an annual annuity payment equal to 6.22% of the trust estate as finally determined for federal estate tax purposes, payable to Brother in quarterly installments for his life. On the death of Brother, all remaining trust assets will be paid to Charity.

The following rulings have been requested:

1. The proposed disclaimers by Brother of the right to receive trust principal distributions and a fractional interest in the trust income during his lifetime will be qualified disclaimers under § 2518.
2. The proposed reformation of the trust will be a qualified reformation under § 2055(e)(3).
3. An estate tax charitable deduction will be allowed for the present value of the remainder interest in the trust, as reformed, and for \$x that will pass directly to Charity as a result of Brother's disclaimer.

Ruling Request No. 1

Section 2518(a) provides that, if a person makes a qualified disclaimer with respect to any interest in property, Subtitle B (relating to the estate, gift and generation-skipping transfer taxes) shall apply with respect to such interest as if the interest had never been transferred to such person.

Section 2518(b) provides that the term “qualified disclaimer” means an irrevocable and unqualified refusal by a person to accept an interest in property but only if—

- (1) such refusal is in writing,
- (2) such writing is received by the transferor of the interest, the transferor’s legal representative, or the holder of the legal title to the property to which the interest related not later than the date which is 9 months after the later of—
 - (A) the date on which the transfer creating the interest in such person is made, or
 - (B) the day on which such person attains age 21,
- (3) such person has not accepted the interest or any of its benefits, and
- (4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either—
 - (A) to the spouse of the decedent, or
 - (B) to a person other than the person making the disclaimer.

Section 25.2518-1(b) of the Gift Tax Regulations provides that if a person makes a qualified disclaimer as described in § 2518(b) and § 25.2518-2, for purposes of the Federal estate, gift, and generation-skipping transfer tax provisions, the disclaimed interest in property is treated as if it had never been transferred to the person making the qualified disclaimer. Instead, it is considered as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer.

Under § 25.2518-3(a)(1), the disclaimer of all or an undivided portion of any separate interest in property may be a qualified disclaimer even if the disclaimant has another interest in the same property. In general, each interest in property that is separately created by the transferor is treated as a separate interest. For example, if an income interest in securities is bequeathed to A for life, then to B for life, with the remainder interest in such securities bequeathed to A’s estate, and if the remaining requirements of § 2518(b) are met, A could make a qualified disclaimer of either the income interest or the remainder, or an undivided portion of either interest. A could not, however, make a qualified disclaimer of the income interest for a certain number of years. Severable property is property that can be divided into separate parts each of which, after severance, maintains a complete and independent existence. For example, a legatee of shares of corporate stock may accept some shares of the stock and make a qualified disclaimer of the remaining shares.

Section 25.2518-3(a)(2) provides that a disclaimer is not a qualified disclaimer under § 2518 if the beneficiary disclaims income derived from specific property

transferred in trust while continuing to accept income derived from the remaining properties in the same trust unless the disclaimer results in such property being removed from the trust and passing, without any direction on the part of the disclaimant, to persons other than the disclaimant or to the spouse of the decedent.

Section 25.2518-3(d), Example 5, describes a situation where, under the provisions of E's will, E's shares of stock in X, Y, and Z corporations were to be transferred to a trust. The trust provides that all income is to be distributed currently to F and G in equal parts until F attains the age of 45 years. At that time the corpus of the trust is to be divided equally between F and G. F disclaimed the income arising from the shares of X stock. G disclaimed 20 percent of G's interest in the trust. F's disclaimer is not a qualified disclaimer because the X stock remains in the trust. If the remaining requirements of § 2518(b) are met, G's disclaimer is a qualified disclaimer.

Section 25.2518-3(d), Example 9, considers a situation where H is the income beneficiary of a trust, and also possesses the right, as trustee, to invade corpus for H's health, maintenance, support, and happiness. In addition, H possesses a testamentary power to appoint trust corpus. The example concludes that if H disclaims both the power to invade corpus for H's benefit and the testamentary power to appoint corpus, while retaining the income interest, H's disclaimer will be a qualified disclaimer.

Section 25.2518-3(d), Example 11, describes a situation where under the terms of a testamentary trust, W is to receive all trust income for life. The trustee has the power to invade trust corpus for the support and maintenance of D during the life of W. At W's death, the trust corpus is payable to D. D disclaims the right to receive distributions of trust corpus during W's lifetime, but retains the right to receive the remainder at W's death. The example concludes that D's disclaimer is a qualified disclaimer.

In the present case, Brother proposes to execute irrevocable disclaimers of certain rights in Trust. It is represented that the disclaimers will be valid under State law, and will be delivered to the appropriate party no later than 9 months after Decedent's death. Further, it is represented that Brother has not accepted any benefits from the interests subject to the disclaimers. As a result of Brother's disclaimer of a fractional share of his income interest, you represent that under State law an equivalent fraction of the trust corpus will immediately be paid to Charity, the residuary remainderman. Cite. Therefore, the disclaimed interest will not remain a part of the trust's corpus.

Based on the above, we conclude that Brother's proposed disclaimer of his right to receive discretionary distributions of trust corpus during his lifetime will constitute the disclaimer of a separate interest in property under § 25.2518-3(a)(1). Further, we conclude that Brother's disclaimer of a fractional portion of his income interest will constitute a disclaimer of an undivided portion of a separate interest in property under § 25.2518-3(a)(1). Accordingly, we conclude that assuming the other requirements of

§ 2518 are satisfied, Brother's proposed disclaimer will be a qualified disclaimer under § 2518.

Ruling Requests Nos. 2 and 3

Section 2055(a) provides that, for purposes of the Federal estate tax, the value of the taxable estate is determined by deducting from the value of the gross estate all bequests to or for the use of certain governmental entities, certain corporations organized and operated exclusively for religious, charitable, scientific, literary, or education purposes, and certain other fraternal and veterans organizations.

Section 2055(e)(2) provides that, 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 that 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), no deduction is allowed under § 2055(a) for the interest that passes to the person, or for the use, described in § 2055(a) unless, (1) in the case of a remainder interest, the 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 § 664(c)(5), or (2) in the case of any other interest, the interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly.

Section 2055-2(c)(1)(i) provides that the amount of a bequest, devise or transfer for which a deduction is allowable under § 2055(a) includes an interest that falls into the bequest, devise or transfer as a result of a qualified disclaimer described in § 2518.

Section 2055(e)(3) provides that a deduction is allowed under § 2055(a) for any qualified reformation. The term "qualified reformation" means a change of a governing instrument by reformation, amendment, construction, or otherwise that 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 5 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) the reformable interest and the qualified interest are for the same period, and

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

Section 2055(e)(3)(C)(i) provides that the term "reformable interest" means any interest for which a deduction would be allowable under § 2055(a) at the time of the decedent's death but for the provisions of § 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 § 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 the restriction in § 2055(e)(3)(C)(ii) does not apply if a judicial proceeding is commenced to change the charitable interest into a qualified interest not later than the 90th day after the last date (including extensions) for filing the estate tax return, if one is required to be filed.

Under § 2055(e)(3)(D), the term "qualified interest" means an interest for which a deduction is allowable under § 2055(a).

In this case, as discussed above, Brother's disclaimer of his right to receive discretionary distributions of trust corpus will be a qualified disclaimer under § 2518. Thus, for estate tax purposes, the interest is treated as never having passed to Brother. Further, as a result of the disclaimer, Brother will be treated under applicable local law as if he predeceased Decedent with respect to the disclaimed interest. Thus, for estate tax purposes, as of the date of Decedent's death, Brother's right to receive trust income is deemed to be the only noncharitable interest in the trust. Therefore, we conclude that, if the disclaimer is executed and the requirements of § 2518 are otherwise satisfied, the charitable interest in the trust prior to reformation would have qualified for an estate tax charitable deduction under § 2055(a), but for the provisions of § 2055(e)(2). In other words, the value of the remainder interest in the trust, determined based on the assumption that all trust income is distributed to the income beneficiary, would qualify for a charitable deduction, but for the provisions of § 2055(e)(2). Accordingly, the first requirement for a qualified reformation under § 2055(e)(3) will be satisfied.

The proposed reformation satisfies the second requirement for a qualified reformation under § 2055(e)(3) because Brother's interest both before and after the proposed reformation will terminate at the same time (i.e., at Brother's death). Moreover, the reformation will be effective as of the date of Decedent's death. Therefore, the proposed reformation satisfies the third requirement.

With respect to the fourth requirement, based on the interest rate under § 7520 for the month of Decedent's death of 6.2 percent, the difference between the actuarial value of the reformable interest in the Section 2, Paragraph (2) trust and the qualified interest after reformation will be less than 5 percent of the actuarial value of the reformable interest. Accordingly, the proposed reformation satisfies the fourth requirement under § 2055(e)(3).

The proposed reformation will satisfy the fifth requirement under § 2055(e)(3) because, even though Brother's interest in the reformable trust is not expressed in a specified dollar amount or a fixed percentage of the fair market value of the trust, it is represented that a judicial proceeding to reform the trust will be commenced within 90 days of the date that the Decedent's federal estate tax return is due.

Accordingly, we conclude that the proposed reformation will be a qualified reformation within the meaning of § 2055(e)(3). Therefore, an estate tax charitable deduction will be allowable under § 2055(a) for the present value of the remainder interest in the trust as reformed, determined under § 20.2055-2(f)(2)(i). In addition, as noted above, based on the submitted representations, Brother's disclaimer of a fractional portion of his income interest in trust will be a qualified disclaimer under § 2518. Further, you represent that under applicable state law, as a result of the disclaimer, a fractional interest in the trust corpus will pass directly to Charity. Therefore, in accordance with § 20.2055-2(c)(i), the value of the interest that passes to Charity as a result of Brother's disclaimer of a fractional portion of his income interest in trust will qualify for an estate tax charitable deduction under § 2055(a).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or 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.

In accordance with a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,
Associate Chief Counsel
(Passthroughs and Special Industries)
By: George Masnik
Chief, Branch 4

Enclosure
Copy for § 6110 purposes