

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:2 - PLR-164222-01

Date:

October 28, 2002

Legend

Estate =

Trust =

Decedent =

A =

B =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

x =

y =

State =

Court =

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Charity 1 =

Charity 2 =

Charity 3 =

Charity 4 =

Dear :

This letter responds to your letter dated October 26, 2001, and subsequent correspondence, submitted on behalf of the Estate, requesting rulings under §§ 664 and 2055 of the Internal Revenue Code.

A, the executor of the Estate, represents that Decedent executed a declaration of trust (Trust), a revocable trust, on D1. Decedent amended Trust on D2 and D3. Decedent died testate on D4. Decedent's will was probated on D5. Decedent's federal estate tax return (Form 706) was timely filed (with extensions) on D6.

Article I of Trust provides that during Decedent's lifetime the trustee is to hold the trust property in trust for the benefit of Decedent (the Lifetime Trust). Under Article IIA, during the Decedent's lifetime, the trustee is directed to distribute to the Decedent so much of the net income as the Decedent shall from time to time direct. In addition, the Decedent had the right, at any time, to withdraw all or any part of the principal of the Lifetime Trust. Under Article IIB, on the death of the Decedent, the trustee is directed to combine the residue of the Lifetime Trust and any property received from the Estate and hold the property in trust designated as the Charitable Remainder Unitrust (the CRUT). Article IIB provides that it is Decedent's intention to establish a charitable remainder unitrust, within the meaning of § 6 of Rev. Proc. 90-31 and § 664(d)(2) and (3) of the Code.

Article IIB(1)-(9) of Trust governs the administration of the CRUT. Under Article IIB(1), as amended prior to the death of Decedent, in each taxable year the trustee of the CRUT is to pay two individual noncharitable beneficiaries, A and B, in equal shares during their joint lifetimes, a unitrust amount equal to the lesser of: (a) trust income for the taxable year; and (b) five (5) percent of the net fair market value of the assets of Trust valued as of the first day of each taxable year of Trust. The unitrust amount for any year shall also include any amount of trust income for the year that is in excess of

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the amount to be distributed under (b) to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as five (5) percent of the net fair market value of Trust assets on the valuation dates. Upon the death of the first of the noncharitable beneficiaries to die, the survivor noncharitable beneficiary shall be entitled to receive the entire unitrust amount. The unitrust amount is to be paid in quarterly installments. Any income of the trust for a taxable year in excess of the unitrust amount is to be added to principal.

Under Article IIB(3), upon the death of the survivor noncharitable beneficiary, the trustee is to distribute all of the then principal and income of the CRUT in equal shares to four charitable remainder beneficiaries, Charities 1 through 4 (collectively, the Charities). If any of the Charities is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time when any principal or income of the CRUT is to be distributed to it, then the trustee is to distribute such principal or income equally to those of the Charities who are described in §§ 170(c), 2055(a), and 2522(a) at such time. If none of the Charities is an organization described in §§ 170(c), 2055(a), and 2522(a) at the time when any principal or income of CRUT is to be distributed to it, then the trustee is to distribute such principal or income to such one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the trustee selects in the trustee's sole discretion.

Article VI of Trust provides that no federal or state estate or inheritance taxes imposed on any interest in property of Trust or on any interest in other property as a result of Decedent's death is to be paid from property of Trust. Should Decedent not provide for the payment of taxes from other sources, then Article VI provides that the trustee shall recover from Estate the amount necessary to pay such taxes.

Item I of Decedent's will provides that all inheritance, succession or estate taxes imposed on Estate are to be paid from the residue of the Estate. After providing for certain specific and cash bequests, Item IV of Decedent's will provides that the residue of the Estate is to be distributed to the CRUT established under Article IIB(I) of Trust.

At Decedent's death, approximately \$x in cash and securities was held in a brokerage account in the name of Decedent as trustee of Trust. Decedent's probate estate included assets valued at approximately \$y. It is represented that there were no other assets included in Decedent's gross estate. The Decedent's probate estate was not sufficient to pay administration expenses and estate taxes. The only other funds available to pay these expenses and taxes were the funds held in the Trust brokerage account, which had been retitled in the name of the CRUT.

On review of Trust, the trustee identified several issues that would preclude the CRUT from satisfying the requirements of § 664. The utilization of the brokerage account to pay the debts, administration expenses, and taxes generated as a result of Decedent's death would not be consistent with § 1.664-1(a)(4) of the Income Tax Regulations. See § 1.664-1(a)(6), Example (3) and Example (4).

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Rev. Proc. 90-31, 1990-1 C.B. 147, contains 6 sample charitable remainder unitrust forms. Section 6 of the Revenue Procedure contains a sample form for an inter vivos trust. Section 9 contains a sample form for a testamentary trust. The trustee determined that Article IIB of Trust incorrectly referenced § 6 of Rev. Proc. 90-31, rather than § 9 of Rev. Proc. 90-31. Consequently, Trust did not contain a deferral provision for the payment of the unitrust amount during the reasonable period of administration as required in the case of testamentary trusts under § 1.664-1(a)(5) and Rev. Rul. 92-57, 1992 C.B. 123.

In addition, the trustee determined that Article VI of Trust prohibited the payment of any federal or state estate or inheritance tax imposed by reason of the Decedent's death on any interest in property held in Trust or any interest in other property. However, because Decedent's probate estate was not sufficient to pay the entire estate tax liability, the Trust funds held in the brokerage account had to be utilized to pay this tax liability.

Prior to D6, the trustee of Trust filed a complaint for reformation with the appropriate Court of State to reform and restate the articles of Trust to qualify the CRUT as a charitable remainder unitrust under §§ 664(d)(2) and (3). The Court concluded that the reformation of Trust was in accordance with the expressed intentions of Decedent and ordered that Trust be administered according to the restated articles effective as of Decedent's death.

Pursuant to the Court order, the provisions of Trust were revised. Article VI was deleted and language was inserted specifically authorizing the trustee to use Trust property to pay Decedent's debts, expenses, taxes and general and specific bequests. The instrument was revised to provide that after payment of these amounts, the trustee is to set aside and pay the remaining assets of Trust to a separate trust designated as the CRUT.

In addition, the reference in Article IIB to § 6 of Rev. Proc. 90-31 was changed to § 9 of Rev. Proc. 90-31. A provision was added, conforming to § 1.664-1(a)(5) and Rev. Rul 92-57, authorizing the deferral of payment of the unitrust interest during a reasonable period of administration.

Section 664(d)(2)(A) provides that a CRUT is a trust from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, 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 term of years (not in excess of 20 years) or for the life or lives of such individual or individuals.

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Section 664(d)(2)(B) provides that a CRUT may pay no amount other than the payments described in § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) to or for the use of any person other than an organization described in § 170(c).

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 trust income which is in excess of the 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 1.664-1(a)(4) provides that in order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Solely for the purposes of § 664 and the regulations thereunder, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code, but in no event prior to the time property is first transferred to the trust.

Section 1.664-1(a)(5) provides that notwithstanding § 1.664-1(a)(4) and §§ 1.664-2 and 1.664-3, for purposes of §§ 2055 and 2106 a charitable remainder trust shall be deemed created at the date of death of the decedent (even though the trust is not funded until the end of a reasonable period of settlement) if the obligation to pay the annuity or unitrust amount with respect to the property passing in trust at the death of the decedent begins as of the date of death of the decedent, even though the requirement to pay such amount is deferred in accordance with the rules provided in § 1.664-1(a)(5). If permitted by applicable local law or authorized by the provisions of the governing instrument, the requirement to pay such amount may be deferred until the end of the taxable year of the trust in which occurs the complete funding of the trust. Within a reasonable period after such time, the trust must pay (in the case of an underpayment) or must receive from the recipient (in the case of an overpayment) the difference between (a) any annuity or unitrust amounts actually paid, plus interest on such amounts computed at the rate of interest specified in § 1.664-1(a)(5)(iv), compounded annually, and (b) the annuity or unitrust amounts payable, plus interest on such amounts computed at the rate of interest specified in § 1.664-1(a)(5)(iv), compounded annually. The amounts payable shall be retroactively determined by using the taxable year, valuation method, and valuation dates which are ultimately adopted by the charitable remainder trust.

Rev. Rul. 92-57 clarifies the proper method for computing deferred payments that is prescribed by § 1.664-1(a)(5) in the case of a testamentary charitable remainder unitrust. It contains sample language which applies the regulation.

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Section 2055(a) provides that, for estate tax purposes, 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, educational and certain other purposes.

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 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 annually).

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 (a) the actuarial value of the qualified interest determined as of the date of decedent's death, and (b) 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 (a) a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) terminates at the same time, or (b) 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 decedent's death.

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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 § 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)(I) 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).

In the present case, we conclude that the charitable remainder interests provided under the CRUT, prior to the reformation, were reformable interests under § 2055(e)(3)(C). The nonremainder interests in the trust will terminate at the same time before and after the reformation. The actuarial value of the charitable remainder interest in the trust before and after the reformation did not change. Thus, the difference between the actuarial value of the qualified interest and the actuarial value of the reformable interest does not exceed 5 percent of the actuarial value of the reformable interest. The reformation of the CRUT will be effective as of the date of the Decedent's death. Therefore, we rule that the reformation as described above constitutes a "qualified reformation" under § 2055(e)(3)(B).

We further rule that the payment of estate taxes and administrative expenses from the property of the Trust, as reformed, will not cause the CRUT to fail to qualify as a charitable remainder unitrust under § 664 and the regulations thereunder. Assuming the CRUT otherwise qualifies as a charitable remainder unitrust, the Estate will be allowed a federal estate tax charitable deduction under § 2055(a) for the present value of the charitable remainder interest of the CRUT.

This ruling is conditioned on the repayment of any overpayments received by A and B from the CRUT under the rules of § 1.664-1(a)(5) and Rev. Rul. 92-57. If the repayments are not made in the time, manner, and amount described in these provisions, this ruling will be void.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express no opinion as to whether the CRUT, as reformed, qualifies as a charitable remainder unitrust.

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This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to the executor of the Estate.

Sincerely yours,

J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
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