

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-118250-02

Date:

SEPTEMBER 30, 2003

In Re:

Legend:

Decedent =
Spouse =
Trust: =

Reformed Trust One =

Reformed Trust Two =

Son =
Daughter-in-law =
Granddaughter =
Corporation =
Charity 1 =
Charity 2 =
Charity 3 =
Charity 4 =
Charity 5 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
X =
\$A =
\$B =
\$C =

Dear _____ :

We received a letter requesting rulings on behalf of Decedent's estate concerning the estate tax consequences under § 2055 of the Internal Revenue Code and the income tax consequences under § 664 of a proposed reformation of a charitable remainder trust. This letter responds to that request.

The facts and representations submitted are summarized as follows:

Decedent established a revocable trust (Trust) under a trust agreement dated Date 1. Decedent died on Date 2 prior to July 29, 1997. Decedent was survived by Spouse, Son and Daughter-in-law. He was also survived by Granddaughter, and three great grandchildren. Decedent's will directs that all assets, except certain designated items, be transferred to Trust.

Trust agreement provides for the distribution of Trust assets after Decedent's death. Under Article VII of Trust agreement, as amended, the trustee is directed to distribute certain items of Decedent's personal property to Spouse. Under Article XV, paragraph 2, of Trust, the trustee is to transfer Decedent's right, title and interest in and to Corporation to Son. Further, Article XV, paragraph 3, directs the trustee to transfer a specific sum to Son.

Article XV, paragraph 4, of Trust, as amended, directs the trustees in accordance with the terms of an ante-nuptial agreement between Decedent and Spouse to pay a specific sum monthly commencing on the date of Decedent's death and continuing until Spouse's death. Further, Article XV, paragraph 4, of Trust agreement provides Decedent's Spouse with a life estate in Decedent's residence and directs the trustee to pay all real estate taxes, insurance, association charges and any other charges or assessments on the property.

Article XV, paragraphs 6 and 8, of Trust, as amended, provide for pecuniary bequests to Decedent's sisters.

Article XV, paragraph 9, of Trust, as amended, provides for pecuniary bequests to each of Charity 1, Charity 2, Charity 3, Charity 4, and Charity 5.

Article XV, paragraph 10, of Trust, directs trustee to set aside a specific amount (\$A) for the college education of Granddaughter. If Granddaughter does not enroll in college, the trustee is to pay Granddaughter a specific sum per year for a period of X years commencing on Granddaughter's twentieth birthday.

Article XV, paragraph 11, of Trust, directs the trustee to pay Son a specific sum annually during his lifetime. Article XV, paragraph 11 of Trust, also provides that, after

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Son's death, if Daughter-in-law survives him, trustee is to pay Daughter-in-law, a specific sum annually during her lifetime.

Article XVIII, paragraph 1, of Trust, directs trustee to provide an amount not to exceed \$A dollars each for the college education of three specified grandchildren of Decedent and any grandchild of Son and Daughter-in-law born after execution of Trust.

Article XV, paragraph 13, of Trust agreement, provides that after the death of Son and Daughter-in-law, all of the assets of Trust then remaining shall be paid in equal shares to the organizations named in paragraph 9 and, thereafter, Trust shall terminate.

Decedent's executor was granted an extension of time to file the Federal Estate and Gift Tax Return (Form 706) until Date 4. In its current form, Trust does not meet the requirements of a charitable remainder trust under § 664. On Date 3, prior to Date 4, trustee filed a petition with the appropriate local court to reform Trust pursuant to § 2055(e)(3). An amended petition will be filed to comply with this submission.

In accordance with the petition, the trustee will pay the specific and pecuniary bequests provided in Article VII, Article XV paragraph 2, Article XV paragraph 3, Article XV paragraph 6 and 8, and Article XV, paragraph 9. The balance of the trust corpus (including Decedent's residence) will be divided between 2 trusts, Reformed Trust 1 and Reformed Trust 2.

The first trust, Reformed Trust 1, will distribute annually, an amount equal to 5 percent of the initial net fair market value of the trust assets. With respect to the 5 percent amount, \$B per month will be paid to Spouse for her life. Upon the death of Spouse, if she predeceases Son and Daughter-in-law, this \$B portion of the annuity will be paid in each taxable year in equal shares to qualified charities named in Article XV of Trust.

In addition, from the 5 percent amount, \$C per month will be paid to Son. Upon the death of Son, if Daughter-in-law survives him, the \$C amount will be distributed one-half to qualified charities named in Article XV of Trust and one-half to Daughter-in-law for life. If Son and Daughter-in-law predecease Spouse, this \$C amount will be paid in each taxable year in equal shares to qualified charities named in Article XV of Trust.

The balance of the 5 percent amount will be paid to the qualified charities named in Article XV of Trust. Upon the death of the survivor of Spouse, Son and Daughter-in-law, Reformed Trust 1 will terminate and the trust assets will be distributed equally to qualified charities named in Article XV of Trust.

Reformed Trust 2 will be funded with the amount necessary to fund the educational bequests provided for in Article XV paragraph 10, and Article XVII, paragraph 1, of Trust. Article II, paragraph First, of Reformed Trust 2 provides that Granddaughter will receive an amount each year as determined in the sole discretion of the trustee for her education; provided that the trustee will not make distributions to or

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on behalf of Granddaughter in a total amount in excess of \$A. When Granddaughter reaches the age of 20 or ceases to attend college, whichever occurs last, the remaining amount is to be distributed to or on her behalf up to a total amount of \$A, if she is then living, in equal shares over a period of five years. Upon the death of Granddaughter, prior to this gift being completely distributed to her, any amount remaining is to be distributed to qualified charities named in Article XV of Trust.

In addition, Reformed Trust 2, Article II, paragraph Second, provides that the living grandchildren of Daughter-in-law on the date of Trust, and each great grandchild of Grantor born subsequent to the date of death of Grantor, will be eligible to receive an total amount of \$A to be used for their college education. The funds are to be distributed at the discretion of the trustee; provided however, that should a recipient attain the age of 28 without having received the total amount of \$A for college education, no further distribution will be made to a grandchild from Trust 2.

Article II, paragraph Third, provides that when there are no living recipients, or when there are no living recipients under the age of 28, whichever occurs first, any such undistributed amount will be distributed to the qualified charities named in Article XV of Trust. If none of the organizations are qualified charities, then the trustee will distribute such income and principal of Trust 2 to such qualified charities as the trustee selects in his sole discretion.

The proposed reformation will be effective as of the date of Decedent's death.

Taxpayer requests the following rulings:

(1) The charitable interests created under Trust are reformable interests under § 2055(e)(3)(c).

(2) The reformation of Trust as proposed will be a qualified reformation, and consequently the Decedent's estate will qualify for a federal estate tax charitable deduction, with respect to the transfer to Reformed Trust 1.

(3) Reformed Trust 1 will be deemed effective as of the date of death of Decedent for income tax purposes.

Section 664(d)(1), as it applied to transfers on or before July 28, 1997, provides that a charitable remainder annuity trust is a trust —

(A) from which a sum certain (which is not less than 5 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 section 170(c) and, in the case of individuals, only to an individual who is living at the time of 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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(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 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 section 170(c) or is to be retained by the trust for such use. Section 2055(a) provides that 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, and transfers to or for a corporation or certain other organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Section 2055(e)(2) provides that where an interest in property 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 or has passed to the person, or for a use, described in § 2055(a), unless in the case of a remainder interest, the interest is in a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)). In the case of an interest other than a remainder interest, the interest must be in the form of a guaranteed annuity, or a fixed percentage distributed annually of the net fair market value of the trust assets, determined annually.

Section 2055(e)(3) provides that a deduction is allowed under § 2055(a) with respect to any qualified reformation.

Section 2055(e)(3)(B) defines the term "qualified reformation" to mean 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) any other interest, the reformable interest and the qualified interest are for the same period, and

(iii) the 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 § 2055(e)(2).

Section 2055(e)(3)(C)(ii) provides that generally 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, in part, that § 2055(e)(3)(C)(ii) does not apply to any interest if not later than 90 days after the last date (including extensions) for filing an estate tax return, if an estate tax return is required to be filed, a judicial proceeding is commenced to change the interest into a qualified interest.

Section 2055(e)(3)(D) defines the term "qualified interest" to mean an interest for which a deduction is allowable under § 2055(a).

In this case, the charitable remainder interests constitute reformable interests under § 2055(e)(3)(C). As originally drafted, Trust provided for charitable remainder interests that were presently ascertainable and severable from the noncharitable interests. See § 20 2055-2(a) and (b). Accordingly, these charitable remainder interests would have qualified for an estate tax charitable deduction under section 2055(a), but for the provisions of section 2055(e)(2). In addition, the reformation proceeding was commenced within the time prescribed in §2055(e)(3)(C)(iii).

Further, the proposed reformation will constitute a qualified reformation under §2055(e)(3)(B). We have determined that the actuarial value of the charitable interests in Reformed Trust 1 will not differ by more than 5 percent from the actuarial value of the charitable remainder interests provided for in Trust prior to reformation, determined under §7520. Therefore, the proposed reformation satisfies the requirements of § 2055(e)(3)(B)(i). In addition, under the terms of proposed Reformed Trust 1, the interests of Spouse, Son and Daughter-in-law will terminate at the same time as these interests would have terminated under the terms of Trust, as originally drafted. Therefore, the proposed reformation satisfies the requirements of § 2055(e)(3)(B)(ii)(II). The reformation will be effective as of the date of Decedent's death. Therefore, the requirement of §2055(e)(3)(B)(iii) is satisfied. Finally, Reformed Trust 1 qualifies as a charitable remainder annuity trust as described in §664(d)(1).

Accordingly, based on the information submitted and representations made, we conclude that the proposed reformation of Trust, as described above, will be a qualified reformation within the meaning of section 2055(e)(3), provided the reformation is effective under local law. Therefore, an estate tax charitable deduction will be allowable under §2055(a) for the present value of the charitable remainder interests in Reformed Trust 1, determined under § 20.2055-2(f)(2)(i). In addition, that portion of the 5 percent

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amount that is to be paid annually to the charities will constitute a guaranteed annuity within the meaning of § 2055(e)(2)(B). Therefore, an estate tax charitable deduction will be allowed under section 2055(a) based on the present value of the guaranteed annuity interest, determined under §20.2055-2(f)(2)(iv). Provided that Reformed Trust 1 is a valid trust under applicable local law, it will qualify as a charitable remainder trust, commencing with the date of Decedent's death, for federal income tax purposes, for any year in which continues to meet the definition of and to function exclusively as a charitable remainder annuity trust. For that year, the trust will be exempt from taxes imposed by subtitle A of the Code, unless it has unrelated business taxable income as defined in section 512 and the applicable regulations.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

George L. Masnik
Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for 6110 purpose