

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: 200628026

Release Date: 7/14/2006

CC:PSI:B02:
POSTF-154465-05

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 664.03-02

date: March 15, 2006

to: David L. Zoss, CC:SB:5:STP
(Small Business/Self-Employed)

from: Tom Hines, Chief, CC:PSI:2
(Passthroughs & Special Industries)

subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Trust =

A =

Date 1 =

ISSUES

(1) Is Trust a charitable remainder unitrust ("CRUT") for federal income tax purposes?

CONCLUSIONS

(2) Trust is not a CRUT for federal income tax purposes.

LAW AND ANALYSIS

You have requested that we examine the Trust instrument to determine if it is a CRUT for federal income tax purposes. We examined the Trust instrument and conclude that the terms of the Trust instrument are consistent with a CRUT, however, the information submitted indicates that the Trust has not been operated as a CRUT.

Section 664(d)(2) of the Internal Revenue Code provides that for purposes of section 664, a charitable remainder unitrust is a trust (A) from which a fixed percent (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) 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 section 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 of or lives of such individual or individuals, (B) from which no amount other than the payments described in section 664(d)(2)(A) and other than qualified gratuitous transfers described in section 664(d)(2)(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 section 664(d)(2)(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 a use or, to the extent the remainder interest is in qualified employer securities (as defined in section 664(g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by section 664(g)), and (D) the value (determined under section 7520) of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in the trust.

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

Section 1.664-1(a)(4) of the Income Tax Regulations 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. Section 1.664-1(a)(4) also provides that solely for the purposes of section 664 and the regulations there under, 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 (relating to grantors and others treated as substantial owners).

Section 1.664-3(a)(4) provides that an amount is not paid to or for the use of any person other than an organization described in section 170(c) if the amount is transferred for full and adequate consideration.

Section 671 provides the general rule that if the grantor or another person is treated as the owner of any portion of a trust, his taxable income and credits shall include those items of income, deduction, and credits against tax of the trust that are attributable to that portion of the trust to the extent that such items would be taken into account in computing the taxable income or credits against tax of an individual.

Section 673 through 677 specify the circumstances under which the grantor is regarded as the owner of a portion of a trust.

Section 677(a) provides that the grantor is treated as the owner of any portion of a trust whose income is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor.

Section 1.677(a)-1(d) provides that under section 677 a grantor is, in general, treated as the owner of a portion of a trust whose income is, or, in the discretion of the grantor or a nonadverse party or both, may be applied in discharge of a legal obligation of the grantor.

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. Section 1.664-1(a)(4). Although the Trust instrument purports to create a charitable remainder trust, the Trust has not functioned exclusively as a charitable remainder trust since its creation.

Section 1.664-1(a)(4) provides that a CRUT 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 (relating to grantors and others treated as substantial owners). On Date 1, A quitclaimed real property encumbered with a mortgage to the Trust. The Trust paid the mortgage liability with the proceeds from the sale of the property. If A remained personally liable on the mortgage encumbering the property at the time the Trust paid the mortgage liability, the Trust would no longer qualify as a CRUT. This is because the Trust's income was used to discharge a legal obligation of the grantor within the meaning of § 1.677(a)-1(d), and therefore, the Trust was a grantor trust. As long as the grantor is treated as the owner of the entire trust under § 677, the trust is not deemed to be created for purposes of § 664. As a result, the Trust was not a CRUT under § 664.

One of the requirements of a charitable remainder unitrust is that no amount other than the unitrust amount can be paid to or for the use of any person other than a § 170(c) organization. Section 664(d)(1)(B). Estate of Atkinson v. Commissioner, 115 T.C. 26, 34 (July 26, 2000) aff'd by 309 F.3d 1290, (11th Cir. 2002). An amount is not paid to or for the use of any person other than an organization described in § 170(c) if the amount is transferred for full and adequate consideration. Section 1.664-3(a)(4). According to the facts submitted, A, as trustee, writes checks from the Trust's checking

account to himself, his wife, and third parties on an apparently random, ongoing basis, as if the account was a personal bank account. For example, A paid monthly installment payments on a pickup truck that he owned personally for approximately two years. These payments do not appear to have been made in exchange for full and adequate consideration. These are payments of other than the unitrust amount for the use of a person other than a § 170(c) organization.

In addition, the Trust has allowed A to use real estate within the Trust rent free, which is a payment of other than the unitrust amount to a person other than a § 170(c) organization. Furthermore, the Trust prepaid A's rent for 10 years in a building owned by a third party, which is also a payment of other than the unitrust amount for the use of a person other than a § 170(c) organization. As a result of these payments, the Trust does not qualify as a CRUT.

The Trust should not be respected as a charitable remainder unitrust under § 664 Article 2.1 of the Trust document provides for the payment of a unitrust amount from the Trust's income to A, the grantor of the Trust. Therefore, income may be distributed to the grantor under § 677. As a result, the Trust is a grantor trust and A is treated as the owner of the Trust under § 677.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call _____ if you have any further questions.