

INTERNAL REVENUE SERVICE
Index No. 2055.12-10
664.03-01
Number: **199903001**
Release Date: 1/22/1999

CC:DOM:P&SI:4/PLR-118464-97

October 19, 1998

Legend:

Grantor =

Child =

Trust =

CRAT =

Charity =

Dear

This is in response to your April 29, 1998 letter and prior correspondence, submitted on your behalf by your authorized representative, in which you request rulings under sections 2055 and 664 of the Internal Revenue Code.

You have represented the facts to be as follows:

Grantor is a founder of Charity, which is a qualified tax exempt charitable organization.

Grantor created a revocable inter vivos trust (the Trust) in 1987 and transferred property, including her personal residence, to the Trust. Grantor amended and restated the trust agreement in 1997 and again in 1998. (All references to the "trust agreement" hereafter are to the trust agreement as amended and restated in 1998). Grantor is the trustee of the Trust. Under the provisions of the trust agreement, income and principal of the Trust are distributable to Grantor during her lifetime. The Trust will become irrevocable at the Grantor's death.

After the Grantor's death, a one-half undivided interest in Grantor's residence is to be distributed outright to Charity. A life estate in the other one-half interest is to be distributed to a Special Needs Trust for the life of Grantor's Child (Child). The remainder interest in this one-half interest is to be distributed outright to Charity at Child's death.

In the trust agreement the Grantor requests, but does not require, that after her death, the trustee of the Special Needs Trust and the Charity enter into a "use agreement" with respect to the residence. The text of the use agreement is attached to the trust agreement as Exhibit A. The use agreement provides that during Child's lifetime, Child will have complete use of the first floor, the back yard, and the pool located in the back yard, as well as access to the second floor for any reasonable purpose with the consent of Charity. Charity will have complete use of the second floor and access to the first floor for any reasonable purpose with the consent of the trustee of the Special Needs Trust.

After the Grantor's death, other specified assets of the Trust are to be distributed according to the terms of the trust agreement. Any property remaining in the Trust following the specific distributions is to be distributed to a charitable remainder annuity trust (CRAT) which is to be established after the Grantor's death. The CRAT is to distribute annually an annuity amount of 8 percent of the net fair market value of the assets, valued at the date of inception of the CRAT, to the Special Needs Trust. At the death of Child, the CRAT will terminate and the remainder interest is to be distributed to Charity.

The terms of the CRAT are included in the trust agreement.

The Special Needs Trust is to be established after the Grantor's death for the lifetime of Child, who is totally and permanently disabled. The stated purpose of the trust is to provide financial aid to supplement, rather than replace, the government benefits provided to Child. The trustee has the sole discretion to distribute income and principal to Child. Child has a general power of appointment over the trust assets. If Child fails to exercise the general power, the balance of the Special Needs Trust is to be distributed to Charity when the trust terminates.

You have requested the following rulings:

(1) that, upon the Grantor's death, the outright distribution to Charity from the Grantor's revocable trust of a one-half undivided interest in Grantor's residence will qualify for the estate tax charitable deduction under § 2055;

(2) that, upon the Grantor's death, the outright distribution to Charity from the Grantor's revocable trust of a remainder interest in the remaining one-half undivided interest in the residence will qualify for the charitable deduction under § 2055;

(3) that the request by Grantor that Charity enter into a "use agreement" with the trustee of the Special Needs Trust will not disqualify the gifts of the residence to Charity for the charitable deduction under § 2055; and

(4) that the CRAT will not be disqualified under § 664 as a charitable remainder annuity trust if the annuity payments are made to the Special Needs Trust in which the trustee has the sole discretion as to the amount of income or principal that will be distributed to the beneficiary of the Special Needs Trust.

Issues 1 and 2 :

Section 2055(a) provides, for estate tax purposes, 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, devices, or transfers for public, charitable, and religious uses.

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 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), no deduction shall be allowed for the interest which passes or has passed to the person, or for the use, 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).

Section 170(f)(3)(A) denies an income tax charitable deduction in the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the donor's entire interest in such property. However, § 170(f)(3)(B) provides that § 170(f)(3)(A) shall not apply to a contribution of (i) a remainder interest in a personal residence or farm, or (ii) an undivided portion of the taxpayer's entire interest in property.

Section 1.170A-7(b)(3) of the Income Tax Regulations provides, in part, that for purposes of § 170(f)(3)(B), the term 'personal residence' means any property used by the taxpayer as his personal residence even though it is not used as his principal residence.

Section 1.170A-7(b)(1)(i) provides, in part, that an undivided portion of a donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in such property and must extend over the entire term of the donor's interest in such property and in other property into which such property is converted. A deduction is allowed under § 170 for a contribution of property to a charitable organization whereby such organization is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in such property. However, a charitable contribution in perpetuity of an interest in property not in trust, where the donor transfers some specific rights and retains other substantial rights, will not be considered a contribution of an undivided portion of the donor's entire interest in property to which section 170(f)(3)(A) does not apply.

In this case, the trust agreement provides that upon the Grantor's death, a one-half undivided interest in the Grantor's personal residence is to be transferred outright to Charity, and a remainder interest in the other one-half undivided interest is to be transferred outright to Charity. These transfers will satisfy the requirements of § 170(f)(3)(B)(i) and (ii). See also Rev. Rul. 75-240, 1975-2 C.B. 78. Thus, § 2055(e)(2) will not apply to disallow the deduction allowed by § 2055(a). Therefore, based upon the facts submitted and representations made, we conclude that the transfers will be eligible for the estate tax charitable deduction under § 2055(a).

Issue 3:

Section 20.2055-2(b)(1) of the Estate Tax Regulations provides, in part, that if the legatee, devisee, donee, or trustee of a transfer under § 2055(a) is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power.

In this case, Charity and the trustee of the Special Needs Trust may enter into a use agreement, specifying which portion of the property Child may use and which portion Charity may use. Whether or not Charity enters into the use agreement is entirely voluntary and is not a condition of the charitable bequest. Charity will receive a one-half undivided interest in the residence and a remainder interest in the other one-half undivided interest whether or not it enters into the use agreement.

Therefore, based on the facts submitted and the representations made, we conclude that the Grantor's request that Charity and the trustee of the Special Needs Trust enter into a use agreement does not constitute a transfer subject to a condition or power, and a charitable deduction will be allowed under § 2055(a) for the transfers to Charity.

Issue 4:

Section 664(d)(1)(A) provides, in part, that a charitable remainder annuity trust is a trust 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 term of years (not in excess of 20 years) or for the life or lives of such individual or individuals.

Section 1.664-1(a)(1) of the Income Tax Regulations provides the general rule that a charitable remainder trust is a trust that provides for a specified distribution, at least annually, to one or more beneficiaries, at least one of which is not a charity, for life or a term of years, with an irrevocable remainder interest to be held for the benefit of, or paid over to, charity.

Section 1.664-1(a)(2) provides that a trust is a charitable remainder trust only if it is either a charitable remainder annuity trust in every respect or a charitable remainder unitrust in every respect.

Section 1.664-2(a)(3) provides, with regard to charitable remainder annuity trusts, that distributions must be payable to or for the use of a named person or persons. However, section 1.664-2(a)(5) provides that only an individual or an organization described in § 170(c) may receive an amount for the life of an individual.

Rev. Rul. 76-270, 1976-2 C.B. 194, provides that an otherwise qualifying charitable remainder trust that makes distributions to a second trust whose only function is to receive and administer those distributions for the benefit of the named individual lifetime beneficiary of the charitable remainder trust is considered to have made the distributions directly to the individual and qualifies as a charitable remainder trust.

In Rev. Rul. 76-270, an individual concurrently created Trust A and Trust B. Under the governing instrument of Trust A, a trust that otherwise qualifies as a charitable remainder trust, the distribution is to be made to Trust B for the benefit of C, an incompetent, who is the individual named as the lifetime beneficiary of Trust A. The governing instrument of Trust B provides that the income of the trust will be used exclusively for the benefit of C and that upon the death of C the trust will terminate. However, Trust B is not required to distribute all of the income to C. Payments of a designated portion of the amounts Trust B receives from Trust A are to be made to C each month, and if at any time in the sole discretion of the trustee, the monthly payment to C is insufficient to provide adequately for the care, support, and maintenance of C, or is insufficient for the needs of C for any reason, additional amounts will be paid as needed on or on behalf of C from Trust B. Any amounts remaining in Trust B at C's death will be distributed to C's estate.

In the revenue ruling, Trust B was not required to distribute all of the income to the incompetent beneficiary and, according to the ruling, the function of Trust B was to receive and administer the payments it received from Trust A for the benefit of C. Similarly, the Special Needs Trust in the present case will receive and administer payments from the CRAT for the benefit of Child. Accordingly, the payments will be paid to a named person or persons within the meaning of § 1.664-2(a)(3). In addition, in the present case, Child has a general power of appointment over the assets of the Special Needs Trust. Thus, the assets of the trust will be includible in Child's gross estate, as they were in C's gross estate in the revenue ruling. Therefore, based on the facts submitted and representations made, we conclude that the payment of the annuity to the Special Needs Trust will not disqualify the CRAT as a charitable remainder annuity trust under § 664.

This ruling is directed to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by adoption of temporary regulations, to the extent the regulations are inconsistent with any conclusions in the ruling. See section 12.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 47. However, when the criteria in section 12.05 of Rev. Proc. 98-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

Except as we have specifically ruled above, we express no opinion on the tax consequences of the proposed transactions under the cited provisions of the Code and Regulations or under any other provisions of the Code or Regulations.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
Katherine A. Mellody
Assistant to the Branch Chief
Branch 4

Enclosure
Copy for 6110 purposes