

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Date:

November 19, 1998

**LEGEND:**

- A =
- B =
- Trust =
- State =
- Date 1 =
- m =
- Cite 1 =
- Cite 2 =

Dear

This letter responds to a letter dated July 22, 1998, written on behalf of Trust requesting a ruling that certain provisions of Trust comply with the requirements for a charitable remainder unitrust under § 664 of the Internal Revenue Code.

**FACTS**

On Date 1, A established Trust for the benefit of B for B's life, with remainder to charity. Trust is intended to qualify as a charitable remainder trust under § 664(d)(2) and (3). A is the initial trustee of Trust. Trust is required to pay to B in each taxable year of Trust the lesser of the trust's income for the taxable year (as defined in § 643(b) and the applicable regulations) or m percent of the net fair market value of the

trust assets as of the first day of the taxable year. If trust income for the taxable year is less than m percent of the fair market value of the trust assets, the income shortfall will accumulate and be distributed in subsequent years if and when trust income exceeds m percent. After B's death, Trust will terminate and all remaining trust assets will be distributed to charitable organizations described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a).

A intends to contribute appreciated securities to Trust. Section 4(h) of Trust's governing instrument provides that the trustee of Trust, in its fiduciary capacity, may reasonably allocate to the income of Trust some or all of the post-contribution capital gains realized by Trust on the sale or other disposition of any stock, bond, or other security that produced limited or no income during the period owned by Trust.

#### LAW AND ANALYSIS

Section 664(d)(2) provides that a charitable remainder unitrust is a trust (A) 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 the individual or individuals, (B) from which no amount other than the payments described in § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c), (C) following the termination of the payments described in § 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c), and (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of the remainder interest in the property is at least 10 percent of the net fair market value of the property as of the date the property is contributed to the trust.

Section 664(d)(3) provides that the trust instrument may provide that the income recipient be paid the amount of trust income, if such amount is less than the amount required to be distributed under § 664(d)(2)(A). In addition, the trust instrument may provide that the income recipient be paid any

excess trust income to the extent that the aggregate of amounts paid in prior years was less than the aggregate of amounts provided in § 664(d)(2)(A).

Section 1.664-3(a)(1)(i)(b)(1) of the Income Tax Regulations provides that the amount of trust income under § 664(d)(3) is the amount of trust income as defined in § 643(b) and the applicable regulations.

Section 643(b) provides that, for purposes of subparts A through D, part I, subchapter J, chapter 1, the term "income," when not preceded by the words "taxable," "distributable net," or "gross," means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends that a fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law are not considered income. Section 1.643(b)-1 provides, however, that trust provisions that depart fundamentally from concepts of local law in the determination of what constitutes income are not recognized.

Under State law, capital gains are generally allocated to principal. Cite 1. However, under Cite 2, if the creating instrument gives the trustee discretion in crediting a receipt or charging an expenditure to income or principal or partly to each, no inference that the trustee has improperly exercised discretion arises because the trustee has made an allocation contrary to a provision of State law.

Trust's governing instrument provides that the trustee of Trust may allocate to trust income some or all of Trust's post-contribution capital gains realized by Trust on the disposition of certain limited income stock, bond, or other security. The allocation is permitted under State law. Thus, under the terms of Trust's governing instrument and applicable local law, trust income may include the appreciation in certain Trust assets that occurred since Trust held those assets.

**CONCLUSIONS**

After applying the relevant law to the facts submitted and representations made, we conclude that including the provisions of Section 4(h) in Trust's governing instrument will not prevent Trust from qualifying as a charitable remainder unitrust under § 664.

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 on whether Trust otherwise qualifies as a charitable remainder trust under § 664.

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

Under a power of attorney on file in this office, we are sending a copy of this letter to your authorized representatives.

Sincerely yours,

Jeff Erickson  
Assistant to the Branch Chief,  
Branch 3  
Office of the Assistant Chief  
Counsel  
(Passthroughs and Special  
Industries)

Enclosures (2)  
Copy of this letter  
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