Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:Br.7-PLR-105397-99
Date:
March 31, 2000

Legend

Decedent:

Siblings:

Annuity Trust 1:

Annuity Trust 2:

Annuity Trust 3:

A:

B:

C:

D:

E:

F:

G:

H:

I:

J:

u:

v:

w:

x:

y:

date 1:

date 2:

Dear :

We received your representatives letter dated, , in which you request a ruling concerning the estate and income tax consequences under §§ 2055 and 664 of the Internal Revenue Code related to the proposed reformation of Decedent's Will and the deductibility of the present value of the charitable remainder interests provided for under the reformed Annuity trusts. This letter is in response to your request.

The represented facts are as follows: Decedent died testate on date 2. Under paragraph Third of the will the residue of the Estate was placed in trust. Under paragraph Third, subparagraph A, the trustees are to pay out to each of Decedent's brothers and sisters who survive Decedent, during their respective lifetimes, twenty percent of the net income of said trust fund, annually.

Paragraph Third, subparagraph B provides that after the death of two or more of decedent's brothers and/or sisters, as the case may be, the trustees are to pay out annually such income of the deceased beneficiaries, and upon the death of the Decedent's last of surviving brother or sister, as the case may be, Decedent directs the trustees to pay eighty percent of the income of the trust corpus, as follows: 5% to A, 10% to B, 10% to C, 5% to D, 10% to E, 10% to F, 5% to G, 10% to H, 10% to I, and 5% to J. The remaining 20% of income of the trust fund shall be added annually to the

corpus of the trust.

Subparagraph B also provides that the trustees shall have complete power and discretion in the management of all trust property, in addition to any conferred upon them by law, and shall be liable to the beneficiaries for malfeasance only. The trustees shall have the power to place any of the assets of the trust in the name of a nominee. The trustees shall have the right to place the assets of the trust into a common fund should they deem it fit.

Trust, as presently drafted, does not qualify for the federal estate tax charitiable deduction. Therefore, the Estate proposes to reform the will. The will as reformed establishes three trusts, Annuity Trust 1, Annuity Trust 2 and Annuity Trust 3, one for each of Decedent's surviving siblings and divides the residue of the estate between them. Annuity Trust 1 and Annuity Trust 2 are to each receive 33.2% of the residue of the Estate and Annuity Trust 3 is to receive 33.6%. Each year the trustees shall, during the life of each annuity trust beneficiary, pay a lump sum annual annuity amount to the annuity recipient of 5% of the initial net fair market value of the annuity trust assets as finally determined for federal estate tax purposes. The annuity amount will be paid annually from income and, to the extent that income is not sufficient, from principal. Any income of the annuity trust for a taxable year in excess of the annuity amount shall be added to principal.

Upon the death of an annuity trust annuity recipient, the trustees will thereupon hold all of the then principal and income of the annuity trust (other than any amount due the annuity recipient or the annuity recipient's estate under the provisions above) solely for the benefit of the charitable organizations described in Subparagraphs 1 through 10 of this Paragraph B. Under the terms of the reformed trust, 80% of the income will be distributed to the named charitable organizations and 20% will be added to the trust corpus. The terms of the reformed instrument further provide that if any of the charitable organizations does not exist or is not an organization described in §§ 170(c) and 2055(a) of the Internal Revenue Code at the time when any principal or income of an annuity trust is to be distributed to it, then the trustees will distribute the principal and income to one or more similar organizations that are described in §§ 170(c) and 2055(a), as the trustees may deem wise and prudent. The reformed instrument also authorizes the trustees to merge one of the annuity trusts with another of the annuity trust after the death of those annuity trusts' respective annuity trust annuity recipients in order to reduce the administrative costs to the trusts.

It is represented that Decedent's estate commenced a judicial proceeding prior to the 90th day after the last day (including extensions) for filing the estate tax return. It is also represented that the reformation will be effective as of Decedent's date of death.

Specifically, you request the following rulings:

1. The proposed reformation will constitute a "qualified reformation" within the meaning of § 2055(e)(3)(B).

2. Each annuity trust, as reformed, will meet the requirements of a charitable remainder annuity trust under § 664(d)(1).

3. A federal estate tax charitable deduction will be allowed under § 2055(a) based on the present value of the charitable remainder interests provided for under the Annuity Trusts, as reformed.

Law and Analysis:

Section 664(d)(1) provides that for purposes of § 664, a charitable remainder annuity trust is a trust–(A) 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 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 or lives of such individual or individuals, (B) from which no amount other than the payments described in § 664(d)(1)(A) and other than qualified gratuitous transfers described in § 664(d)(1)(C) may be paid to or for the uses of any person other than an organization described in § 170(c), (C) following termination of the payments described in § 664(d)(1)(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 § 664(g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined § 664(g)), and (D) the value (determined under § 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 2055(a)(2) provides that for purposes of the tax imposed by § 2001, 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, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, which is not disqualified for tax exemption under § 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

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 under § 2055 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).

The charitable split interest rules of § 2055(e)(2) were enacted by the Tax Reform Act of 1969 and are applicable, with exceptions not relevant here, to estates of decedents dying after December 31, 1969. With respect to decedents dying before January 1, 1970, § 20.2055-2(a) of the Estate Tax Regulations provides that if a trust is created or property is transferred for both a charitable and a private purpose, a deduction may be taken for the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

Section 2055(e)(3) provides for reformations of interests to comply with the requirements of § 2055(e)(2).

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 for purposes of § 2055(e), 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 (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) such 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 the split-interest rules of § 2055(e)(2).

Under § 2055(e)(3)(C)(ii) 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, however, that the restriction in § 2055(e)(3)(C)(ii) does 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) provides that for purposes of § 2055(e)(3), the term "qualified interest" means an interest for which a deduction is allowable under § 2055(a).

Section 7520 provides that the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest, shall be determined–(1) under tables prescribed by the Secretary, and (2) by using an interest rate equal to 120 percent of the Federal midterm rate in effect under § 1274(d)(1) for the month in which the valuation date falls. If an income, estate, or gift tax charitable contribution is allowable for any part of the property transferred, the taxpayer may elect to use the Federal midterm rate for either of the 2 months preceding the month in which the valuation date falls for purposes of § 7520(a)(2). In the case of transfers of more than 1 interest in the same property with respect to which the taxpayer may use the same rate under § 7520(a)(2), the taxpayer shall use the same rate with respect to each such interest. The applicable § 7520 rate for the proposed reformation is 6.2 percent.

Trust, prior to reformation, required that 20 percent of the trust income be paid to each of the Siblings, noncharitable beneficiaries, while all of Siblings were living, with the remaining 40 percent to be accumulated in Trust. Upon the death of the first sibling to die, the remaining two siblings were to receive 20 percent of the trust income with the remaining 60 percent to be accumulated. Upon the death of the second sibling to die the last surviving sibling is to receive 20 percent of the trust income, while 40 percent is to be accumulated and 40 percent is to be distributed to charities. Upon the death of the last surviving sibling, 80 percent of the trust income was to be distributed to charity with the remaining 20 percent accumulated. Under the terms of Decedent's will, prior to reformation the original trust corpus is to be funded with $u. The present value of the charitable remainder prior to reformation is no greater than $v.

The reformation as proposed will divide the residue into three separate trusts of approximately equal amounts. Each of these trusts is to pay an annuity of 5 percent of the initial value of the trust corpus for the lifetime of the respective beneficiary. Each sibling will receive an annuity of $w per year for their respective lifetimes. The total present value of these three annuities is $x. The present value of the charitable remainder as reformed is $u minus $x or $y. The actuarial present value of the charitable remainder in the reformed trust is not less than 95 percent of the value of the charitable remainder in the pre-reformed trust.

The difference between the actuarial value of the "reformed" charitable remainder interest (determined as of the date of the Decedent's death) and the actuarial value (as so determined) of the "reformable" charitable remainder interest

does not exceed 5 percent of the actuarial value of the "reformable" interest. Therefore, the proposed reformation satisfies the 5 percent requirement of § 2055(e)(3)(B)(i).

The Siblings interests in the Annuity Trusts 1, 2 and 3 will terminate at the same time that the Siblings interests in the Trust would terminate. Moreover, it is represented that pursuant to the proposed Trust reformation, the reformation will be effective as of the date of Decedent's death. Therefore, the proposed reformation satisfies the requirements of § 2055(e)(3)(B)(ii) and (iii).

Finally, the value of the charitable remainder interest is presently ascertainable and, hence, severable from the noncharitable interest. Thus, the charitable interest provided in trust is a reformable interest within the meaning of § 2055(e)(3)(C)(i) because an estate tax deduction for the value of the remainder interest would have been allowable under § 2055(a) but for the split-interest provisions of § 2055(e)(2). The payments to persons other than the charitable interests were not expressed in specified dollar amounts or a fixed percentage of the fair market value of the property, as required by s 2055(e)(3)(C)(ii). However, pursuant to § 2055(e)(3)(C)(iii), the interest will qualify as a reformable interest because a judicial proceeding was commenced on or before the 90th day after the last date (including extensions) for filing the estate tax return.

Based on the facts and representations made, we therefore conclude that the reformation of Trust, as proposed, qualifies as a qualified reformation under § 2055(e)(3)(B).

The governing instruments of the annuity trusts contain the provisions set forth in Rev. Rul. 72-395, 1972-2 C.B. 340, as modified by Rev. Rul. 80-123, 1980-1 C.B. 205, and Rev. Rul. 82-128, 1982-2 C.B. 71, and clarified by Rev. Rul. 82-165, 1982-2 C.B. 117. Therefore, we conclude that each of the annuity trusts will meet the requirements of a charitable remainder annuity trust under § 664(d)(1), provided that the annuity trusts will be valid trusts under the applicable local law.

Accordingly, the annuity trusts will qualify as charitable remainder annuity trusts, for federal income tax purposes, for any year in which the trusts continue to meet the definition of and function exclusively as charitable remainder annuity trusts. Because the trusts will qualify as charitable remainder annuity trusts, an estate tax charitable deduction will be allowed under § 2055(a) for the present value of the remainder interests passing to charity. The amount of any charitable contribution deduction in respect of such remainder interests will be determined in accordance with § 2055 and the applicable regulations.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

Except as we have specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

This letter 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.

Sincerely,

Joseph H. Makurath

Joseph H. Makurath
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