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Date:
March 2, 2001

A =

B =

D1 =

D2 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

X =

Trust =

Amendment =

Dear :

This letter responds to your letter dated February 24, 2000, and subsequent correspondence, submitted on behalf of A and B, the grantors and trustees of Trust, requesting certain rulings under the Internal Revenue Code.

The information submitted states that A and B established Trust on D1. A and B represent that Trust was intended to qualify as a charitable remainder unitrust under § 664.

Section 1.01(p) of Trust provides that the term "Trust income" refers to the income generated by the Trust assets,

determined by the trustee in accordance with generally accepted fiduciary accounting principles, except that the following items shall in no event be deemed Trust income: (i) extraordinary dividends or taxable stock dividends which the trustee, acting in good faith, determines to be allocable to principal; (ii) stock splits; and (iii) gains from the sale, exchange, or other disposition of any Trust asset.

Section 1.01(v) provides that, with respect to any Trust year, the "unitrust amount" is an amount equal to the lesser of (i) the Trust income for such Trust; or (ii) x percent of the net fair market value of the Trust assets.

Section 1.04 provides that Trust is irrevocable in all respects, and neither A nor B, nor any other person or organization, including the trustee, shall have the power during the Trust term to alter, amend, or revoke any of the provisions of Trust or to appropriate the Trust assets or the income therefrom in violation of the provisions of Trust, except that (a) the trustee, in its discretion as a fiduciary of the trust, may amend Trust to comply fully with the requirements of § 664 and § 1.664-1 and 1.664-3 of the Income Tax Regulations; (b) A and B reserve to themselves the limited power of revocation/termination set forth in § 2.04; and (c) A and B reserve to themselves the power to amend § 4.01 solely for the purpose of: (i) adding thereto the names of additional qualified charities who shall be entitled to receive distribution of amounts from Trust as of or subsequent to the Trust termination date, (ii) deleting therefrom the names of those designated charities who shall no longer be entitled to receive distribution of any amounts from Trust as of or subsequent to the Trust termination date (provided there is at all times at least one qualified charity designated to receive distribution amounts), and (iii) altering the amount of any such distribution payable to a designated qualified charity.

Section 2.01 provided, prior to the Amendment, that (a) during each taxable year, the trustee shall pay the unitrust amount applicable to such taxable year to the following persons, which unitrust amount shall be allocated between and among such persons in the following proportions: (i) to A and B, 100 percent of the applicable unitrust amount, for and during their respective lifetimes; (ii) following the death of A and B, to A and B's named nieces and nephews, in equal shares, per stirpes, 100 percent of the applicable unitrust amount, for a period of twenty years. Upon the death of a unitrust recipient, the share of the unitrust amount allocable to that deceased unitrust recipient shall be paid to the unitrust recipients then living, to be divided among them, pro rata, according to the ratio which each of their respective shares of the unitrust amount (as in

effect just after the death of the unitrust recipient whose share is being divided) bears to the total unitrust amount.

Section 2.04 provides that (a) A and B thereby reserve to themselves the power to revoke or terminate the interest of any unitrust recipient which is not a qualified charity and (b) this reserved power shall be exercisable by A or B only by a specific reference in a last will and testament to the exercise of such power.

Section 4.01 provides that upon the occurrence of the Trust termination date, or not later than the expiration of a reasonable period of time commencing on the Trust termination date, the trustee shall distribute all the Trust assets and any accumulated income therefrom, in final liquidation of the Trust, to named qualified charities, in equal proportions.

Subsequent to the establishment of Trust, A and B discovered that the unitrust payment provisions of § 2.01 did not satisfy the requirements of § 664 and the regulations thereunder. On D2, A and B executed Amendment to Trust.

Section 2.01(a)(i) of Trust, as altered by Amendment, provides that during each taxable year, the trustee shall pay the unitrust amount applicable to such taxable year to the following persons, which unitrust amount shall be allocated between and among such persons in the following proportions: to A and B, 100 percent of the applicable unitrust amount, for and during their respective lifetimes. However, should both of the named unitrust recipients decease prior to the expiration of twenty years from the date of the inception of said unitrust, 100 percent of the unitrust amount shall be paid to named individual beneficiaries, in equal shares, per stirpes, until the expiration of said twenty year period.

In the Year 1, Year 2, Year 3, Year 4, and Year 5 Trust taxable years, A and B mistakenly paid themselves, as current Trust beneficiaries, a unitrust amount equal to x percent of the fair market value of the Trust assets, rather than the lesser of such amount or the Trust income for the year, as required by § 1.01(v). These distributions were comprised of all of the ordinary income and some of the principal of Trust for each of those years. Trust realized capital gains during one or more of those years from the sale of Trust assets, and A and B treated the principal distributions received as carrying out a portion of capital gains under the tier method of accounting for CRUTs.

A and B request a ruling that Trust is eligible for a "qualified reformation" pursuant to §§ 2522(c)(4) and 2055(e)(3) to perfect the qualification of Trust as a charitable remainder

unitrust as described in § 664. Alternatively, if Trust is not eligible for a qualified reformation, A and B request a ruling that the contribution of property to Trust did not constitute a completed gift to any person or organization for federal gift tax purposes.

RULING 1

Section 664(d)(2)(A) provides that a charitable remainder unitrust is a trust from which a fixed percentage (which is not less than 5 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.

Section 1.664-1(a)(4) 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 2522(c) provides that in the case of property transferred in trust for the benefit of both charitable and noncharitable beneficiaries, no deduction for gift tax purposes is allowed for a contribution of a remainder interest to a charitable organization unless the remainder interest is in a trust that is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)).

Section 2522(c)(4)(A) provides that a deduction is allowed under § 2522(a) in respect of any qualified reformation (within the meaning of § 2055(e)(3)(B)). Section 2522(c)(4)(B) provides that for purposes of § 2522(c)(4), rules similar to the rules of § 2055(e)(3) shall apply.

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) such change is effective as of the date of the decedent's death.
>
> A nonremainder interest (before reformation) for a term of years in excess of 20 years shall be treated as satisfying subclause (I) of clause (ii) if such interest (after reformation) is for a term of 20 years.

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 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)(I) provides, however, that § 2055(e)(3)(C)(ii) shall 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) defines a "qualified interest" as an interest for which a deduction is allowable under § 2055(a).

The legislative history underlying § 2055(e)(3) makes clear that the principles of that section are applicable to inter vivos trusts and that in order to be a qualified reformation, the reformation of an inter vivos trust must be retroactive to the date of the trust's creation. See H.R. Rep. No. 432, 98th Cong., 2nd Sess. 1516 (1984).

In the present case, the D2 Amendment of Trust did not constitute a qualified reformation under § 2055(e)(3). After the D2 Amendment, the difference between the actuarial value (determined as of the date of the initial transfer) of the qualified interest, and the actuarial value (as so determined) of the reformable interest, exceeded 5 percent of the actuarial value (as so determined) of the reformable interest. Accordingly, the Amendment did not satisfy the requirements of § 2055(e)(3)(B)(i). Furthermore, after the D2 Amendment, the nonremainder interest (before and after the reformation) did not terminate at the same time as required in § 2055(e)(3)(B)(ii)(I). With regard to a proposed future reformation, we note that the requirements of § 2055(e)(3)(B)(ii)(I) would still not be satisfied. Accordingly, we conclude that Trust initially failed to qualify as a CRUT, that the D2 Amendment failed to qualify Trust as a CRUT, and that any future reformation would not constitute a qualified reformation under § 2055(e)(3) that would qualify Trust as a CRUT.

RULING 2

Section 2501 of the Code imposes a tax on the transfer of property by gift by an individual. Section 2511 provides that the tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that a gift is complete when the donor has so parted with dominion and control as to leave in the donor no power to change the property's disposition, whether for the donor's own benefit or for the benefit of another. Section 25.2511-2(b) further provides that if the donor reserves any power over the property's disposition, the gift may be wholly or partially incomplete. Section 25.2511-2(c) provides that a gift is incomplete if a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

In the present situation, under Trust, A and B have retained the power to revoke, by will, the unitrust interests of any named noncharitable beneficiaries. Accordingly, the transfer to the unitrust beneficiaries is not a completed gift for gift tax purposes under § 25.2511-2(c). See also, Rev. Rul. 79-243, 1979-2 C.B. 343. In addition, A and B have also retained the power to add or delete charitable beneficiaries and the power to change the amount payable to a named charitable beneficiary. In view of these retained powers, the transfer to the remainder beneficiaries is also an incomplete gift under § 25.2511-2(c).

Cf. Rev. Rul. 77-275, 1977-2 C.B. 346, illustrating that a retained power to designate charitable beneficiaries of a trust renders the transfer to charity incomplete for gift tax purposes.

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the transactions described above under any other provision of the Code.

This ruling is directed only to the taxpayer on whose behalf it was requested. Section 6110(k)(3) provides that it may not be used or cited as precedent. Pursuant to a power of attorney on file with this office, copies of this letter are being sent to A and B and to their other authorized representative.

Sincerely yours,
J. THOMAS HINES
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
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