

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:  
Bradford R. Poston  
Telephone Number:  
(202) 622-3060  
Refer Reply To:  
CC:PSI:2 - PLR-113964-00  
Date:  
July 19, 2001

Trust =

A =

B =

C =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

D7 =

D8 =

Year 1 =

Year 2 =

Court =

State =

x =

y =

z =

xx =

Dear :

This letter responds to a letter dated July 7, 2000, and subsequent correspondence, submitted by you as the authorized representative of the trustee of Trust, requesting rulings under § 642 of the Internal Revenue Code.

The information submitted states that Trust was created on D1 and amended on D2. The settlors of Trust, A and B, died on D3 and D4, respectively. The dates D1, D2, and D3 were pre-October 9, 1969. Pursuant to its terms, Trust became irrevocable upon the death of the first of its settlors. After the death of both settlors, the terms of Trust provide that all of the net income of Trust is to be distributed among a group of named individuals in specified proportions, and to the survivors of that group, until the death of the last of the group. The principal of Trust is required to remain intact and held in perpetuity for named charities and general charitable purposes, in specified proportions. After the death of the last of the named individual beneficiaries, the charitable remainder beneficiaries are entitled to receive Trust's net income.

Trust's assets consist of property which was part of the trust estate on or before October 9, 1969, and the proceeds of the investment and reinvestment of such property. The trustee of Trust represents that no assets have been contributed to Trust by any person after October 9, 1969.

On D6, Court issued an order granting a petition for deviation from the terms of Trust filed by the trustee of Trust. On D7, the trustee of Trust, C (the last surviving individual beneficiary of Trust), the named charitable remainder beneficiaries of Trust, and the attorney general of State agreed to a stipulation interpreting the Court order. C died on D8 of Year 2. The Court order and the stipulation interpreting the Court order are conditioned upon a favorable letter ruling from the Internal Revenue Service.

Trust, as modified by the order and stipulation, provides that, effective beginning with the Year 1 taxable year, "net income," which was payable to C during C's life, shall be the greater of (1) the net trust accounting income or (2) not more than x% of the value of the trust principal determined at the beginning of the year in which distributions are required to be made (the unitrust amount).

The trustee may satisfy the unitrust amount from trust principal, but the amount of principal that may be distributed shall be limited to the "current year's growth," defined as the

amount by which the total fair market value of trust principal at the end of the year exceeds the total fair market value of the trust principal as of the beginning of the year in which the distribution is required to be made. In calculating the amount of principal at the end of the current year, the trustee shall include the amount of principal distributed to the income beneficiary during that year at a value determined at the time of actual distribution.

If the trustee incorrectly determines the fair market value of Trust's assets, then within a reasonable period after the correct value is finally determined, the trustee must redetermine the unitrust amount. If the initially determined value is found to have been too low, the trustee must pay the difference between the unitrust amount then determined and previously determined to the beneficiary otherwise entitled to the distribution, but only if the redetermined amount does not exceed the net income of the trust estate for the year. If the initially determined value is found to have been too high, the beneficiary otherwise entitled to the distribution must pay the amount of the overpayment to the trustee, but only to the extent it is in excess of the net income of the trust estate for the year. Any payment made to correct an error in valuation shall be payable with interest computed at the applicable rate under § 7520.

If distributions to the income beneficiary include some principal, but the total amount distributed to the income beneficiary is less than x% of the beginning principal balance of Trust for a given year, the trustee shall not "make up" the shortfall in future years. If distributions to the income beneficiary include only income, but the total amount distributed to the income beneficiary exceed x% of the beginning principal balance of the trust for a given year, the income beneficiary shall not be required to repay Trust for any amounts of income received.

In no case may the trustee of Trust invade principal to make income distributions to C if the result of such distributions would cause the principal balance to fall below the value of the trust estate as of D5, which was \$y. Net capital gains not distributed as a part of the "current year's growth" shall become principal and shall not be invaded or used to satisfy a distribution of part or all of the unitrust amount payable to beneficiary except for a charity described in § 501(c)(3).

From D5 to the end of Year 1, Trust's "current year's growth" was \$z, resulting in an account balance of \$xx at the end of Year 1.

The trustee of Trust requests rulings that (1) any amount of Trust's gross income set aside and deducted pursuant to § 642(c) in Year 1 and prior taxable years will not be disallowed as a result of the modification of Trust and (2) for taxable years after Year 1, Trust, as modified, will be treated as a trust created before October 9, 1969, will be allowed a deduction under § 642(c) of the amount of its gross income set aside, and the gross income set aside will be treated as income earned with respect to amounts contributed prior to October 9, 1969.

Section 642(c)(1) provides, in general, that in the case of an estate or trust (other than a trust meeting the specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year. The election shall be made at such time and in such manner as the Secretary prescribes by regulations.

Section 642(c)(2) provides that, in the case of an estate, and in the case of a trust (other than a trust meeting the specifications of subpart B) required by the terms of its governing instrument to set aside amounts which was (A) created on or before October 9, 1969, if (i) an irrevocable remainder interest is transferred to or for the use of an organization described in § 170(c), or (ii) the grantor is at all times after October 9, 1969, under a mental disability to change the terms of the trust; or (B) established by a will executed on or before October 9, 1969, if (i) the testator dies before October 9, 1972, without having republished the will after October 9, 1969, by codicil or otherwise, (ii) the testator at no time after October 9, 1969, had the right to change the portions of the will which pertain to the trust, or (iii) the will is not republished by codicil or otherwise before October 9, 1972, and the testator is on such date and at all times thereafter under a mental disability to republish the will by codicil or otherwise, there shall also be allowed as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in § 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the

establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit. In the case of a trust, the preceding sentence shall apply only to gross income earned with respect to amounts transferred to the trust before October 9, 1969, or transferred under a will to which § 642(c)(2)(B) applies.

Section 1.642(c)-2(b)(1) of the Income Tax Regulations provides, in general, that any part of the gross income of a trust to which either § 1.642(c)-2(b)(3) or § 1.642(c)-2(b)(4) applies, that by the terms of the governing instrument (i) is permanently set aside during the taxable year for a purpose specified in § 170(c), or (ii) is to be used (within or without the United States or any of its possessions) exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit, shall be allowed, subject to the limitation provided in § 1.642(c)-2(b)(2), as a deduction to the trust in lieu of the limited charitable contributions deduction authorized by § 170(a). The preceding sentence applies only to a trust which is required by the terms of its governing instrument to set amounts aside. See § 642(c)(6) and § 1.642(c)-4 for disallowance of a deduction under this section to a trust which is, or is treated under § 4947(a)(1) as though it were, a private foundation (as defined in § 509(a) and the regulations thereunder) that is not exempt from taxation under § 501(a).

Section 1.642(c)-2(b)(2) provides that § 1.642(c)-2(b)(1) applies only to the gross income earned by a trust with respect to amounts transferred to the trust under a will executed on or before October 9, 1969, and satisfying the requirements of § 1.642(c)-2(b)(4) or transferred to the trust on or before October 9, 1969. For such purposes, any income, gains, or losses, which are derived at any time from the amounts so transferred to the trust shall also be taken into account in applying § 1.642(c)-2(b)(1). If any such amount so transferred to the trust is invested or reinvested at any time, any asset received by the trust upon such investment or reinvestment shall also be treated as an amount which was so transferred to the trust. In the case of a trust to which § 1.642(c)-2(b) applies which contains (i) amounts transferred pursuant to transfers described in the first sentence of § 1.642(c)-2(b)(2) and (ii) amounts transferred pursuant to transfers not so described, § 1.642(c)-2(b)(1) shall apply only if the amounts described in § 1.642(c)-2(b)(2)(i), together with all income, gains, and losses derived therefrom, are separately accounted for from the amounts described in § 1.642(c)-2(b)(2)(ii), together with all income, gains, and losses derived therefrom. Such separate

accounting shall be carried out consistently with the principles of § 53.4947-1(c)(4) of the Foundation Excise Tax Regulations, relating to accounting for segregated amounts of split-interest trusts.

Section 1.642(c)-2(b)(3)(i) provides that a trust to which § 1.642(c)-2(b) applies is a trust, testamentary or otherwise, which was created on or before October 9, 1969, and which must have been created under the terms of an instrument granting an irrevocable remainder interest in such trust to or for the use of an organization described in § 170(c). If the instrument granted a revocable remainder interest but the power to revoke such interest terminated on or before October 9, 1969, without the remainder interest having been revoked, the remainder interest will be treated as irrevocable for purposes of the preceding sentence.

Section 1.642(c)-2(d) provides, in part, that no amount will be considered to be permanently set aside, or to be used, for a purpose described in § 1.642(c)-2(a) or § 1.642(c)-2(b)(1) unless under the terms of the governing instrument and the circumstances of the particular case the possibility that the amount set aside, or to be used, will not be devoted to such purpose or use is so remote as to be negligible. Thus, for example, where there is a possibility of the invasion of the corpus of a charitable remainder trust, as defined in § 1.664-1(a)(1)(ii), in order to make payment of the annuity amount or unitrust amount, no deduction will be allowed under § 1.642(c)-2(a) in respect of any amount set aside by an estate for distribution to such a charitable remainder trust.

Section 1.642(c)-3(b)(1) provides, in part, that if an estate, pooled income fund, or other trust pays, permanently sets aside, or uses any amount of its income for a purpose specified in § 642(c)(1), (2), or (3) and that amount includes any items of estate or trust income not entering into the gross income of the estate or trust, the deduction allowable under § 1.642(c)-1 or § 1.642(c)-2 is limited to the gross income so paid, permanently set aside, or used.

Based solely on the facts and representations submitted, we conclude that the possibility that amounts set aside under Trust, as modified, will not be used for a purpose described in § 1.642(c)-2(b)(1) is not so remote as to be negligible. Therefore, we further conclude that (1) any amount of Trust's gross income set aside and deducted pursuant to § 642(c) in Year 1 and prior taxable years would be disallowed as a result of the modification of Trust and (2) for taxable years after Year 1, Trust, as modified, will not be allowed a deduction under § 642(c) of the amount of its gross income set aside.

Except as specifically ruled above, we express no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code.

This ruling is directed only to the taxpayer that requested it. 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, a copy of this letter is being forwarded to the trustee of Trust.

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

Enclosures: 2  
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