

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200425027**

Release Date: 6/18/04

Index Number: 2055.00-00, 501.00-00

Person To Contact:

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Refer Reply To:

**CC:PSI:B04 – PLR-138860-03**

Date: FEBRUARY 27, 2004

In Re:

**LEGEND:**

Decedent =  
Trust =  
Foundation =  
Trustee =

Date 1 =  
Date 2 =  
Date 3 =

a =  
b =  
c =  
d =  
e =

Plan 1 =  
Plan 2 =  
Annuity =  
Court =

State =  
Citation 1 =  
Citation 2 =

Dear :

This is in response to your August 29, 2003 letter, and prior correspondence, in which you requested rulings concerning the federal estate and income tax consequences of the proposed reformation of a trust, as described below.

The facts and representations submitted are summarized as follows: Decedent died on Date 1. Article Fifth of Decedent's will provides that the residue of Decedent's estate is to be held in Trust for the benefit of Foundation. Foundation is a foundation described in sections 501(c)(3) and 2055 of the Internal Revenue Code.

Article Fifth A. provides that one year after the date of Decedent's death and continuing annually thereafter, Trustee is to distribute from the principal of Trust to Foundation an amount equal to the then value of the principal assets of Trust, if there has been an increase in the value of the principal assets of Trust during the year, but not exceeding a% of the then value of principal assets of Trust on the first anniversary, b% on the second anniversary, c% on the third anniversary, d% on the fourth anniversary, or e% on the fifth through the twentieth anniversary, and after the twentieth anniversary an amount equal to the prior year's increase in value of the principal assets of Trust, regardless of whether or not it exceeds any top limit.

Article Fifth B. provides that Foundation is to keep distributions received in a separate fund called the Decedent Memorial Fund of Foundation.

Article Fifth C. provides that Trustee is to hold the assets of the trust subject to the provisions of Foundation.

Article Fifth D. provides that Foundation is to distribute all amounts received from Trustee to educational and charitable institutions qualifying as charities under the Internal Revenue Code in such proportions as may seem proper to the Foundation.

Article Fifth E. provides that Trustee is to add income to the principal of Trust annually after distribution of principal.

In addition to receiving the residue of the Decedent's estate, Trust will be funded by a distribution from Decedent's Plan 1 and Decedent's Plan 2 (the "Plans"). In addition, Trust will be funded by a distribution from Decedent's Annuity. It is represented that (1) the Plans are qualified plans under section 401; (2) the Annuity is not a qualified plan under section 401 or an individual retirement account (IRA), but is a tax-sheltered annuity that was purchased by Decedent as an investment; and (3) the Decedent's basis in the Annuity was greater than the fair market value of the Annuity at the date of Decedent's death.

Decedent's attorney, scrivener of Decedent's will, stated by affidavit, that he inadvertently failed to include the appropriate language in Trust to qualify it for the charitable estate tax deduction and ensure that the receipt for the Plans and the Annuity

by Trust would not be subject to income tax because Trust would be a tax-exempt organization. The scrivener stated “[Decedent] thought his estate would get the same tax treatment as it would have if he had simply left the residue of his estate to [Foundation].”

On Date 2, the executor of Decedent’s estate petitioned Court to reform Trust. Trust, as reformed, provides that the trustee is to distribute the net income of Trust at least annually to Foundation. Trust, as reformed, provides that any successor in interest to Foundation shall be a qualifying charity under section 501(c)(3).

Trust, as reformed, also provides that the direction given to the trustee to distribute the net income and portions of the principal is to be exercised solely for the purposes herein expressed and is to be subject to the following conditions:

1. This trust is organized and shall be operated exclusively for one or more “exempt purposes” and, if the trustee so elects for the trust to qualify as an organization described in section 509(a)(3), for one or more of the purposes described in section 509(a)(3)(A). As used in this trust, “exempt purposes” shall mean only such purposes as constitute charitable, educational, religious, literary or scientific purposes within the meaning of section 501(c)(3) and also with the meaning of sections 170(c)(2) and 2055(a), but only to the extent they also constitute public charitable purposes under the applicable laws of State.
2. No part of the net income or principal of this trust shall at any time inure to the benefit of or be distributable to any trustee or other individual; except that reasonable compensation may be paid for services rendered to or for the trust pursuant, but not limited to, the provisions of Item Sixth, G below, and payments and distributions may be made in furtherance of its purposes.
3. No substantial part of the activities of this trust shall be the carrying on of propaganda, or otherwise attempting to influence legislation in or to intervene in (including the publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office.
4. The trustee shall not engage in any activity not permitted to be carried on by, and shall not exercise any power or discretion granted by the terms of this instrument or by law which may not be exercised by, a trust which is exempt from federal income taxation, under section 501(a) as an organization described in section 501(c)(3).
5. If at any time the trust is a “private foundation” as defined in section 509(a), the trustee: shall distribute income for each taxable year at such time and in such manner as not to become subject to the tax on undistributed income imposed by section 4943; shall not engage in any act of self-dealing as defined in section

4941(d); shall not retain any excess business holdings as defined in section 4943(c); shall not make any investments in a manner which will incur liability under section 4944; and shall not make any taxable expenditures as defined in section 4945(d).

6. It is Decedent's intent that this trust shall be an organization exempt from federal income taxation under section 501(a) as an organization described in section 501(c)(3), be exempt from or not subject to income taxation under the laws of State, be described in both sections 170(c)(2) and 2055(a), and if the trustee so elects for the trust to qualify as an organization described in section 509(a)(3), be described in section 509(a)(3), and the provisions of this instrument shall be liberally construed to effect such intent. In furtherance of this intent the trustee may reduce or release any right, power or discretion granted to the trustees by the terms of this instrument or by law. The trust herein evidenced may not be altered, amended, modified, or revoked by the trustees.

On Date 3, Court ordered that Trust be reformed in accordance with the petition. The Order is effective when the Internal Revenue Service issues the requested favorable letter ruling effective as of Date 1, the date of Decedent's death.

The executor of Decedent's estate requests the following rulings:

1. An estate tax charitable deduction will be allowed for the value of Trust, as reformed.
2. Decedent's qualified plan benefit will not be subject to tax as income when received by Trust, as reformed, since Trust is a tax-exempt organization under section 501(c)(3).

#### Ruling Request 1

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2055(a)(3) provides, generally, that for purposes of the tax imposed by section 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 a trustee or trustees, but only if such contributions or gifts are to be used by such trustee or trustees exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, such trust would not be disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and such trustee or trustees 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 20.2055-1(a)(3) of the Estate Tax Regulations provides, generally, that a deduction is allowed under section 2055(a) from the gross estate of a decedent who was a citizen or resident of the United States at the time of his death for the value of property included in the decedent's gross estate and transferred by the decedent during his lifetime or by will to a trustee or trustees, if the transferred property is to be used exclusively for religious, charitable, scientific, literary, or educational purposes (or for the prevention of cruelty to children or animals), if no substantial part of the activities of such transferee is carrying on propaganda, or otherwise attempting, to influence legislation, and if, in the case of transfers made after December 31, 1969, such transferee does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Supreme Court held that where the issue involved is the determination of property interests for federal estate tax purposes, and the determination is based on state law, the highest court of the state is the best authority on its own law. The Service, however, is not bound by a lower court decision. If there is a decision by a lower court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

In Citation 1, State's Supreme Court stated that "[i]t is well settled in this state that the mistake of a scrivener in preparing a deed or other writing may be established by parol evidence, and the instrument reformed accordingly. However, the evidence required to reform a written instrument must be clear, precise, convincing, and of the most satisfactory character (citations omitted)."

In Citation 2, State's Supreme Court stated that "under appropriate circumstances a court in equity may reform a deed. Whether the omission in the deed was in truth and in fact a mistake or inadvertence depends upon findings of fact of a chancellor who sees and hears the witness, and which, if approved by the court in banc, would warrant a decree of reformation."

In this case, Decedent's charitable intention to benefit Foundation is clear from his will. From the sworn affidavit, Decedent's attorney stated that the Decedent intended that Trust would qualify for a charitable estate tax deduction, but a scrivener's error was made. Accordingly, based on the facts submitted and representations made, we conclude that an estate tax charitable deduction will be allowed for the value of Trust, as reformed.

Ruling Request 2

Section 501(a) exempts from federal income taxation organizations described in section 501(c).

Section 501(c)(3) describes corporations, trusts, and associations, organized and operated exclusively for charitable and other exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 501(b) provides that an organization exempt from taxation under section 501(a) shall be subject to tax to the extent provided in parts II (referring to the tax on termination of private foundation status), III (referring to the tax on unrelated business income of charitable, etc., organization), and VI (referring to the tax on political organizations) of subchapter F, but (notwithstanding parts II, III, and VI of subchapter F) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

Section 4940(a) imposes on each private foundation which is exempt from taxation under section 501(a) for the taxable year, with respect to the carrying on of its activities, a tax equal to 2 percent of the net investment income of such foundation for the taxable year.

Section 4940(c)(1) provides that, for purposes of subsection (a), the net investment income is the amount by which (A) the sum of the gross investment income and the capital gain net income exceeds (B) the allowable deductions.

Section 4940(c)(2) provides that the term "gross investment income" means the gross amount of income from interest, dividends, rents, payments with respect to securities loans (as defined in section 512(a)(5)), and royalties, but not including any such income to the extent included in computing the tax imposed by section 511.

Section 53.4940-1(d)(2) of the Foundation and Similar Excise Taxes Regulations provides that, in the case of a distribution from an estate or a trust described in section 4947(a)(1) or (2), such distribution shall not retain its character in the hands of the distributee for purposes of computing the tax under section 4940.

Except in certain situations not relevant here, the income of an organization described in section 501(c)(3) (other than income from an unrelated trade or business) is not subject to federal income tax by reason of section 501(a).

Trust is an organization described in section 501(c)(3). Income received by Trust in the form of distributions from Decedent's Plans and Annuity is not income from an unrelated trade or business. Therefore, distributions from Decedent's Plans and Annuity are not subject to tax as income when received by Trust.

Distribution amounts from qualified employee pension plans and individual retirement accounts are treated as deferred compensation for federal income tax purpose. The term “gross investment income” under section 4940 includes interest, dividends, rents, payments with respect to securities loans, and royalties, but does not include deferred compensation. Therefore, distributions to Trust from Decedent’s Plans will not constitute gross investment income for purposes of imposing the excise tax described in section 4940.

Although distributions from an annuity to a private foundation might include gross investment income for purposes of section 4940, in this case there would be no gross investment income because Decedent’s basis in the Annuity was greater than the fair market value of the Annuity on the date of Decedent’s death. Accordingly, we rule that Trust will not recognize taxable income upon receipt of distributions from Decedent’s Plans and Annuity and that Trust will not be subject to the federal excise tax on net investment income under section 4940 when it receives distributions form Decedent’s Plans and Annuity.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for the ruling, it is subject to verification on examination.

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

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

Sincerely,

Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures:

Copy of letter for section 6110 purposes

Copy of this letter

cc: