

Internal Revenue Service

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Department of the Treasury

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Person To Contact:

, ID No.

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Refer Reply To:

CC:PSI:04

PLR-165248-04

Date: JUNE 22, 2005

Legend:

Decedent =

Spouse =

X =

A =

B =

C =

D =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Museum =

Conservancy =

Probate Court =

State =

State law =

Cite =

Dear :

This letter is in response to a letter dated December 15, 2004 and subsequent correspondence from your authorized representative requesting a ruling concerning the federal estate tax consequences of the proposed reformation of a statutory elective share trust resulting from an election against a will into a qualified charitable remainder trust in accordance with § 2055 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows:

Decedent died testate on Date 1, survived by Spouse and two children. Decedent's will was probated in State Probate Court on Date 2. Paragraph FIRST of Decedent's will bequeaths tangible personal property primarily to Decedent's children and a charity, Museum, with the remaining tangible personal property in equal shares to Spouse and children who survive Decedent to be divided among them as they may agree or if they do not agree as Decedent's executors determine in their absolute discretion. Paragraph SECOND devises real property to a charity, Conservancy. Paragraph THIRD bequeaths certain partnership interests to Decedent's children. Paragraph FOURTH exercises a power of appointment in favor of Decedent's children. Paragraph FIFTH bequeaths the residue of Decedent's estate in equal shares to fourteen named charitable organizations and all of these organizations are described in §§ 501(c)(3) and 2055.

Within six months after probate, on Date 3, Spouse elected against Decedent's will in accordance with State law. State law provides that the surviving spouse of a deceased person, within six months after the probate of the will of such deceased person, may waive any provisions that may have been made in it for him or for her, and if the deceased left issue, surviving spouse shall take one-third of the personal and one-third of the real property except that if surviving spouse would take real and personal property in an amount exceeding twenty-five thousand dollars in value, surviving spouse shall receive, in addition to that amount, only the income during surviving spouse's life of the excess of his or her share of such estate above that amount, the personal property to be held in trust and the real property vested in him or her for life, from the death of the deceased person.

Subsequently, within the nine-month period after Decedent's death, on Date 4, Spouse disclaimed Spouse's interest in Decedent's partnership interests and in certain items of tangible personal property, which is passing to Spouse as a result of Spouse's exercise of the right of election. Spouse certified in the disclaimer document that there has been no assignment, conveyance, encumbrance, pledge, transfer or other disposition of the disclaimed property and Spouse has not accepted any interest or any benefit from the disclaimed property. As a result of Spouse's election against Decedent's will coupled with the disclaimer, Spouse is entitled to receive \$X outright, the income for life from the excess of one-third of Decedent's real and personal property over \$X, and under State law the personal property is to be held in trust and the real property vested in Spouse for life, from the date of Decedent's death. Specifically, Spouse's interest in Decedent's estate consists of \$X payable outright, and a right to all income from one-third of Decedent's tangible

personal property, a painting, that was bequeathed to Museum; one-third of Decedent's real estate bequeathed to Conservancy, and one-third of the residue of Decedent's gross estate as reduced by the \$X payable outright.

Decedent's United States Estate (and Generation-Skipping Transfer) Tax Return, Form 706, was timely filed. On Schedule M of the Form 706, a qualified terminable interest property (QTIP) election under § 2056(b)(7) was made with respect to the value of one-third of Decedent's tangible personal property, one-third of Decedent's real estate, and one-third of the residue of Decedent's gross estate as reduced by the \$X payable outright in accordance with Spouse's disclaimer.

Under State law, as a result of Spouse's election against the will coupled with Spouse's disclaimer, the residue of Decedent's gross estate as reduced by \$X is required to be held in trust (Statutory Trust). Statutory Trust does not include the tangible personal property bequeathed to Museum. Museum and Spouse agreed to share possession of the painting on a one-third, two-third basis rather than convert it to an income producing asset. Statutory Trust does not include the real property bequeathed to Conservancy. Conservancy and Spouse have sold and entered into agreements to sell the real property. The Statutory Trust provides income to Spouse for life with the remainder passing to the charitable organizations in accordance with paragraph FIFTH of Decedent's will (Charitable Beneficiaries). See Cite.

The Statutory Trust does not qualify as a charitable remainder trust. The parties propose to reform the Statutory Trust under § 2055(e)(3) to qualify as a charitable remainder unitrust. Under the proposed reformation, the trustees are to pay Spouse in each taxable year of the trust, Spouse's share of the unitrust percentage defined as an amount equal to five percent (5%) of the net fair market value of the assets held in trust, determined annually on the first business day of each taxable year of the trust and is to be payable A% to Spouse and B% in equal shares to the Charitable Beneficiaries; provided however, that the trustees may in their sole discretion adjust the allocation of the unitrust percentage between Spouse and the Charitable Beneficiaries for purposes of the trust's qualifying under § 2055(e). The unitrust amount is to be paid quarterly each taxable year from income, and to the extent income is not sufficient, from principal. In addition, in determining the unitrust amount, the trustees are to prorate the same on a daily basis for a short taxable year and for the taxable year in which the payment period terminates.

Further, the proposed reformation provides, that if in any year the net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the value is finally determined, the trustees are to pay any remaining unitrust amounts (in the case of an undervaluation) or receive from the recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid. All assets passing to the trust as a result of Spouse's waiver of Decedent's will are considered the initial

contribution. No additional contributions may be made. The obligation to pay the unitrust amount is to commence with the date of death of Decedent.

Upon the death of Spouse, the trustees are to distribute the property then remaining in trust, including any income which has been added to principal to the Charitable Beneficiaries. On Date 5, Decedent's executors, Spouse and several charitable beneficiaries filed a Complaint with State Probate Court to reform Statutory Trust by substituting for its terms the proposed terms described above; provided that such reformation be contingent upon the issuance of a private letter ruling from the Internal Revenue Service that the reformed trust under § 2055(e)(3) will qualify as a charitable remainder unitrust. On Date 6, State Probate Court reformed the Statutory Trust in accordance with the Complaint.

The executors of Decedent's estate request the following rulings:

1. The Statutory Trust is eligible for reformation under § 2055(e)(3).
2. The proposed reformation will be a qualified reformation within the meaning of § 2055(e)(3), the value of the charities unitrust interest and remainder interest in the reformed trust will be deductible under § 2055, and the value of Spouse's unitrust interest will be deductible under § 2056(b)(8).

Section 2046 provides that disclaimers of property interests passing upon death are treated as provided in § 2518.

Section 2518(a) provides that, if a person makes a qualified disclaimer with respect to any interest in property, the disclaimed interest is treated as if it had never been transferred to the person making the qualified disclaimer for purposes of the federal estate, gift, and generation-skipping transfer tax provisions.

Section 2518(b) provides that a "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property, but only if: (1) the disclaimer is in writing; (2) the writing is received by the transferor of the interest, his legal representative, or the holder of the legal title to the property to which the interest relates not later than 9 months after the date on which the transfer creating the interest in the person making the disclaimer is made, or the date on which the person making the disclaimer attains age 21; (3) the person making the disclaimer has not received the interest or any of its benefits; and (4) as a result of the disclaimer, the interest passes without any direction on the part of the person making the disclaimer to the decedent's spouse or to a person other than the person making the disclaimer.

Section 2055(a) provides that 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, and transfers to or for a corporation or certain other organizations organized and operated exclusively for religious, charitable, scientific, literary, or

educational purposes.

Section 2055(e)(2)(A) provides that where an interest in property 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 that 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 is allowed under § 2055(a) for the interest that passes or has passed to the person, or for a use, described in § 2055(a), unless in the case of a remainder interest, the interest is in a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)).

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 such 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) 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 gratuitous transfer (as defined by § 664(g)), and

(D) with respect to each contribution of property to the trust, the value (determined under § 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Section 2055(e)(3)(A) provides that a deduction is allowed under § 2055(a) with respect to any qualified reformation.

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) the 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 § 2055(e)(2).

Section 2055(e)(3)(C)(ii) provides that, generally, 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, that § 2055(e)(3)(C)(ii) does not apply to any interest if not later than 90 days after the last date (including extensions) for filing an estate tax return, if an estate tax return is required to be filed, a judicial proceeding is commenced to change the interest into a qualified interest.

Section 2055(e)(3)(D) defines the term "qualified interest" to mean an interest for which a deduction is allowable under § 2055(a).

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(1) provides that where, on the lapse of time, on the occurrence of an event or contingency, or the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction is allowed with respect to such interest –

(A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and (B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy

any part of such property after such termination or failure of the interest so passing to the surviving spouse.

Section 2056(b)(7) provides an exception to this terminable interest rule in the case of qualified terminable interest property (QTIP). For purposes of § 2056(a), qualified terminable interest property is treated as passing to the surviving spouse, and no part of the property is treated as passing to any person other than the surviving spouse. Under § 2056(b)(7)(B)(i), qualified terminable interest property is property which passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under § 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(v) provides that the election to treat property as QTIP under § 2056(b)(7) is made by the executor on the return of tax imposed by § 2001. The election, once made, is irrevocable.

Section 2044(a) and (b) provides generally that the value of the gross estate includes the value of any property in which the decedent had a qualifying income interest for life and with respect to which a deduction was allowed for the transfer of the property to the decedent under § 2056(b)(7).

Section 2056(b)(8) provides that, if the surviving spouse of the decedent is the only beneficiary of a qualified charitable remainder trust who is not a charitable beneficiary nor an ESOP beneficiary, § 2056(b)(1) will not apply to any interest in such trust which passes or has passed from the decedent to the surviving spouse.

Under § 2056(b)(8)(B)(i), the term "charitable beneficiary" means any beneficiary that is an organization described in § 170(c). Under § 2056(b)(8)(B)(iii), the term "qualified charitable remainder trust" means a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664).

In this case, the Statutory Trust did not qualify as a charitable remainder unitrust described in § 664. The charitable remainder interest, however, is a reformable interest within the meaning of § 2055(e)(3)(C) because (1) a deduction would have been allowable for the interest under § 2055(a) but for the requirements of § 2055(e)(2), and as provided in § 2055(e)(3)(C)(iii), a judicial proceeding was commenced to reform Statutory Trust on or before the ninetieth day after the last date (including extensions) for filing Decedent's estate tax return.

Spouse elected against Decedent's will and subsequently filed a qualified disclaimer. See Rev. Rul. 90-45. The parties propose to reform the Statutory Trust under § 2055(e)(3) to qualify as a charitable remainder unitrust. The reformed trust contains qualified interests as defined in § 2055(e)(3)(D). The present value of the remainder interest before reformation is C%. The present value of the qualified interest after the proposed reformation is D%. The change from the present value of

the pre-reformed interests to the present value of the qualified interests after the proposed reformation is less than 5 percent. In addition, the nonremainder interest in the trust before the reformation terminates at the same time as the nonremainder interest after the reformation. Further, the reformation of the Statutory Trust will be effective as of Date 1, the date of Decedent's death. The reformed trust will be a charitable remainder unitrust as described in § 664 and as a result Decedent's estate will be entitled to a federal estate tax charitable deduction under § 2055 for the present value of the remainder interest passing to Charitable Beneficiaries. Further, Spouse is the only beneficiary under the reformed trust who is not a charitable beneficiary. Assuming the reformed trust will qualify as charitable remainder unitrust under § 664, the present value of Spouse's unitrust interest under the reformed trust will qualify for the estate tax marital deduction pursuant to § 2056(b)(8).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In addition, we express or imply no opinion regarding the value of the property transferred to the trust.

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 rulings, it is subject to verification on examination.

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

Each 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
(Passthroughs & Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter