

Internal Revenue Service

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Department of the Treasury

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Person to Contact:

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Refer Reply To:

CC:PSI:4 - PLR-112807-99

Date:

July 26, 2000

Legend:

Husband =

Wife =

Husband's Trust Agreement =

Wife's Trust Agreement =

Date 1 =

Date 2 =

Date 3 =

Individual =

Bank =

Foundation =

Child 1 =

Dear _____ :

This is in response to the letter dated July 19, 2000, and prior correspondence submitted on your behalf by your authorized representative, in which rulings are requested under sections 2055 and 2041 of the Internal Revenue Code.

Facts

The facts submitted and representations made are as follows:

On Date 1, Husband and Wife each executed a revocable trust agreement (Husband's Trust Agreement and Wife's Trust Agreement)

and transferred substantially all of their property, except jointly owned property, to their respective trusts. On Date 2, Husband and Wife completely amended and restated their respective trust agreements and executed their wills.

Under each spouse's will, any property a spouse owns at death will pass to his or her trust. Under the terms of the trust agreements, upon the death of the first spouse, all residences and personal property are to be given to the surviving spouse. The remaining trust assets of the deceased spouse are to be divided into a marital trust and a family trust. The family trust is to be funded with the deceased spouse's available applicable credit amount. The marital trust is intended to qualify for the federal estate tax marital deduction as qualified terminable interest property and is to be funded with that amount of property which will reduce the deceased spouse's estate tax to zero. The marital trust is to be further divided into a generation-skipping transfer tax (GSTT) exempt trust (marital trust 1) and a GSTT nonexempt trust (marital trust 2).

At the death of the second spouse, a family trust will be temporarily created under that spouse's trust agreement. Following the death of the second spouse, after bequests to the children of Husband and Wife and a bequest to charity, all of the remaining assets held under each spouse's trust agreement will pass to a charitable lead unitrust (CLUT) and a charitable lead annuity trust (CLAT). The CLUT will be funded with the remainder of marital trust 1 together with an amount equal to the second spouse's remaining generation-skipping tax (GST) exemption. The CLAT will be funded with the remaining assets held under each spouse's trust agreement.

The terms of the CLUT and the CLAT are set forth in Husband's Trust Agreement as amended and restated on Date 2 and as further amended in accordance with the proposed amendment submitted on Date 3.

Under the terms of Husband's Trust Agreement, as amended in accordance with the Date 3 submission, the term of the CLUT will begin on the date of death of the second spouse to die and will continue for 25 years. The unitrust amount will be 8 percent of the net fair market value of the CLUT valued as of the first day of each taxable year of the CLUT. The unitrust amount will be paid in equal quarterly installments on the last day of each quarter, from current income, and to the extent current income shall be insufficient, from accumulated income, and to the extent accumulated income shall be insufficient, from principal (including capital gains). Any income of the CLUT for a taxable year which exceeds the unitrust amount will be added to principal.

In determining the charitable contribution deduction for the charitable lead interest of the CLUT, the Trustee will use the lowest interest rate allowable under § 7520; i.e., for the month

of the death of the second spouse to die or either of the two preceding months, or, if the alternate valuation date is used, the month of the alternate valuation date or either of the two preceding months.

The unitrust amount may be paid only to or for the use of charitable organizations as described in §§ 170(c)(2), 2055(a) and 2522(a) of the Internal Revenue Code. The charitable beneficiaries will be those charitable organizations selected by the trustee in the trustee's sole discretion, including Foundation, and may be changed by the trustee from time to time. If, when distributions are due, a selected beneficiary is no longer a charitable organization described in §§ 170(c)(2), 2055(a) and 2522(a) of the Code, the trustee may make payment to a charity that is so described. The trustee may not appoint any property of the CLUT to the trustee, the trustee's estate, the trustee's creditors, or the creditors of the trustee's estate.

No additions may be made to the CLUT after it is funded.

The obligation to pay the unitrust amount from the CLUT commences with the date of the death of the second spouse, but payment may be deferred to the end of the taxable year in which the trust is completely funded. Within a reasonable period from that date, the trustee shall pay to, in the case of an underpayment, or shall receive from the charitable income beneficiaries, in the case of an overpayment, the difference between any amounts actually paid to the charities and the amounts payable, plus interest compounded annually.

If the net fair market value of the CLUT assets is incorrectly determined for any taxable year, within a reasonable period after determination of the correct value, the trustee will pay to the charitable beneficiaries in the case of an undervaluation, or will receive from the charitable beneficiaries in the case of an overvaluation, an amount equal to the difference between the amount payable and the amount actually paid.

The trustee is prohibited from engaging in any act of self-dealing as defined in § 4941(d) of the Code, from retaining any excess business holdings as defined in § 4943(c) which would subject the trust to a tax under § 4943, from making any investments which would subject the trust to tax under § 4944, and from making any taxable expenditures as defined in § 4945(d). To the extent required, the trustee will distribute property of the trust at such time and in such manner as not to subject the trust to tax under § 4942.

At the end of the charitable lead period, the assets remaining in the CLUT will be distributed to a trust for the grandchildren of Husband and Wife.

Under the terms of Husband's Trust Agreement, as amended in accordance with the Date 3 submission, the term of the CLAT will begin on the date of death of the second spouse to die and will terminate on the twenty-fifth anniversary of that date. The annuity amount will be 8 percent of the initial fair market value of the CLAT assets as finally determined for federal estate tax purposes of the estate of the second spouse to die.

In determining the charitable contribution deduction, the trustee will apply the lowest available interest rate under § 7520; i.e., for the month of the death of the second spouse to die or either of the two months preceding the second spouse's death, or, if the alternate valuation date under § 2032 is used, the month of the alternate valuation date or either of the two months preceding that date.

The guaranteed annuity amount will be paid in equal quarterly installments from current income, and to the extent current income shall be insufficient, from accumulated income, and to the extent accumulated income shall be insufficient, from principal (including capital gains). Any income of the CLAT for a taxable year which exceeds the guaranteed annuity amount will be added to principal.

No additions may be made to the CLAT after it is funded.

Charitable beneficiaries of the CLAT will be those charitable organizations selected by the trustee in the trustee's sole discretion, including Foundation, and may be changed by the trustee from time to time. If, when distributions are due, a selected beneficiary is no longer a charitable organization described in §§ 170(c)(2), 2055(a) and 2522(a), the trustee may make payment to a charity that is so described. The trustee may not appoint any property of the CLAT to the trustee, the trustee's estate, the trustee's creditors, or the creditors of the trustee's estate.

If the initial net fair market value of the trust assets is incorrectly determined, the trustee will pay to the charitable income beneficiaries in the case of an undervaluation, or receive back from the beneficiaries in the case of an overvaluation, an amount equal to the difference between the amount properly payable and the amount actually paid, including interest.

If there is a delay in funding the CLAT, the trustee will pay the charitable beneficiaries an estimated annuity amount which will be subsequently adjusted. The trustee will pay to the charitable income beneficiaries in the case of an underpayment, or receive back from the beneficiaries in the case of an overpayment, an amount equal to the difference between the amount properly payable and the amount actually paid, including interest.

The trustee is prohibited from engaging in any act of self-dealing as defined in § 4941(d) of the Code, from retaining any excess business holdings as defined in § 4943(c) which would subject the trust to a tax under § 4943, from making any investments which would subject the trust to tax under § 4944, and from making any taxable expenditures as defined in § 4945(d). To the extent required, the trustee will distribute property of any of the trust at such time and in such manner as not to subject the trust to tax under § 4942.

At the end of the charitable lead term of the CLAT, one-half of the remaining assets will be distributed to a trust for the grandchildren of Husband and Wife, and the other half will be distributed, per stirpes, among the issue of Husband and Wife.

Husband and Wife are each appointed as the initial trustee under each spouse's respective trust agreement with Child 1, Individual, and Bank to serve as successor trustee in that order. If none of those named as successor trustee is able to serve, then the successor trustee must be a bank with trust company powers.

You have requested the following rulings:

1. The charitable annuity interest payable under the CLAT will qualify as a guaranteed annuity interest under § 2055(e)(2)(B) and § 20.2055(e)(2)(vi).
2. The charitable unitrust interest payable under the CLUT will qualify as a unitrust interest under § 2055(e)(2)(B) and § 20.2055(e)(2)(vii).
3. The power of the trustee to designate which charitable beneficiaries will receive payments from the CLUT and the CLAT and to change the charitable beneficiaries from time to time will not constitute a general power of appointment under § 2041.

Law and Analysis

Charitable Deduction

Section 2055(a) provides that for purposes of the federal estate tax, 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, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

Under § 20.2055-2(a), the amount passing to charity must be ascertainable and determinable as of the date of death. Similarly, under § 20.2055-2(b)(1), if the trustee is empowered to divert the property or fund, in whole or in part, to a

noncharitable purpose, the deduction is limited to that portion, if any, of the property which is exempt from an exercise of the power.

Under § 2055(e)(2), the estate tax charitable deduction is not allowable 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), 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).

Under § 20.2055-2(e)(1)(i), in the case of decedents dying after December 31, 1969, where an interest in property passes from the decedent for charitable purposes and an interest in the same property passes from the decedent for private purposes, no deduction is allowed under § 2055(a) for the value of the interest passing for charitable purposes unless the interest is a "deductible interest".

Under § 20.2055-2(e)(2)(vi)(a), the term "deductible interest" includes a guaranteed annuity interest. A "guaranteed annuity interest" is a right to receive a guaranteed annuity. A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term or for the life or lives of an individual or individuals, each of whom must be living at the date of death of the decedent and can be ascertained at such date. An amount is determinable if the exact amount which must be paid under the conditions specified in the instrument of transfer can be ascertained as of the appropriate valuation date.

Under § 20.2055-2(e)(2)(vi)(b), a charitable interest is a guaranteed annuity interest only if it is a guaranteed annuity interest in every respect. Under § 20.2055-2(e)(2)(vi)(d), where a guaranteed annuity interest is in trust, the instrument may provide that income of the trust in excess of the amount required to pay the guaranteed annuity interest shall be paid to or for the use of a charity. Nevertheless, the amount of the deduction is limited to the fair market value of the guaranteed annuity interest. Under § 20.2055-2(f)(2)(iv), a deduction will be allowed under § 2055 only for the minimum amount it is evident

the charity will receive. Thus, if the date of death value of the guaranteed annuity interest exceeds the date of death value of the trust assets, the allowable deduction is limited to the date of death value of the trust assets.

Under § 20.2055-2(e)(2)(vii)(a), the term "deductible interest" includes a unitrust interest. A "unitrust interest" is a right to receive payment, not less often than annually of a fixed percentage of the net fair market value, determined annually, of the property which funds the unitrust interest. The unitrust interest may be paid for a specified term, or for the life or lives of named individuals, each of whom must be living at the creation of the trust.

Under § 20.2055-2(e)(2)(vii)(b), a charitable interest is a unitrust interest only if it is a unitrust interest in every respect. Under § 20.2055-2(e)(2)(vii)(e), where a unitrust interest is in trust, the instrument may provide that income of the trust in excess of the amount required to pay the unitrust interest shall be paid to or for the use of a charity. Nevertheless, the amount of the deduction is limited to the fair market value of the unitrust interest. Under § 20.2055-2(f)(2)(v), the present value of a unitrust interest is determined by subtracting the present value of all interests in the transferred property other than the unitrust interest from the fair market value of the transferred property.

In the present case, with respect to the CLAT, a charitable annuity of 8 percent of the initial net fair market value of the CLAT assets as finally determined for estate tax purposes of the estate of the second spouse to die will be paid in equal quarterly installments over a 25-year term. With respect to the CLUT, a charitable unitrust amount equal to 8 percent of the net fair market value of the CLUT valued as of the first day of each taxable year of the CLUT will be paid in equal quarterly installments on the last day of each quarter over a 25-year term.

Accordingly, based on the facts submitted and representations made, and based on the proposed amendments to the trust agreements, we conclude as follows:

1. The charitable annuity interest payable under the CLAT, as determined under the terms of Husband's Trust Agreement as amended on Date 2 and as further amended in accordance with the Date 3 submission, will qualify as a guaranteed annuity interest under § 2055(e)(2)(B) and § 20.2055(e)(2)(vi).

2. The charitable unitrust interest payable under the CLUT, as determined under the terms of Husband's Trust Agreement as amended on Date 2 and as further amended in accordance with the Date 3 submission, will qualify as a unitrust interest under § 2055(e)(2)(B) and § 20.2055(e)(2)(vii).

Power of Appointment

Under § 2041(a)(2), the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has, at the time of death, a general power of appointment created after October 21, 1942.

Section 2041(b)(1) defines "general power of appointment" as a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.

In the present case, the trustee may only pay the unitrust amount from the CLUT and the annuity amount from the CLAT to or for the use of charitable organizations as described in §§ 170(c)(2), 2055(a) and 2522(a). In addition, the trustee may not appoint any assets from either charitable lead trust to the trustee, the trustee's estate, the trustee's creditors or the creditors of the trustee's estate. Accordingly, we rule that the power of the trustee to designate which charitable beneficiaries will receive payments from the CLUT and the CLAT and to change the charitable beneficiaries from time to time will not constitute a general power of appointment under § 2041.

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. In particular, we express no opinion as to whether or not Foundation is described in §§ 170(b)(1)(A), 170(c)(2)(B), 2055(a), and 2522(a).

This 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 yours,

Associate Chief Counsel
(Passthroughs and Special
Industries)

By _____
Katherine A. Mellody
Senior Technician Reviewer
Branch 4

Enclosure

Copy for section 6110 purposes