

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Legend

Decedent =

Spouse =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Son =

Granddaughter 1 =

Granddaughter 2 =

Charities =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Court =

Dear :

We received a letter dated March 28, 2003, and prior correspondence, from your authorized representative requesting rulings under § 2055 of the Internal Revenue Code with respect to the proposed reformation of certain trusts. This letter responds to that request.

On Date 1, Decedent and Spouse created Trust 1. Spouse died on Date 2. Upon Spouse's death, Trust 1 was divided into three trusts: (1) Trust 2, an irrevocable trust with assets equal to Spouse's unified credit, (2) Trust 3, an irrevocable qualified terminable interest trust, and (3) a trust (holding Decedent's separate property) that was revoked by Decedent during her lifetime. Decedent created Trust 4, a revocable trust, on Date 3. Decedent died on Date 4.

After the death of Decedent, the net income of Trust 2 and Trust 3 is to be distributed 60% to Son, 20% to Granddaughter 1 and 20% to Granddaughter 2. The trustees have the sole discretion to distribute trust principal to Son for Son's health, support and maintenance. Upon Son's death, the remaining trust assets are to be distributed in equal shares to Charities. Trust 4 provides that, after the death of Decedent, all net income is to be distributed to Son for his lifetime, and the trustee has the sole discretion to distribute principal to Son for his health, support and maintenance. Upon Son's death, the remaining trust assets are to be distributed in equal shares to Charities.

In their present form the trusts do not qualify for the estate tax charitable deduction under § 2055(a). The parties initiated a proceeding for a judicial reformation of Trust 3 and Trust 4 in accordance with § 2055(e)(3) in order to qualify as charitable remainder unitrusts (CRUTs) under § 664(d)(2). The parties propose to divide Trust 3 into two trusts. One trust, Son's Trust, will be funded with 60% of the assets of Trust 3 for Son and reformed to qualify as a CRUT. A separate trust for Granddaughter 1 and Granddaughter 2 will be established with the remaining 40%. The trust for the granddaughters will not be reformed to qualify as a CRUT and is not the subject of this ruling request.

Trust 4 and Son's Trust, as reformed, will provide for an annual payment equal to 6.25% of the net fair market value of the assets of Trust 4 and Son's Trust payable to Son in quarterly installments for his life. On the death of Son, all remaining assets of Trust 4 and Son's Trust will be paid to the Charities. Son has irrevocably disclaimed any right to a distribution of principal or income that is in excess of the unitrust payments.

On Date 5, Court issued an order approving the division of Trust 3 and the proposed modifications to Trust 4 and Son's Trust. Date 5 is within 90 days after the last date (including extensions) for filing Decedent's estate tax return.

Trust 4 and Son's Trust, as reformed, contain the provisions set forth in Rev. Rul. 72-395, 1972-2 C.B. 340, as modified by Rev. Rul. 92-57, 1992-2 C.B. 123.

The following rulings have been requested:

1. The proposed reformations of Trust 4 and Son's Trust will be qualified reformations under § 2055(e)(3).
2. An estate tax charitable deduction will be allowed under § 2055(a) for the present value of the remainder interests in Trust 4 and Son's Trust, as reformed.

LAW AND ANALYSIS

Section 2055(a) provides that, for purposes of the federal estate tax, the value of the taxable estate is determined by deducting from the value of the gross estate the amount of all bequests to or for the use of certain governmental entities, certain corporations organized and operated exclusively for religious, charitable, scientific, literary, or education purposes, and certain other fraternal and veterans organizations.

Section 2055(e)(2) provides that, 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 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 to the person, or for the use, described in § 2055(a) unless, (1) in the case of a remainder interest, the 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 (2) in the case of any other interest, the interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly.

Section 2055(e)(3) provides that a deduction is allowed under § 2055(a) for any qualified reformation. The term "qualified reformation" means 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.

Section 2055(e)(3)(C)(i) provides that the term "reformable interest" means any interest for which a deduction would be allowable under § 2055(a) at the time of the decedent's death but for the provisions of § 2055(e)(2).

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

Under § 2055(e)(3)(D), the term “qualified interest” means an interest for which a deduction is allowable under § 2055(a).

In this case, the charitable interests in Trust 4 and Son’s Trust would have qualified for an estate tax charitable deduction under § 2055(a), but for the provisions of § 2055(e)(2). Accordingly, the first requirement for a qualified reformation under § 2055(e)(3) will be satisfied.

The proposed reformation satisfies the second requirement for a qualified reformation under § 2055(e)(3) because Son’s interest both before and after the proposed reformation will terminate at the same time (i.e., at Son’s death). The reformation will be effective as of the date of Decedent’s death and, therefore, the proposed reformation satisfies the third requirement under § 2055(e)(3).

With respect to the fourth requirement, based on the interest rate under § 7520 for the month of Decedent’s death the actuarial value of the charitable remainder as reformed will not differ by more than 5 percent of the actuarial value of the charitable remainder interest prior to reformation. Accordingly, the proposed reformation satisfies the fourth requirement under § 2055(e)(3).

Finally, the proposed reformation will satisfy the fifth requirement under § 2055(e)(3) because, even though Son’s interest in the reformable trust is not expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property, a judicial proceeding to reform the trusts was commenced within 90 days of the date that the Decedent’s federal estate tax return was due (including extensions).

Accordingly, we conclude that the proposed reformation of Trust 4 and Son’s Trust will be a qualified reformation within the meaning of § 2055(e)(3), provided the reformation is effective under local law. Therefore, an estate tax charitable deduction will be allowable under § 2055(a) for the present value of the remainder interests in Trust 4 and Son’s Trust as reformed, determined under § 20.2055-2(f)(2).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or

any other provisions of the Code.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,

Associate Chief Counsel
(Passthroughs and Special
Industries)

By _____
Lorraine E. Gardner
Senior Counsel, Branch 4

Enclosure
Copy for § 6110 purposes