

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-142063-02

Date:

JUNE 25, 2003

In Re:

Legend:

Decedent =
Trust =

Reformed Trust =

Friend =
Trustee =
Charity =
City =
Date 1 =
Date 2 =
Date 3 =
Court =

\$A =
\$B =

Dear :

We received a letter requesting rulings on behalf of Decedent's estate concerning the estate tax consequences under § 2055 of the Internal Revenue Code and the income tax consequences under § 664 of a proposed reformation of a split-interest charitable trust. This letter responds to that request.

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The facts and representations submitted are summarized as follows:

Decedent established a testamentary Trust under his will dated Date 1. Decedent died on Date 2. Decedent was survived by Friend. Decedent's will directs that all assets, except certain designated items, be transferred to Trust.

Article VI of Will, directs Trustee to distribute all of Decedent's interests in personal items to Friend. Will provides for the distribution of Trust assets after Decedent's death.

Under Article VIII, paragraph (a), Trustee is to pay all of the income of Trust monthly or in other convenient installments to Friend.

Article VIII, paragraph (b) provides generally that if the income is not reasonably sufficient for Friend's health, including medical, surgical, hospital and other institutional care and expenses of invalidism and for Friend's support and maintenance in his accustomed manner of living, then Trustee may pay, or use for Friend's benefit, as much of the principal as Trustee shall deem necessary for those purposes.

Article VIII paragraph (c) provides that upon Friend's death Trustee is to distribute the entire balance of Trust to Charity. Charity must certify that it will use the funds for specific charitable purposes. If Charity will not make the required certification then Trustee is directed to select any other Tax Exempt Foundation or Entity operating in City.

In its current form, Trust does not meet the requirements of a charitable remainder trust under § 664 because Trust does not provide for distributions to the non-charitable beneficiary either as a specified dollar amount which is equal to a percentage of the initial fair market value of the Trust's property (charitable remainder annuity trust) or a fixed percentage of the Trust's property's fair market value determined annually (charitable remainder unitrust). On Date 3, within 90 days of the due date of the estate tax return, trustee filed a petition for reformation of Trust with Court. Court approved the petition for reformation contingent on the trust qualifying as a charitable remainder trust under §§ 664 and 2055.

Trustee proposes to reform Trust to comply with the requirements of § 664. Reformed Trust, will provide an annual payout to Friend equal to 8 percent of the fair market value of the trust's assets (unitrust amount), determined on the first day of each taxable year of Trust and Trustee will be permitted to use principal of Trust only to meet the required unitrust payment. In addition, in determining the unitrust amount, Trustee will prorate the same on a daily basis for a short taxable year and for the taxable year in which the payment period terminates.

Reformed Trust further provides that if in any year the net fair market value of the Reformed Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, Trustee shall pay any

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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.

Upon the death of Friend, Trust will terminate and Trust assets will be distributed to Charity according to the terms of Grantor's will.

Taxpayer requests the following rulings:

(1) The charitable remainder interest in Trust qualifies as a reformable interest within the meaning of § 2055(e)(3)(C);

(2) The difference between the actuarial value of the qualified remainder interest and the actuarial value of the reformable remainder interest does not exceed five percent of the actuarial value of the reformable remainder interest.

(3) That as approved by Court, the proposed reformation of Trust is a qualified reformation for purposes of § 2055(e)(3) and that as a result of such reformation, the estate will be entitled to a federal estate tax charitable deduction for the remainder interest in the Reformed Trust passing to the designated charitable organization.

(4) After the qualified reformation, Reformed Trust qualifies as a charitable remainder unitrust as described in § 664.

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

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organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of 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 subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 170(c).

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of an organization described in section 170(c) or is to be retained by the trust for such use.

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)(A) provides that a deduction is allowed under § 2055(a) for any qualified reformation.

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 20.2055-2(e)(2) of the Estate Tax Regulations identifies deductible interests for purposes of § 2055. Under § 20.2055-2(e)(2)(ii), if a decedent devises to charity a remainder interest in a personal residence and bequeaths to his surviving spouse a life estate in such property, the value of the remainder interest is deductible under § 2055. In addition, the remainder interest in a charitable remainder annuity trust, as defined in § 664(d)(1) and § 1.664-2, is a deductible interest provided that the charitable organizations receiving the remainder interest satisfy the requirements of §§ 2055(a) and 664(d)(1)(C).

Revenue Procedure 90-30, 1990-1 C.B. 534, provides that trusts containing language that substantially follows one of the sample forms of trust contained in that Revenue Procedure will be recognized by the Service as meeting all of the requirements of a charitable remainder unitrust, provided that the trust operates in a manner consistent with the terms of the instrument creating the trust and provided it is a valid trust under local law.

Under the terms of Trust as of Date 2, Trust did not qualify as a charitable remainder unitrust or a charitable remainder annuity trust 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 Trust on or before the ninetieth day after the last date (including extensions) for filing Decedent's estate tax return.

Prior to reformation, Trustee of Trust was to pay Friend all the income from the trust monthly or in other convenient installments. In addition, Trustee could invade principal of Trust for Friend pursuant to an ascertainable standard. At Friend's death the trust was to be distributed to Charity.

After reformation, Reformed Trust will pay a unitrust amount to Friend for life and at Friend's death the Trust terminates and Trust assets will be distributed to Charity according to the terms of Grantor's will.

Reformed Trust contains qualified interests as defined in § 2055(e)(3)(D). The present value of the remainder interest before reformation is \$A. The present value of the qualified interest after the proposed reformation is \$B. 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 interests in Trust before the reformation terminate at the same time as the nonremainder interests after the reformation. Further, the reformation of Trust will be

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effective as of Date 2, the date of Decedent's death. Therefore, because Court has approved the reformation of Trust, and provided that Trust is amended as submitted, the reformation will be a qualified reformation for purposes of § 2055(e)(3). Reformed Trust will be charitable remainder unitrust as described in § 664 and as a result Grantor's estate will be entitled to a federal estate tax charitable deduction under § 2055 for the present value of the remainder interest passing to Charity.

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.

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

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

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.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4

Enclosures
Copy for 6110 purpose

cc: