

## Internal Revenue Service

Department of the Treasury

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### Legend

Estate =

A =

B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Trust =

Amount =

Charity =

Court =

X =

This is in reply to your letter dated September 28, 1998, requesting a ruling on behalf of Estate regarding a proposed reformation of Trust pursuant to § 2055(e)(3) of the Internal Revenue Code.

The facts are represented to be as follows: A died testate on Date 1. A executed a will on Date 2 and subsequently executed codicils to his will, with the latest codicil executed on Date 3. The codicil executed on Date 4 created Trust for the benefit of B. Under the terms of Trust, Amount was to be placed in Trust and B was to receive the income for life. Upon B's death, Trust's principal was to be paid to Charity, a charitable foundation established pursuant to Decedent's will. Trust does not currently qualify as a charitable remainder trust under § 664. Estate initiated reformation proceedings in Court to reform Trust in accordance with § 2055(e)(3). The proposed reformation is described below.

Article Fourth, ¶ B of Trust as reformed provides that, in each taxable year, the trustees shall pay B during B's lifetime a unitrust amount equal to x percent of the net fair market value of the assets of Trust valued as of the first day of each taxable year. The unitrust amount is to be decreased if the taxable year is a short taxable year or is the taxable year of B's death. Trust's taxable year is the calendar year and the trustee is required to use the same valuation methods for each taxable year.

Article Fourth, ¶ C provides that the unitrust amount is to be paid in equal quarterly installments from income and, to the extent income is not sufficient, from principal.

Article Fourth, ¶ D provides that, if the net income for any taxable year exceeds the unitrust amount, the trustees must add the excess to principal.

Article Fourth, ¶ E provides that Trust terminates upon B's death. Under ¶ F, when Trust terminates, the assets are to be distributed to Charity if Charity is a charity described in §§ 170(c) and 2055(a) at that time. If Charity is not then described in §§ 170(c) and 2055(a), ¶ F provides alternative distributions, each of which requires that the organization or organizations receiving Trust assets be described in §§ 170(c) and 2055(a) at the time of distribution.

Article Fourth, ¶ G(1) provides that, if the net fair market value of Trust's assets has been determined incorrectly for any taxable year, within a reasonable time after the correct value is finally determined, the trustee is to pay to B (in the case of an undervaluation) or B is to repay the trustee (in the case of an overvaluation) an amount

equal to the difference between the unitrust amount that should have been paid and the unitrust amount that was actually paid.

Article Fourth, ¶ G(2) requires the trustees to prorate the unitrust amount on a daily basis for a short taxable year and for the taxable year of B's death. Under ¶ G(3), the obligation to pay the unitrust amount commences on the date of A's death. Payment may be deferred, however, until the end of the taxable year in which Trust is funded provided interest is paid computed at the rate prescribed under § 1.664 of the Income Tax Regulations, compounded annually. Paragraph G(4) provides that no additional contributions may be made to Trust.

Article Fourth, ¶ H(1) provides that the trustees shall not engage in any act of self-dealing as defined in § 4941(d), nor make any taxable expenditures, as defined in § 4945(d). Paragraph H(2) provides that the trustees shall not retain any excess business holdings as defined in § 4943(c) that would subject Trust to tax under § 4943, nor shall the trustees retain or acquire any investments that would subject Trust to tax under § 4944. Paragraph H(3) prohibits the trustees from making distributions that would subject Trust to tax under § 4942. Paragraph H(4) provides that no provision is to be construed to restrict the trustees from investing Trust's assets in a manner that could result in the annual realization of a reasonable amount of income on, or gain from the sale or disposition of, Trust's assets. Paragraph H(5) provides that the trustees shall not invest Trust's assets in any manner that could cause Trust to realize unrelated business taxable income, as defined in §§ 512 and 513, nor shall the trustees borrow money if any such indebtedness could be deemed acquisition indebtedness or cause Trust to realize unrelated debt-financed income as defined in § 514.

Article Fourth, ¶ I grants the trustees the power, acting alone, to amend Trust in any manner required for the sole purpose of ensuring that Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of § 664.

Estate requests a ruling that: (1) Trust, as reformed, will not be subject to § 664(d)(2)(D) and will be a qualified charitable remainder unitrust within the meaning of § 664(d)(2); and (2) the proposed reformation will be a qualified reformation under § 2055(e)(3).

Section 664(d)(2) provides that a charitable remainder unitrust is a trust:

(A) from which a fixed percentage (that 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 subparagraph (A) and other qualified gratuitous transfers described in subparagraph (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 subparagraph (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 subsection (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 qualified gratuitous transfer (as defined in subsection (g)), and

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

Section 664(d)(2)(D) was added to the Code by the §1086 of the Taxpayer Relief Act of 1997, P.L. 105-34, and generally applies to transfers in trust after July 28, 1997. Section 1089(b)(6) provides, however, that the amendment does not apply to transfers in trust under the terms of a will (or other testamentary instrument) executed on or before July 28, 1997, if the decedent (i) dies before January 1, 1999, without having republished the will (or amended such instrument by codicil or otherwise), or (ii) was on July 28, 1997, under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of his death.

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 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, in the case of interests other than charitable remainder interests described in § 664 or pooled income funds described in § 642(c)(5), 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).

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) in the case of 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) 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 90<sup>th</sup> 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).

Under the provisions of Trust prior to the proposed reformation, the charitable remainder interest was a reformable interest because a deduction would have been allowable under § 2055(a) for the charitable interest but for the requirements of § 2055(e)(2).

B's nonremainder interest terminates at the same time before and after the reformation. The reformation will be effective as of the date of A's death. The actuarial value of the charitable remainder interest in Trust before the reformation is \$0.09018 for each \$1.00 of trust corpus, and the actuarial value of the charitable remainder interest after the reformation will be \$0.08572 for each \$1.00 of trust corpus. The difference between the actuarial value of the qualified charitable remainder interest (determined as of the date of decedent's death) and the actuarial value (as so determined) of the reformable charitable remainder interest will not exceed 5 percent of the actuarial value of the reformable interest.

Trust, as reformed, contains provisions set forth in Rev. Rul. 72-395, 1972-2 C.B. 340, as modified by Rev. Rul. 80-123, 1980-1 C.B. 205, and Rev. Rul. 82-128, 1982-2 C.B. 71, and clarified by Rev. Rul. 82-165, 1982-2 C.B. 117. Since A died on Date1, prior to July 28, 1997, § 664(d)(2)(D) does not apply to Trust and Trust, as reformed, will meet the requirements of a charitable remainder unitrust under § 664 as in effect prior to the enactment of § 664(d)(2)(D). Accordingly, provided that the reformed trust is valid under applicable local law, we conclude that the proposed reformation will be a qualified reformation within the meaning of § 2055(e)(3).

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.

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.

Sincerely,

Assistant Chief Counsel  
(Passthroughs and Special  
Industries)

By \_\_\_\_\_  
George L. Masnik  
Chief, Branch 4

Enclosure  
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