

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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CC:PSI:B01- PLR-143201-01

Date:

July 23 2002

Legend:

Trust =

X =

Y =

Z =

Date 1 =

Date 2 =

Date 3 =

Year 1 =

Dear :

This letter is in response to a letter dated August 10, 2001, and subsequent correspondence submitted on behalf of Trust, seeking a ruling concerning the effects of Trust's judicial reformation under sections 664 and 4941 of the Internal Revenue Code.

Facts

The information submitted states that the Trust was established under an irrevocable Trust Agreement made by X, on Date 1. The irrevocable Trust Agreement named X and Y as trustees of Trust. Z was named as the Independent Special Trustee of Trust for the specific purpose of selling shares contributed to Trust. The Trust Agreement, as drafted by X's attorney, created a net income charitable remainder unitrust with a make-up provision (NIMCRUT). The Trust Agreement provides that the unitrust amount each year is equal to the lesser of the trust income (as defined in section 643(b)) and a fixed percentage of the value of Trust's assets (as revalued on the first business day of January each year). The unitrust amount also includes any income in excess of a fixed percentage of the fair market value of Trust's assets, to the extent that prior year distributions were less than the fixed percentage of the net fair market value in any given year.

In establishing Trust, the primary objective of X and Y was to generate a consistent income of a fixed percentage of the value of Trust's assets each year such as a charitable remainder trust with a fixed percentage payout under section 664(d)(2) (CRUT). The Trust represents that X and Y were aware that the amount of the net income they received each year from Trust could fluctuate annually as the value of Trust's assets fluctuated. Trust represents that X and Y were not interested in a NIMCRUT because it was unlikely that Trust could generate income in the amount of a fixed percentage of the value of Trust's assets.

Despite this, the Trust Agreement was drafted by X's attorney as establishing a NIMCRUT. Trust represents that at the time of signing, X and Y were unaware that the Trust Agreement had set up a NIMCRUT. Trust further represents that neither X, nor Y would have signed the Trust Agreement had such a fact been known to them at the time of signing.

Following the establishment of Trust, Z sold certain shares contributed to Trust and reinvested the proceeds in various marketable securities and other investments. Z, who served as agent for the Trustees, believed that Trust was established as a CRUT and not a NIMCRUT. The investment counselor attended all of the meetings with X and Y and their attorney and, consistent with those meetings, believed that Trust was a CRUT. In accordance with that belief, Z made distributions to X as if Trust provided for a fixed percentage of the value of Trust's assets unitrust amount from the inception of Trust until the end of Year 1. It was not until Date 2 that Z became aware of the net income limitation in the Trust Agreement.

X and Y, as Trustees, filed a petition in state court requesting the judicial reformation of Trust to correct and remove the net income limitation currently in the Trust Agreement and replace it with a straight percentage unitrust amount as originally intended by X upon the establishment of Trust. The court granted X and Y's request

effective on Date 3.

Law and Analysis

Section 644(d)(2) provides that the term “charitable remainder unitrust” is defined as a trust (A) from which a fixed percentage (which is not less than 5 percent and not greater than 50 percent) of the initial 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 section 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 than qualified gratuitous transfers described in subparagraph (C) may be paid out 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 or, to the extent the remainder interest is in qualified employer securities (as defined in (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4957(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g)), and (D) with respect to each contribution of property to the trust, the value (determined under section 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 664(d)(3) of the Code creates what is commonly referred to as a NIMCRUT. Specifically, the section states that, notwithstanding the provisions of sections 664(d)(2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year (A) the amount of the trust income, if such amount is less than the amount required to be distributed under section 664(d)(2)(A), and (B) any amount of the trust income which is in excess of the amount required to be distributed under section 664(d)(2)(A), to the extent that (by reason of section 664(d)(2)(A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

Section 1.664-3(a)(3)(ii) of the Income Tax Regulations provides that a trust is not a charitable remainder unitrust if any person has the power to alter the amount to be paid to any named person other than an organization described in section 170(c) if such power would cause any person to be treated as the owner of the trust, or any portion thereof, if subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code were applicable to such trust.

Section 1.664-3(a)(4) provides in part, that the trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than

the organization described in section 170(c). Notwithstanding the preceding sentence, the grantor may retain the power exercisable only by will to revoke or terminate the interest of any recipient other than an organization described in section 170(c).

Section 4941(a)(1) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(a)(2) of the Code generally imposes a tax on the participation of a foundation manager in an act of self-dealing knowing that it is such act, payable by the foundation manager.

Section 4941(d)(1)(E) of the Code provides that the term “self-dealing” means any direct or indirect transfer to, or the use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a) of the Code provides the term “disqualified person” with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), a family member of a substantial contributor (including children), and a foundation manager (including a trustee).

Section 4947(a)(2) of the Code provides generally that split-interest trusts are subject to the provisions of section 4941 in the same manner as if such trusts were private foundations, but, under section 4947(a)(2)(A), not with respect to any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under section 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

Section 53.4947-1(c)(2)(i) of the Foundation and Similar Excise Taxes Regulations provides that under section 4947(a)(2)(A) of the Code, section 4941 does not apply to any amounts payable under the terms of the a split-interest trust to income beneficiaries unless a deduction was allowed under section 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(b), with respect to the income interest of any such beneficiary.

As a charitable remainder unitrust under section 664(d)(2) of the Code, the Trust is a split-interest trust described in section 4947(a)(2) and, therefore, subject to section 4941, which imposes an excise tax on acts of self-dealing. Under section 4947(a)(2)(A), the self-dealing rules of section 4941 do not apply, however, to any amounts payable under the terms of the split-interest trust to income beneficiaries as long as no deduction was allowed for such income interest under section 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

X is a substantial contributor to the Trust and a Trustee of Trust and, as such, X is a disqualified person with respect to the Trust. Y is a Trustee of Trust and is also the spouse of a substantial contributor to the Trust. Accordingly, Y is also a disqualified person with respect to the Trust.

Conclusions

Based on the facts and representations made by the taxpayer, the judicial reformation of Trust does not violate section 664 or any of the applicable regulations. Accordingly, we also conclude that the judicial reformation of the Trust under state law will not adversely affect Trust's qualification as a charitable remainder unitrust under section 664(d)(2) and the applicable regulations.

Further, the circumstances presented by the taxpayer indicate that there is no self-dealing, since the signatory parties to the Trust Agreement never intended to create a NIMCRUT. This is based on facts and representations made by the taxpayer such as the consistent administration of Trust using a fixed percentage of the value of Trust's assets each year. In addition, the taxpayers have submitted an affidavit from the investment counselor attesting to the fact that X and Y never intended to have a net income limitation. Consistent with this affidavit is the investment counselor's administration of Trust, allowing only the fixed percentage payout. Finally, there appears to be a lack of evidence that X and Y are reducing their own taxes, or using the benefit of hindsight in making the change to the fixed percentage payment method.

Except as provided in this ruling, no other opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item 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 ruling is being sent to the taxpayer and taxpayer's representative.

Sincerely,

/s/ Carolyn Gray

Carolyn Gray
Acting Assistant Branch Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for section 6110 purposes

