Internal Revenue Service

Number: **200233008**
Release Date: 8/16/2002
Index Number: 664.03-02

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2-PLR-112510-01
Date:
        February 8. 2002

Legend

Trust:

Grantor:

Trustee:

Court:

State:

<u>D1</u>:

<u>D2</u>:

Year 1:

Year 2:

<u>a</u>:

Dear   :

        This letter responds to the letter dated February 7, 2001, and subsequent correspondence, submitted by Trust's authorized representatives on behalf of Trustee and Trust, requesting rulings under §§ 664, 4941 and 170 of the Internal Revenue Code concerning the effect of a proposed judicial reformation of Trust.

        The information submitted states that on <u>D1</u>, Grantor established Trust as a Charitable Remainder Unitrust (CRUT). Grantor instructed the attorneys who drafted the CRUT that for purposes of determining the unitrust payment, January 1 be treated as the valuation date. Grantor wanted the benefit of a January 1 valuation date for Trust to enable Trustee to make the correct quarterly unitrust distributions.

        The attorneys who drafted Trust misunderstood Grantor's instructions and intent. Trust failed to qualify as a CRUT because the charitable remainder was less that 10

percent of the net fair market value of the property as of the date the property was contributed to Trust. Trust incorrectly provided that the last day of the taxable year (December 31) would serve as the valuation date for quarterly unitrust distributions that preceded that date.

Trust was modified on D2, both to qualify Trust as a CRUT and to follow the Grantor's intent. Trustee represents that the modification was a qualified modification of a charitable remainder interest under § 2055(e)(3). The modification of Trust qualified Trust as a CRUT by making the charitable remainder at least 10 percent of the net fair market value of the property as of the date the property was contributed to Trust. However, the modification did not use Grantor's intended valuation date. The modification provided that in each taxable year of the Trust, Trustee shall pay to or apply for the benefit of the beneficiary a unitrust amount equal to a percent of the net fair market value of the trust property valued as of the first business day of the taxable year (the "valuation date"). This modification resulted in the valuation date being the first business day of the taxable year rather than January 1, as intended by Grantor.

Trustee proposes to petition Court to correct this scrivener's error by further amending Trust to provide that the valuation date for a year is January 1 of that year rather than the first business day of such taxable year as provided in the D2 modification. The proposed amendment will be effective *ab initio*. If Court approves the petition, it may be necessary to correct the distributions for Year 1 and Year 2 based on changing the valuation date from the first business day of each year to January 1 of each year in order to correct the erroneous distributions for the Year 1 and Year 2 taxable years.

Specifically, Trustee requests the following rulings:

1. That the proposed judicial reformation, *ab initio*, of Trust will not adversely affect Trust's qualification as a CRUT under § 664.

2. That the proposed judicial reformation, *ab initio*, of Trust will not constitute an act of self-dealing under § 4941.

3. That the proposed judicial reformation, *ab initio*, of Trust will not reduce Grantor's income tax deduction for transfers to Trust under § 170.

ISSUE 1

Section 664(d)(2) provides that for purposes of § 664, a CRUT 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 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 § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(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 § 664(d)(2)(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 § 664(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 § 664(g)), and (D) with respect to each contribution of property to the trust, the value (determined under § 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 1.664-1(a)(1)(iii)(a) of the Income Tax Regulations provides that the term "charitable remainder trust" means a trust with respect to which a deduction is allowable under §§ 170, 2055, 2106, or 2522 and which meets the description of a charitable remainder annuity trust (as described in § 1.664-2) or a CRUT (as described in § 1.664-3).

Section 1.664-3(a)(1)(iii) provides that where the governing instrument provides that in the case where the net fair market value of the trust assets is incorrectly determined by the fiduciary, the trust shall pay to the recipient (in the case of an undervaluation) or be repaid by the recipient (in the case of an overvaluation) an amount equal to the difference between the amount which the trust should have paid the recipient if the correct value were used and the amount which the trust actually paid the recipient. Such payments or repayments must be made within a reasonable period after the final determination of such value. Any payment due to a recipient by reason of such incorrect valuation shall be considered to be a payment required to be distributed at the time of such final determination for purposes of § 1.664-1(d)(4)(ii). See § 1.664-1(d)(4) for rules relating to the year of inclusion of such payments and the allowance of a deduction for such repayments. See § 1.664-3(b) for rules relating to additional contributions.

In regard to CRUTs, § 1.664-3(a)(4) provides 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 an organization described in § 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 § 170(c).

Based solely on the facts and representations made and provided that Court determines that a scrivener's error was made in drafting the trust agreement and modifies Trust to correct this error and provided that Court's modification is in accordance with State law, we conclude that the proposed judicial reformation to change the valuation date from the first business day of each year to January 1 of each year for determining the unitrust distributions for that calendar year will not adversely affect Trust's qualification as a CRUT under § 664. If the change in valuation dates results in a change in the value of the trust assets and therefore the unitrust amount for

prior years of the trust, adjustments must be made. The noncharitable beneficiary is required to repay Trust for any excess distributions in the case of an overvaluation and Trust is required to pay to the noncharitable beneficiary additional amounts in the case of undervaluations in accordance with § 1.664-3(a)(1)(iii).

ISSUE 2

Section 4941 imposes an excise tax on any act of self-dealing between a private foundation and any disqualified person defined under § 4946.

Section 4946 defines the term "disqualified person" to include a person who is a substantial contributor.

Section 4946(a)(2) defines a substantial contributor as a person described in § 507(d)(2).

Under § 507(d)(2), the term "substantial contributor" includes the creator of a trust.

Based solely on the facts and representations made we conclude that the proposed judicial reformation, *ab initio*, of Trust will not constitute an act of self-dealing under § 4941.

ISSUE 3

Section 170 permits a deduction for any charitable contribution payment of which is made within the taxable year.

Section 170(f)(2)(A) generally provides that, in the case of property transferred in trust, no charitable contribution deduction is allowed for the value of the charitable remainder interest unless the trust is a charitable remainder annuity trust or a charitable remainder unitrust as described in § 664, or a pooled income fund described in § 642(c)(5).

Based solely on the facts and representations made, assuming Trust continues to qualify as a CRUT, we conclude that the proposed judicial reformation, *ab initio*, of Trust to change the valuation date from the first business day of each year to January 1 of each year will not reduce the amount of Grantor's income tax charitable contribution deduction under § 170 that was available upon funding Trust using a valuation date of the first business day of the year.

Except as we have specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

This letter 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.

PLR-112510-01

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to Trust's authorized representative.

<div style="text-align: right;">

Sincerely,
J. Thomas Hines
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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Enclosures:
    Copy of a letter
    Copy for § 6110 purposes