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Washington, DC 20224

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CC:PSI:4

PLR-125848-20

Date:

May 07, 2021

Legend

| | |
|-----------|---|
| Trust | = |
| Spouse 1 | = |
| Spouse 2 | = |
| Charity 1 | = |
| Charity 2 | = |
| Attorney | = |
| Date 1 | = |
| Date 2 | = |
| Date 3 | = |
| Date 4 | = |
| <u>x</u> | = |
| State | = |
| Court | = |

| | |
|-----------|---|
| Statute 1 | = |
| Statute 2 | = |

Dear :

This letter responds to a letter dated October 20, 2020, and additional correspondence, submitted by your authorized representative, requesting a ruling that a state court reformation of a trust is a qualified reformation under § 2055(e)(3) of the Internal Revenue Code (Code).

Spouse 1 and Spouse 2 (the Settlers) created Trust, an inter vivos, irrevocable trust, on Date 1. Trust provides that the Settlers intend that Trust qualify as a charitable

remainder unitrust under the Code and that all provisions under the governing instrument shall be interpreted according to this intention.

Under Article III of Trust, in each taxable year of the trust, the trustee is to pay to the Settlers, during their joint lives, and thereafter to the survivor of them for the survivor's lifetime, an amount equal to x percent of the fair market value of Trust assets valued on the last day of each taxable year of the Trust (the unitrust amount). Article III of Trust further provides that instead of the unitrust amount, the trustee may pay either the amount described in (1) or the sum of (1) and (2), as follows:

- (1) The amount of trust income (as defined in § 643(b) and the regulations thereunder) for the taxable years to the extent that such amount is not more than the amount required to be distributed as the regular unitrust amount for that taxable year;
- (2) The amount of trust income for a taxable year which is in excess of the regular unitrust amount for that taxable year to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the regular unitrust amounts for those prior years.

Article III further provides that upon the death of the last survivor of Settlers, the Trustee shall distribute all of the then principal and income of Trust to Charity 1 and Charity 2, but only if they are described in §§ 170(c), 2055(a), and 2522(a) at the time principal or income is to be distributed to them. If neither are so described, the Trustee shall distribute the principal or income to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) that are selected by the Trustee in the Trustee's discretion.

Article IV of Trust provides that Trust is irrevocable; however, the Trustee shall have 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 the Code.

Article IV of Trust further provides that Settlers may amend or revoke the charitable remainder beneficiary designation of Charity 1 and Charity 2 by specific written instrument to the Trustee, provided the written notification is signed by both Settlers (if both Settlers are living) or one of the Settlers (if only one of the Settlers is living).

Article V of Trust provides as follows:

The Settlers agree that the trustee shall not be liable for any federal or state death taxes payable as a result of the inclusion of all or any portion of the Trust Estate in the surviving Settlor's gross estate at the time of the surviving Settlor's death. The Settlers impose an obligation on their respective estate to pay all such taxes, and the Settlers agree to provide for the payment thereof.

From Date 1 to the present, the Trustee of Trust has made no distributions in excess of net income and has administered Trust as a net income with make-up charitable remainder unitrust described in § 664(d)(2) and (3) of the Code.

More than 20 years after Date 1, Settlers engaged Attorney for planning advice. Upon reviewing the governing instrument of Trust, Attorney determined that several provisions do not satisfy the requirements of § 664(d)(2) and (3), specifically, the provision in Article III relating to the method of determining the unitrust amount and the provision in Article V relating to the payment of any taxes that may be payable upon the death of the first Settlor to die. With respect to the latter, the tax payment provision fails to eliminate the possibility that Trust will have to pay federal estate taxes. See Rev. Rul. 82-128, 1982-2 C.B. 71.

On Date 2, under the authority of Statute 1 and Statute 2 and with the consent of the Trustee and Charity 1 and Charity 2, Settlers petitioned Court in State to reform Trust to satisfy the requirements of § 664(d)(2) and (d)(3). On Date 3, Court granted Settlers' petition and ordered the reformation, effective as of Date 1.

As reformed by the Date 3 Order, Article III of Trust integrates provisions of Rev. Proc. 2005-55, 2005-2 C.B. 367, including the net income with make-up provision for calculating the unitrust amount in § 6.09 of Rev. Proc. 2005-55 and the tax payment provision in paragraph 3 of § 4 of Rev. Proc. 2005-55. The Date 3 Order also modifies Trust to include an additional provision that adopts the State Uniform Principal and Income Act to govern principal and income determinations and allocation of receipts and expenses between these accounts.

In integrating the net income with make-up method of calculating the unitrust amount in § 6.09 of Rev. Proc. 2005-55, the Date 3 Order inadvertently changes the valuation date of Trust to the first day of the taxable year of Trust. Accordingly, on Date 4, the Trustee of Trust petitioned Court in State to amend the Date 3 Order to correct the valuation date, and certain affected provisions (i.e., last day of each taxable year, additional contributions), so that the valuation date remains the last day of each taxable year of Trust as originally prescribed, effective as of Date 1.

You have asked that the Court ordered reformation on Date 3, and the Court ordered reformation in accordance with the Date 4 Petition, will be a qualified reformation under §2055(e)(3)(A).

LAW AND ANALYSIS

Section 664(d)(2)(A) provides that a charitable remainder unitrust is a trust from which a fixed percentage (which is not less than 5 percent nor more 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 § 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. No amount other than the payments described above may be paid to or for the use of any person other than an organization described in § 170(c). Section 664(d)(2)(B). Following the termination of the annual payments, the remainder interest in the trust must 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. Section 664(d)(2)(C). The value (determined under § 7520) of the remainder interest must be at least 10 percent of the initial net fair market value of all property placed in the trust. Section 664(d)(2)(D).

Under § 664(d)(3), the governing instrument of a charitable remainder unitrust may provide that the trustee shall pay the income beneficiary for any year—(A) the amount of trust income, if such amount is less than the fixed percentage amount required to be distributed under § 664(d)(2)(A), and (B) any amount of the trust income which is in excess of the fixed percentage amount required to be distributed under § 664(d)(2)(A), to the extent that the aggregate of the amounts paid in prior years (by reason of § 664(d)(3)(A)) was less than the aggregate of such required amounts.

Section 664(e) provides, in relevant part, that for purposes of determining the amount of any charitable contribution, the remainder interest of a charitable remainder unitrust is to be computed on the basis that an amount equal to five percent of the net fair market value of its assets (or a greater amount, if required under the terms of the trust instrument) is to be distributed each year.

For estate tax purposes, a deduction for certain charitable transfers is allowed under § 2055(a). Section 2055(e)(2) disallows a deduction for the charitable transfer of a remainder interest unless the transfer is made in an acceptable form, including a charitable remainder annuity trust or unitrust described in § 664.

Section 2055(e)(3)(A) provides that a deduction shall be allowed under § 2055(a) in respect of any qualified reformation.

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) such change is effective as of the date of the decedent's death.

Section 2055(e)(3)(C)(i) defines the term “reformable interest” to mean any interest that would be deductible under § 2055(a) but for § 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. For purposes of determining whether all such payments are expressed as a fixed percentage of the fair market value of the property, § 664(d)(3) shall be taken into account.

The legislative intent behind the rule in § 2055(e)(3)(C)(ii) is to require that the governing instrument evidence an intent to comply with the Tax Reform Act of 1969. H.R. Rep. No. 98-432, at 1516-1519 (1984); S. Rep. No. 98-169, at 731-734 (1984). The legislative history indicates how this requirement is satisfied:

The governing instrument evidences an intent to comply with the 1969 Act rules if all current payouts from the trust are expressed as a fixed dollar amount or a fixed percentage of the value of the trust’s assets. ... In addition, an interest will be treated as expressed as a fixed percentage of the value of the trust’s assets if the current payout is expressed as the lesser of trust income or a fixed percentage of the value of the trust’s assets or the current payout is expressed in any other formulation which indicates an intent to create a trust described in section 664(d)(3).

H.R. Rep. No. 98-432, at 1518-1519. See also S. Rep. No. 98-169, at 733-734.

Section 2055(e)(3)(D) provides that a “qualified interest” is an interest for which a deduction is allowable under § 2055(a).

Sections 170(f)(7)(B) and 2522(c)(4)(B) of the Code provide, respectively, that rules similar to the rules of § 2055(e)(3) shall apply in the case of a qualified reformation of an inter vivos charitable remainder trust, where the grantor would otherwise be eligible to claim the income and gift tax charitable deductions rather than the estate tax charitable deduction. The legislative history of these provisions indicates that the reformation must be valid under local law in order to be qualified and that the reformation must be retroactive to the date of creation of the inter vivos trust. H. Rep. No. 98-432, at 1517-1519; S. Rep. No. 98-169, at 732-734.

In this case, Trust is an inter vivos trust created for both charitable and private purposes. However, Trust does not meet the requirements of § 664(d)(2) and (3) based on the payment provision in Article III and the tax payment provision in Article V. Thus, no deduction is allowable under § 170(c), 2522(a), or 2055(a) unless Trust is reformed in a manner consistent with the rules in § 2055(e)(3).

With respect to § 2055(e)(3)(C), the charitable interest in Trust must be a reformable interest. Before reformation, Article III of Trust provides for the payment to designated individuals during their lifetimes of no more than a fixed percentage of the annual net fair market value of the assets of the trust, with the remainder payable to designated charities. Thus, the charitable interest is presently ascertainable and severable from the non-charitable interest and would have qualified for an estate tax charitable deduction under § 2055(a) but for the provisions of § 2055(e)(2). Accordingly, we conclude that the requirement in § 2055(e)(3)(C)(i) is satisfied.

The second requirement of § 2055(e)(3)(C), as described in § 2055(e)(3)(C)(ii), is satisfied if all of the payments to the non-charitable beneficiaries are expressed as specified dollar amounts or a fixed percentage of the net fair market value of trust property, and § 664(d)(3) must be taken into account in making this determination. In this case, the governing instrument of Trust, and in particular, Article III of Trust, evidences a clear attempt to comply with § 664(d)(2) and (3) and to create a charitable remainder unitrust that uses the net income with make-up method of determining the unitrust amount. Accordingly, we conclude that the requirement in § 2055(e)(3)(C)(ii) also is satisfied and the charitable interest in Trust is a reformable interest.

In addition, we conclude that the reformation of Trust by the Date 3 Order, and as further proposed in the Date 4 Petition, satisfies the requirements of § 2055(e)(3)(B) for a qualified reformation as applied to an irrevocable, inter vivos trust. First, the actuarial value of the reformable interest is the same as the actuarial value of the qualified interest, determined as of the date of creation of Trust (and in accordance with the valuation assumptions prescribed in § 664(e) and the applicable regulations). Second, the non-remainder interest terminates at the same time both before and after the reformation. Finally, the reformation is effective as of Date 1, the date of creation of Trust.

Based on the above, we conclude that the reformation of Trust by the Date 3 Order, and as further proposed in the Date 4 Petition, will be a qualified reformation under § 2055(e)(3), provided that Trust, as judicially reformed, is a valid trust under applicable State law and satisfies all of the requirements of § 664(d)(2) and (3) and the applicable regulations. Our ruling is contingent on a final order of Court that reforms Trust in accordance with the Date 4 Petition.

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, including whether Trust meets the requirements of § 664(d)(2) and (d)(3) of the Code and the applicable regulations.

The ruling contained in this letter is 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 ruling request, it is subject to verification on examination.

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

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representative.

Sincerely,

Karlene M. Lesho
Karlene M. Lesho
Senior Technician Reviewer, Branch 4
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure
Copy for § 6110 purposes

cc: