

## Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:DOM:P&SI:4-PLR-114987-99  
Date: May 4, 2000

Legend:

Decedent =

Spouse =

Niece =

Trust =

Trustee of Unitrust =

Trustees of Marital Trust =

Charity =

Date 1 =

Date 2 =

State =

Dear \_\_\_\_\_ :

This is in response to your letter dated August 27, 1999, in which you requested rulings concerning the tax consequences of a proposed reformation to a charitable remainder unitrust.

On Date 1, Decedent executed Trust. Decedent died on Date 2 and Trust became irrevocable. Decedent is survived by Spouse. Trust provides for the disposition of property upon Decedent's death.

Paragraph 3.6(a) of Article Three of Trust provides that if spouse survives Decedent, one-half of the remaining property is to be held as a marital trust for Spouse in accordance with the provisions of Article Four ("Marital Trust").

Paragraph 4.2 of Article Four of Trust provides that all income is to be distributed currently to Spouse for life at monthly or other convenient intervals, but not less often than annually.

Paragraph 4.3 of Article Four of Trust provides that principal is to be distributed as Trustee deems suitable for care, support, and maintenance of Spouse.

Paragraph 4.4 of Article Four of Trust provides that upon the death of Spouse all remaining Trust property is to be administered as a unitrust named for Niece and Charity in accordance with provisions of Article Five ("Unitrust").

Paragraph 5.3 of Article Five of Trust provides that Trustee of Unitrust is to distribute to Niece for the period of Niece's life, an amount which is the lesser of 5 percent of the net fair market value of the trust assets as determined as of the Valuation Date ("Unitrust Amount") or the trust income (as defined in § 643(b) of the Code and the Regulations thereunder) for the taxable year.

Paragraph 5.5 of Article Five provides that upon Niece's death, Trustee is to distribute all of the the remaining income and principal to Charity.

Paragraph 5.10 of Article Five provides that Trustee of Unitrust is prohibited from engaging in any act of self-dealing as defined in § 4941(d), from retaining any excess business holdings as defined in § 4943(c) which would subject Trust to tax under § 4943, from making any investments which would subject Trust to tax under § 4944, and from making any taxable expenditures as defined in § 4945(d). Additionally, Trustee is to make distributions at such time and in such manner as not to subject Trust to tax under § 4942.

Trustees of Marital Trust propose to reform Unitrust to permit the Unitrust amount to be paid for an initial period in accordance with § 1.664-3-(a)(1)(i)(b) of the Income Tax Regulations, and then to be paid as a fixed percentage for the remaining portion of the trust term in accordance with § 1.664-3-(a)(1)(i)(c).

The proposed paragraph provides:

Notwithstanding the foregoing provisions of Article Five, this paragraph 5.14 shall supersede paragraphs 5.3 and 5.4 with respect to Unitrust created under 4.4 of this agreement.

(a) Trust Term: The period for payment of the Annual Amount for the trust ("the Trust Term") shall begin on the date of death of [Spouse], and shall end upon the death of the Recipient of the trust, [Niece].

(b) Computation of Annual Amount during First Phase: For each taxable year of the trust during the period ("the First Phase") which begins with the first day of the trust's first taxable year and ends on December 31 of the trust's first taxable year (the last day of the taxable year of the trust in which the Triggering Event occurs), the Annual Amount shall equal the lesser of:

(i) an amount ("Unitrust Amount") which equals five (5) percent of the net fair market of the trust assets as determined on the Valuation Date for that taxable year, or

(ii) the trust income for that taxable year as defined in § 643(b) of the Code and the Regulations thereunder.

(c) Triggering Event: The Triggering Event shall be December 31 of the year in which [Spouse] dies.

(d) Computation of Annual Amount during First Phase: For each taxable year of the trust during the period ("the Second Phase") which begins with the first day of the first taxable year of the trust after the taxable year of the trust in which the Triggering Event occurs and continues for the balance of the Trust Term, the Annual Amount shall be five (5) percent of the net fair market value of the trust assets as determined as of the Valuation Date for that taxable year.

(e) Valuation Date: The Valuation Date for a taxable year of a trust shall be the first business day of that taxable year. If no Valuation Date occurs in a short taxable year for the trust other than the taxable year in which the Trust Term ends, trust assets shall be valued, for purposes of computing Unitrust Amount, as of the last day of such short taxable year. In the case of the taxable year of the trust in which the Trust Term ends, if no Valuation occurs before the day the Trust Term ends, trust assets shall be valued, for purposes of computing Unitrust Amount, as of the day the Trust Term ends.

The terms governing Unitrust became irrevocable on Date 2, however the assets are presently held in a marital trust which satisfies the requirements for a qualified terminable interest trust under § 2056(b)(7). Unitrust will not come into existence until the death of the Spouse. Trustees of Marital Trust filed a petition in State court to reform Unitrust as provided in proposed paragraph 5.14. The court granted the order conditioned upon the Internal Revenue Service issuing the following requested rulings:

1. The proposed reformation will not prevent Unitrust from qualifying as a charitable remainder unitrust under § 664 when it is created (upon the death of Spouse) or at any point during its term.

2. The proposed reformation will not result in an act of self-dealing under § 4941 at the time the order reforming Article Five is issued, at the time the method for computing Unitrust amount changes, or at any other time during the term of Unitrust.

3. The proposed reformation will not cause the present value of the remainder interest in Unitrust from qualifying for an estate tax charitable deduction under § 2055(a) in Spouse's estate.

#### Ruling Request 1

Section 664(d)(2) defines a charitable remainder unitrust as a trust that provides for the distribution of the unitrust amount, at least annually for life or a term of years, to one or more persons (at least one of which is not a charitable organization) with an irrevocable remainder interest to be held for the benefit of, or paid over to, a qualified charitable organization.

Section 1.664-3(a)(1)(i)(c) provides that the governing instrument may provide that the

trust will pay not less often than annually the amount described in § 1.664-3(a)(1)(i)(b) for an initial period and then pay the amount described in § 1.664-3(a)(1)(i)(a) (calculated using the same fixed percentage) for the remaining years of the trust.

Section 1.664-3(a)(1)(i)(f)(1) provides that § 1.664-3(a)(1)(i)(c) applies to charitable remainder trusts created on or after December 10, 1998.

Section 1.664-1(a)(4) provides that in order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Solely for the purpose of § 664 and the applicable regulations, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust, but in no event prior to the time property is first transferred to the trust.

Section 1.664-3(a)(1)(i)(f)(3) of the regulations provides that a charitable remainder trusts may be reformed to allow for a combination of methods as provided in § 1.664-3(a)(1)(i)(c) without causing the trust to fail to function exclusively as a charitable remainder unitrust under § 1.664-1(a)(4), if the trustee begins legal proceedings to reform by June 8, 1999 (extended to June 30, 2000 by Notice 99-31, 1999-23 I.R.B. 6).

In the present case, property will not be transferred to Unitrust until the death of Spouse. Trustees of Marital Trust have filed a petition in State court that complies with the special reformation rules under § 1.664-3(a)(1)(i)(f)(3). Accordingly, we rule that the proposed reformation of Trust will not prevent Unitrust from qualifying as a charitable remainder unitrust under § 664(d)(2).

### Ruling Request 2

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

Section 4941(d)(1) defines self-dealing as any direct or indirect – (A) sale or exchange, or leasing, of property between a private foundation and a disqualified person; (B) lending of money or other extension of credit between a private foundation and a disqualified person; (C) furnishing of goods, services, or facilities between a private foundation and a disqualified person; (D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person; (E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; (F) agreement by a private foundation to make any payment of money or other property to a government official (as defined in § 4946(c)), other than certain employment agreements.

Section 4947(a)(2) generally provides that in the case of a trust which is not exempt from tax under § 501(a), not all of the unexpired interests of which are devoted to charitable purposes, and which has amounts in trust for which a charitable deduction was allowed, §§ 507, 508(e), 4941, 4943, 4944, and 4945 apply as if such trust were a private foundation, except for amounts in trust for which a charitable deduction was not allowed and which are segregated from amounts for which a charitable deduction was allowed.

Section 1.664-3(a)(1)(i)(f)(3) provides that a charitable remainder trust may be reformed to allow for a combination of methods as provided in § 1.664-3(a)(1)(i)(c) without causing the

trust to fail to function exclusively as a charitable remainder unitrust under § 1.664-1(a)(4) or to engage in an act of self-dealing under § 4941, if the trustee begins legal proceedings to reform by June 8, 1999 (extended to June 30, 2000 by Notice 99-31, 1999-23 I.R.B. 6).

Section 53.4947-1(c)(1)(iii) of the Foundations and Similar Excise Taxes Regulations provides that a newly created trust shall, for purposes of § 4947(a)(2), be treated as having amounts in trust for which a deduction was allowed under §§ 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522 from the date of its creation, even if a deduction was allowed for such amounts only at a later date. For purposes of § 53.4947-1(c)(1)(iii), the date of creation of a charitable remainder trust shall be determined by applying the rules in § 1.664-1(a)(4).

Section 53.4947-1(c)(6)(iii) provides that a revocable trust that becomes irrevocable upon the death of the decedent-grantor under the terms of the governing instrument of which the trustee is required to hold some or all of its net assets in trust after becoming irrevocable for both charitable and noncharitable beneficiaries is not considered a split-interest trust under § 4947(a)(2) for a reasonable period of settlement after becoming irrevocable except that § 4941 may apply if the requirements of § 53.4941(d)-1(b)(3) are not met. After that period, the trust is considered a split-interest trust under § 4947(a)(2). For such purpose, the term “reasonable period of settlement” means that period reasonably required (or if shorter, actually required) by the trustee to perform the ordinary duties of administration necessary for the settlement of the trust. These duties include, for example, the collection of assets, the payment of debts, taxes, and distributions, and the determination of rights of the subsequent beneficiaries.

In the present case, Unitrust will be a split-interest trust as defined in § 4947(a)(2). When Unitrust becomes a split-interest trust, then § 4941 will fully apply to it as if it were a private foundation. By the terms of the governing instrument, Unitrust will not receive property until the death of Spouse. Sections 53.4947-1(c)(1)(iii) and 1.664-1(a)(4) indicate that a unitrust is not deemed created before property is first transferred to the trust. As the facts do not indicate any gift of property to the charitable remainder unitrust for which a charitable deduction was allowed, the trust is not a split-interest trust subject to § 4941 at this time. Therefore, the proposed reformation cannot be an act of self-dealing. If Unitrust were created and a split-interest trust subject to § 4941, then Unitrust could still engage in the proposed reformation so long as it complied with the special reformation rules under § 1.664-3(a)(1)(i)(f)(3).

Accordingly, the proposed reformation will not result in an act of self-dealing under § 4941 either (i) at the time the order reforming Article Five is issued, (ii) at the time the Unitrust is created (upon the death of the Decedent's spouse), (iii) at the time the method for computing the Unitrust amount changes (at the beginning of the calendar immediately following the year in which the Decedent's spouse dies) or (iv) at any other time during the term of the Unitrust.

### Ruling Request 3

Section 2044(a) provides that the gross estate includes property in which the decedent possesses a qualifying income interest for life, and with respect to which a deduction was allowed under § 2056(b)(7). Under § 2044(b), property included in the gross estate under § 2044 is treated as passing from the decedent for purposes of the estate tax.

Section 2055(a) provides that the value of the taxable estate at the decedent's death shall be determined by deducting from the value of the gross estate the amount of all bequests,

legacies, devises, and transfers to a person or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

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 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 subsection (a), no deduction shall be allowed under § 2055 for the interest which passed or has passed to the person, or for the use, described in § 2055(a) unless, in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)).

Section 20.2055-2(a) of the Estate Tax Regulations provides that if a trust is created or property is transferred for both a charitable and a private purpose, a deduction may be taken for the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

Under § 20.2055-2(e)(1)(i), in the case of decedents dying after December 31, 1969, where an interest in property passes from the decedent for charitable purposes and an interest in the same property passes from the decedent for private purposes, no deduction is allowed under § 2055(a) for the value of the interest passing for charitable purposes unless the interest is a "deductible interest".

Under § 20.2055-2(e)(2)(vii)(a), the term "deductible interest" also includes a unitrust interest. The term "unitrust interest" includes a right pursuant to the instrument of transfer, to receive payment, not less often than annually of a fixed percentage of the net fair market value, determined annually, of the property which funds the unitrust interest.

In the present case, Trustees of Marital Trust propose to reform Unitrust to permit Unitrust to use a combination of methods as provided in § 1.664-3(a)(1)(i)(c). Trustees of Marital Trust have filed a petition in State court that complies with the special reformation rules under § 1.664-3(a)(1)(i)(f)(3). The proposed reformation of Trust will not prevent Unitrust from qualifying as a charitable remainder unitrust under § 664(d)(2). Accordingly, we rule that a federal estate tax charitable deduction will be allowed to Spouse's estate under § 2055(a).

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.

These rulings are expressly contingent on the issuance of a court order authorizing the proposed reformation.

We express no opinion on any other provisions of Trust or on the federal tax consequences of the formation and operation of Unitrust under any other provisions of the Code. Specifically, no opinion is expressed as to whether Unitrust will qualify as a charitable remainder trust under § 664.

The rulings contained in this letter are 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.

Pursuant to a Power of Attorney on file, a copy of this letter is being sent to the taxpayer.

Sincerely yours,  
Robert G. Honigman  
Acting Assistant to the Branch Chief  
Branch 4

Enclosure  
Copy for section 6110 purposes