

Internal Revenue Service

Department of the Treasury

Index Number: 2055.12-05; 2055.12-10

Washington, DC 20224

Number: **199935041**

Release Date: 9/3/1999

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:4-PLR-120457-98

Date:

June 4, 1999

Legend

Estate =

Decedent =

Trust A =

Trust B =

Trust C =

A =

B =

Association =

Charity 1 =

Charity 2 =

Charity 3 =

Charity 4 =

Date 1 =

Date 2 =

Amount 1 =

Amount 2 =

Amount 3 =

Amount 4 =

Amount 5 =

Amount 6 =

Trustee =

Court =

This is in reply to a letter dated November 2, 1998, and subsequent correspondence, from your authorized representative requesting a ruling on behalf of Estate regarding a proposed reformation of Trust A pursuant to § 2055(e)(3) of the Internal Revenue Code.

FACTS

The facts are represented to be as follows: Decedent died testate on Date 1. Decedent's Last Will and Testament executed on Date 2, created Trust A to be funded with the residue of Decedent's estate. Under the terms of Trust A, the trust corpus is to be held in perpetuity and specified amounts of trust income are to be distributed to individuals A (Amount 3) and B (Amount 4) for life, to Association (an organization that does not satisfy the requirements of § 2055(a)) (Amount 2), and to Charity 1 (Amount 5), Charity 2 (Amount 6), and Charity 3 (Amount 6). The balance of the trust income is payable to Charity 4. Trust A does not qualify as a charitable remainder trust under § 664 and Estate proposes to reform Trust A in accordance with § 2055(e)(3). The proposed reformation is described below.

As reformed, Trust A will be divided into Trust B and Trust C. Trust B will be funded with Amount 1. The Trustee of Trust B will pay Amount 2 from the net income of Trust B to Association, in perpetuity. The remaining net income of Trust B at the end of each calendar year is to be paid to Charity 4. Trust C will be funded with the balance of the residuary estate. The Trustee of Trust C will pay an annuity amount equal to 5% of the initial net fair market value of the assets in Trust C to be distributed as follows:

1. Amount 3 to A for life.
2. Amount 4 to B for life.
3. Amount 5 to Charity 1.
4. Amount 6 to Charity 2.
5. Amount 6 to Charity 3.

The balance of the annuity amount is to be paid to Charity 4. The annuity is to be paid quarterly from income and, to the extent that income is not sufficient, from principal.

As reformed, Item VI.B, paragraph (e) provides that no payment is to be made to an organization unless such organization is a charitable organization described in §§ 170(c), 2055(a), and 2522(a) at the time when assets of Trust C are to be distributed. If any of the charitable organizations is not an organization described in those sections, then the Trustee shall distribute such principal or income to Charity 4, provided that it is then an organization described in those sections. If Charity 4 is not an organization described in §§ 170(c), 2055(a), and 2522(a), then the Trustee shall distribute such principal or income to one or more organizations described in those sections as the Trustee selects in its sole discretion. No additional contributions shall be made to Trust C after the initial contribution.

As reformed, Item VI.B, paragraph (f) provides that upon the death of the survivor of A and B, the Trustee is to hold all of the then principal and income of Trust C (other than any amount due either A, B, or the estates of A or B) in trust, in perpetuity for the benefit of Charity 1, Charity 2, Charity 3, and Charity 4.

As reformed, Item VI.B, paragraph (h) provides that, if the net fair market value of the assets of Trust C is incorrectly determined, then, within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the beneficiaries (in the case of an undervaluation) or received from the beneficiaries (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

As reformed, Item VI.B, paragraph (l) provides that the obligation to pay the annuity amount commences with the date of Decedent's death, but the payment of the annuity amount may be deferred from such date until the end of the taxable year of Trust C in which occurs the complete funding of Trust C. Within a reasonable time after

the end of the taxable year in which the complete funding of Trust C occurs, the Trustee must pay to the beneficiaries (in the case of an underpayment) or receive from the beneficiaries (in the case of an overpayment) the difference between (1) any annuity amounts actually paid, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under § 664 of the Code prescribe for such computation for such period; and (2) the annuity amounts payable, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under § 664 prescribe for such computation for such period.

As reformed, Item VI.B, paragraph (j) provides that, in determining the annuity amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the death of the survivor of A and B.

Estate requests the following rulings:

1. The charitable interest in Trust A is a reformable interest under § 2055(e)(3)(C).
2. The proposed reformation will constitute a qualified reformation under § 2055(e)(3).
3. Trust C meets the requirements of a charitable remainder annuity trust under § 664(d)(1).
4. A federal estate tax charitable deduction will be allowed under § 2055 based on the present value of the charitable interests provided for in Trust C.

LAW

Section 664(d)(1) provides that a charitable remainder annuity trust is a trust:

(A) from which a fixed percentage (that is not less than 5 percent nor more than 50 percent of the initial net fair market value of all property placed in trust) 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) the value (determined under § 7520) of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in the trust.

Section 664(d)(1)(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 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 educational 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 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 remainder interests passing to charity such interest is in a charitable remainder trust described in § 664, or a pooled income fund described in § 642(c)(5). In the case of interests other than charitable remainder interests, such interest is in the form of a guaranteed annuity described in § 20.2055-2(e)(2)(vi) or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly) (a unitrust interest described § 20.2055-2(e)(2)(vii)). Section 20.2055-2(e)(2)(vi) provides that the term guaranteed annuity interest means the right pursuant to the terms of the instrument to receive a guaranteed annuity. A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term or for the life or lives of a named individual or individuals.

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 90th 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 A, the charitable interests are reformable interests because a deduction would have been allowable under § 2055(a) for the charitable interests but for the requirements of § 2055(e)(2). A’s and B’s nonremainder interests terminate at the same time before and after the reformation and the reformation will be effective as of the date of Decedent’s death. The difference between the actuarial

value of the qualified interests (determined as of the date of decedent's death) and the actuarial value (as so determined) of the reformable interests does not exceed 5 percent of the actuarial value of the reformable interests.

Trust C, 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, and therefore, Trust C, as reformed, will meet the requirements of a charitable remainder annuity trust under § 664. Further, the charitable interest in the annuity amount constitutes a guaranteed annuity interest under § 20.2055-2(e)(2)(vi). Accordingly, provided that the reformed trust is valid under applicable local law, and the reformation proceeding is commenced within the time prescribed under § 2055(e)(3)(C)(ii), we conclude that the proposed reformation will be a qualified reformation within the meaning of § 2055(e)(3). Estate will be entitled to a charitable deduction under § 2055 with respect to the present value of the charitable guaranteed annuity and remainder interests in Trust C.

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.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George L. Masnik
Chief, Branch 4

Enclosure
Copy for § 6110 purposes