

Internal Revenue Service

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Department of the Treasury
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Person To Contact:

, ID No.

Telephone Number:

In Re:

Refer Reply To:

CC:PSI:04 – PLR-143622-03

Date: APRIL 13, 2004

DO:

Legend:

Decedent	=
Spouse	=
State 1	=
State 2	=
County	=
Trust	=

Reinstated Trust	=
Foundation	=
Trust 1	=
Trust 2	=
Trust 3	=

Agreement	=
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Partnership	=
Court	=
Trustees	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
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Dear ,

This is in response to your authorized representative's submission dated July 9, 2003, on behalf of the trustees of Reinstated Trust, seeking a ruling on the estate tax consequences of a proposed reformation of Reinstated Trust.

According to the facts submitted, on Date 1, Decedent and Spouse entered into an ante-nuptial agreement (Agreement). In general, under the terms of the Agreement, in consideration of the couple's intended marriage and other consideration, Decedent and Spouse each agreed to release the other from any and all claims or right that he or she might have in the others property under State law or otherwise by reason of their marriage, during both their lifetimes, and upon the death of either. Decedent agreed that within 12 months of their marriage, he would create and fund an inter vivos trust to provide the benefits described below. The benefits are to commence on the date of Decedent's death provided Spouse is living with Decedent as his lawfully wedded wife at the time of Decedent's death. Further, the benefits are to be paid to Spouse free from all estate, inheritance, succession or other death taxes.

The benefits provided to Spouse under the Agreement are as follows:

1. Level Salary A sum equal to b% of the salary of a member of the , to be paid in semi-annual installments for so long as she remains unmarried adjusted yearly to remain consistent with adjustments to the salary paid to members of the , but in no event less than \$g annually.
2. Maintenance Payment A monthly sum to be paid for Spouse's life equal to the cost of maintaining the home of the parties at the time of Decedent's death, including rent, utilities, maintenance, repair, and cleaning services, the determination of which is left to the trustee's discretion and not subject to challenge
3. Rent Free Use of Condominium Either \$h paid semi-annually, or the rent-free use of Decedent's condominium in State 2, without any actual cost or expense to Spouse, to be paid for Spouse's life. Spouse must choose, in writing, at the beginning of each year, which benefit to receive.

4. Medical and Dental Expenses All medical and dental expenses incurred by Spouse not otherwise paid during her life or reimbursed from some other source or by professional courtesy agreements.

5. Lump Sum Payment The trustee is to pay Spouse the sum of \$y within six months of Decedent's death.

Decedent created Trust, a revocable trust, one year later, in Year 1 in accordance with the terms of Agreement. Trust was funded with an x% interest in Partnership. Decedent retained the right to receive trust income for his life, and on his death the benefits described in the Agreement were to be paid to Spouse. However, the Trust provides that it is to terminate on Spouse's death or remarriage at which time the corpus is to pass to Foundation, a charitable organization described in section 501(c)(3) of the Code. On the other hand, under Agreement the benefits (other than the Cabinet Level Salary) continue for Spouse's life, regardless of whether Spouse remarries.

In Year 2, Decedent revoked Trust. In Year 3, he reinstated Trust (the Reinstated Trust) providing the same terms with regard to the Maintenance Payment, Rent Free Use Payment, Medical Payment, and Salary as contained in Trust. Under the terms of Reinstated Trust, Decedent designated himself as sole trustee and Foundation as the remainder beneficiary upon Spouse's death or remarriage. Decedent reserved to himself the right to alter, amend, or revoke Reinstated Trust, or to add or withdraw assets from Reinstated Trust. Decedent recontributed the same assets to Reinstated Trust as were initially contributed to Trust. Reinstated Trust was funded with an x% interest in Partnership.

On Date 5, Decedent executed a First Amendment to Reinstated Trust, which directed that Trustees serve as the sole successor trustees of the trust upon Decedent's death. Decedent died on the same day, a resident of County, State. At the time of Decedent's death, Decedent and Spouse were married and living together as husband and wife. Reinstated Trust became irrevocable upon Decedent's death.

It is represented that Spouse, the Trustees of Reinstated Trust and Foundation agree that the terms of the Reinstated Trust regarding the Maintenance Payments, Rent Free Use, and Medical Payments to Spouse should be reformed to conform to the terms of the Agreement. The parties agree that a payment of \$p each year will provide Spouse with the Salary that she is entitled to under Agreement. The benefit will be paid to Spouse for life or until her remarriage. The parties also agree that a total amount of \$w per year for Spouse's life will be sufficient to provide the payments to Spouse for Maintenance, Rent Free Use and Medical Expenses provided under Agreement. The payments are to be made quarterly, for Spouse's life. The one-time payment to Spouse of \$y, as provided for in Agreement has already been paid.

The Trustees of Reinstated Trust filed a petition on Date 6, a date that is within 90 days after the due date of Decedent's estate tax return, including extensions, with Court to conform Reinstated Trust to the Agreement and to reform Reinstated Trust pursuant to section 2055(e)(3)(B) of the Code. As a result of discussions with the IRS, upon receipt of a favorable ruling the Trustees will amend the petition to conform to the proposed reformation approved by the IRS, as described below.

The assets of Reinstated Trust will be divided into three trusts:

- 1) Trust 1 is to be held as a separate trust that is intended to qualify as a charitable remainder annuity trust described in section 664(d)(1). Trust 1 will be funded with cash or other property with a total value on the date of distribution of \$t. Trust 1 will pay to Spouse, for her life, an annual annuity amount of \$w. On Spouse's death, Trust 1 will terminate, and the trust corpus will be paid to Foundation.
- 2) Trust 2 is to be held as a separate trust that is intended to qualify as charitable remainder annuity trust described in section 664(d)(1). Trust 1 will be funded with cash or other property with a total value on the date of distribution of \$s. Trust 2 will pay to Spouse, for her life, or until her remarriage, an annual annuity amount of \$p. On Spouse's death, or her remarriage, whichever occurs first, Trust 2 will terminate, and the trust corpus will be paid to Foundation.
- 3) Trust 3 is to be held as a separate trust that is intended to qualify as a charitable remainder annuity trust described in section 664(d)(1). Trust 3 will be funded with the balance of the property remaining in Reinstated Trust. Trust 3 will pay to Spouse, for her life, an annual annuity amount of \$f. In addition, Trust 3 will pay Foundation for Spouse's life an annuity, to be determined at the time Trust 3 is funded, that will qualify as a guaranteed annuity described in section 20.2055-2(e)(2)(vi) of the Estate Tax Regulations. On Spouse's death, Trust 3 will terminate, and the trust corpus will be paid to Foundation.

The following rulings are requested.

1. The reformation of Reinstated Trust into Trust 1, Trust 2, and Trust 3 will constitute a qualified reformation under section 2055(e)(3), and the present value of the remainder interests in Trust 1, Trust 2, and Trust 3 will qualify for the estate tax charitable deduction under section 2055(e)(2)(A).
2. The present value of the annuity payments to Foundation payable under Trust 3, will qualify for the estate tax charitable deduction under section 2055(a) of the Code.

3. The present value of Spouse's lifetime annuity interests payable under Trust 1, Trust 2, and Trust 3 will qualify for the estate tax marital deduction under section 2056(a) and section 2056(b)(8).

Law and Analysis

Rulings 1 and 2

Section 664(d)(1) provides that for purposes of section 664, a charitable remainder annuity trust is a trust: (A) from which a sum certain (which 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 frequently 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 creation of the trust) for a terms 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 section 664(d)(1)(A) and other than qualified gratuitous transfers described in section 664(d)(1)(C) may be paid to or for the uses of any person other than an organization described in section 170(c); (C) following termination of the payments described in section 664(d)(1)(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 a use or, to the extent the remainder interest is in qualified employer securities (as defined in section 664(g)(4)), all or a part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined in section 664(g)); and (D) the value (determined under section 7520) of the remainder interest passing to charity is at least 10 percent of the initial net fair market value of all property placed in the trust.

Section 664(f)(1) provides generally that if a trust would, but for a "qualified contingency", meet the requirements of section 664(d)(1)(A) or (2)(A), then the trust shall be treated as meeting such requirements. Under section 664(f)(3), the term "qualified contingency" means any provision of a trust which provides that, upon the happening of a contingency, the payments described in section 664(d)(1)(A) or 2(A) (as the case may be) will terminate not later than such payments would otherwise terminate under the trust. Finally, under section 664(f)(2) for purposes of determining the amount of any charitable contribution (or the actuarial value of any interest), a qualified contingency is not to be taken into account.

Section 2001(a) of the Internal Revenue code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2055(a) provides that for purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to or for the use

charitable, religious, scientific, literary, or educational organizations described in sections 2055(a)(1) –(a)(4).

Section 2055(e)(2) provides that where an interest in property (other than an interest described in section 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in section 2055(a), and an interest (other than an interest which is extinguished upon the decedent's death) 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 § 2055(a), no deduction shall be allowed under section 2055 for the interest which passes or has passed to the person, or for the use described in section 2055(a) unless--(A) 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 section 664) or a pooled income fund (described in section 642(c)(5)), or (B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).

Section 2055(e)(3) provides for the reformation of interests to comply with the requirements of section 2055(e)(2). Section 2055(e)(3)(A) provides that a deduction shall be allowed under section 2055(a) in respect of any qualified reformation■.

Section 2055(e)(3)(B) provides that for purposes of § 2055(e), the term "qualified reformation" means a change of a governing instrument by reformation, amendment, construction, or otherwise which 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 for which a deduction would be allowable under § 2055(a) at the time of the decedent's death but for the split-interest rules of § 2055(e)(2). Under section 2055(e)(3)(C)(ii) 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 section 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)(I) provides, however, that the restriction in section 2055(e)(3)(C)(ii) does not apply to any interest if a judicial proceeding is commenced to change such interest into a qualified interest not later than the 90th day after the last date (including extensions) for filing an estate tax return, if an estate tax return is required to be filed.

Section 2055(e)(3)(D) provides that for purposes of section 2055(e)(3), the term “qualified interest” means an interest for which a deduction is allowable under section 2055(a).

In this case, under the terms of Reinstated Trust, an interest in the trust will pass for both charitable and non-charitable purposes. Reinstated Trust, however, does not meet the requirements of section 664(d) described above. Therefore, the property passing to Reinstated Trust does not qualify for the estate tax charitable deduction under section 2055(e)(2).

The interest passing to Foundation under Reinstated Trust is a reformable interest within the meaning of section 2055(e)(3)(C)(i) because the value of the charitable interest at the date of Decedent’s death was ascertainable and, hence severable from the non-charitable interest. Prior to the enactment of section 2055(e)(2), such an interest would have been deductible under section 2055(a). See section 20.2055-2(a) of the Estate Tax Regulations. Although the payments to Spouse were not expressed in specified dollar amounts or a fixed percentage of the fair market value of the property as required by section 2055(e)(3)(C)(ii), a judicial proceeding was commenced, as provided under section 2055(e)(3)(C)(iii), before the 90th day after the last date (including extensions) for filing Decedent’s estate tax return.

In addition, (1) the difference between the actuarial value (determined as of the date of decedent’s death) of the qualified interest and 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; (2) the nonremainder interest terminates at the same time both before and after the reformation; and (3) the reformation is effective as of the date of Decedent’s death.

Provided that the judicial reformation of Reinstated Trust conforms with the most recently submitted proposed reformation, as described above, and provided that Trust 1, Trust 2, and Trust 3, as judicially reformed are valid trusts under applicable state law, and provided that Trust 1, Trust 2, and Trust 3 as reformed satisfy the requirements of section 664(d)(1) and the applicable regulations, we conclude, based on the facts submitted and representations made, as follows:

1. The proposed reformation of Reinstated Trust into Trust 1, Trust 2, and Trust 3 will be a qualified reformation within the meaning of section 2055(e)(3). Therefore, an estate tax charitable deduction will be allowable under section 2055(a) for the present value of the charitable remainder interests in Trust 1, Trust 2, and Trust 3

determined under section 20.2055-2(f). In this regard, we note that, in accordance with section 664(f)(2), in determining the present value of the charitable remainder interest in Trust 2, the qualified contingency (the possibility that the trust will terminate on Spouse's remarriage), is not taken into account.

2. With respect to Trust 3, assuming the annuity amount payable to Foundation qualifies as a guaranteed annuity within the meaning of section 2055(e)(2)(B) of the Code and section 20.2055-2(e)(2)(vi) of the Estate Tax Regulations, a charitable deduction will be allowed under section 2055(a) based on the present value of the annuity interest created determined in accordance with section 20.2055-2(f)(2)(iv).

RULING 3

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(1) provides that where on the lapse of time, on the occurrence of an event or contingency, or the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction is allowed with respect to such interest - (A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and (B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse.

Section 2056(b)(8) provides that, if the surviving spouse of the decedent is the only beneficiary of a qualified charitable remainder trust who is not a charitable beneficiary nor an ESOP beneficiary, section 2056(b)(1) will not apply to any interest in such trust which passes or has passed from the decedent to the surviving spouse.

Under section 2056(b)(8)(B)(I), the term "charitable beneficiary" means any beneficiary that is an organization described in section 170(c). Under Section 2056(b)(8)(B)(iii), the term "qualified charitable remainder trust" means a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664).

In the present case, Spouse is the only beneficiary under Trust 1, Trust 2, and Trust 3 who is not a charitable beneficiary. Assuming that Trust 1, Trust 2, and Trust 3 as reformed will qualify as charitable remainder annuity trusts under section 664(d)(1), as reformed, the present value of Spouse's annuity interests under Trust 1, Trust 2, and Trust 3 will qualify for the estate tax charitable deduction pursuant to section 2056(b)(8).

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

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.

Sincerely,

George Masnik
Chief, Branch 4
(Office of Passthroughs and
Special Industries)

Enclosures

Copy for section 6110 purposes
Copies of this letter

cc: