

## Internal Revenue Service

## Department of the Treasury

Number: **200240027**

Washington, DC 20224

Release Date: 10/4/2002

Index Number: 642.00-00, 2522.00-00,  
2033.00-00, 2041.00-00

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-131730-01

Date:

JUNE 26, 2002

Re:

### LEGEND

Grantor A	=
Grantor B	=
Grantors	=
Child A	=
Child B	=
Child C	=
Date 1	=
Date 2	=
Date 3	=
Trust 1	=
Trust 2	=
Trust 3	=
State statutes	=
C	=
D	=
E	=

Dear :

This is in response to your May 23, 2001 letter submitted on behalf of the Grantors in which you requested rulings concerning the income, gift, and estate tax consequences of the creation of Trust 1, Trust 2, and Trust 3 (collectively, the Trusts), charitable lead unitrusts.

The information submitted states that Grantor A and Grantor B (the Grantors), husband and wife, executed Trust 1, Trust 2, and Trust 3 on Date 1 and designated C, as trustee. The Grantors transferred assets to the Trusts on Date 2. The

PLR-131730-01

Grantors have three children, Child A, Child B, and Child C.

### **Trust 1**

Article II, paragraphs (a), (b), and (c) of Trust 1 provide that the trust is irrevocable, the Grantors declare that the trust agreement constitutes an irrevocable gift in trust of all property at any time held under the trust agreement, and that any right, title or reversionary interest of any kind or description which either or both of the Grantors now have or may subsequently acquire, either by operation of law or otherwise, is renounced and relinquished forever, except as specifically provided in the trust agreement. The Grantors waive and release the power to revoke, alter, amend, or modify the trust either alone or in conjunction with any other person. The trustee has the power to amend the trust agreement in any manner required for the sole purpose of ensuring that the trust created qualifies as a charitable lead unitrust within the meaning of sections 170(f)(2)(B), 2522(c)(2)(B), and 2055(e)(2)(B) of the Internal Revenue Code.

Under Article III, paragraphs (a) and (b), the term of the trust shall commence on the effective date of the trust and shall end on the 20<sup>th</sup> anniversary of the effective date. The trustee shall pay (in cash, in kind, or partly in each) to such organization or organizations selected by the trustee that is/are described in each of sections 170(b)(1)(A), 170(c), 2055(a), and 2522(a), to be used in furtherance of each organization's religious and charitable purposes, in such proportions as are determined by the trustee, in each taxable year during the trust term, an amount equal to six percent of the net fair market value of the trust assets (valued as of the first day of each taxable year of the trust) (the unitrust amount). The unitrust amount shall be paid on an annual basis on the 31<sup>st</sup> day of December of each year during the trust term, first from ordinary income (excluding unrelated business income), then from short-term capital gain, then from long-term capital gain, then from unrelated business income, then from tax-exempt income, and, to the extent that the foregoing items for the taxable year are not sufficient, from principal. Any income of the trust for a taxable year that exceeds the unitrust amount shall be added to principal. Notwithstanding any existing or hereafter enacted state law, no amount may be paid during the trust term to or for the use of any person other than an organization described in section 170(b)(1)(A), section 170(c), section 2055(a) and section 2522(a). However, an amount shall not be deemed to be so paid if the amount is paid for full consideration, such as reasonable trustee fees.

Article III, paragraph (c) provides that the first year of the trust begins with the effective date of the trust agreement (Date 1) and shall end on Date 3 (a 20-year period). Subsequent taxable years shall be on a calendar year basis. In the case of a taxable year which is for a period of less than twelve months, the unitrust amount which must be distributed shall be such amount multiplied by a fraction the numerator of which is the number of days in the taxable year of the trust, and the denominator of which is 365 (366 if February 29 is a day included in the numerator). In the case of the

PLR-131730-01

taxable year in which the trust term ends, the unitrust amount which must be distributed shall be such amount multiplied by a fraction the numerator of which the number of days in the period beginning on the first day of the taxable year and ending on the date the trust term ends, and the denominator for which is 365 (366 if February 29 is a day included in the numerator).

Article III, paragraph (d) provides that, on the expiration of the trust term, and after the unitrust amount due to the charities has been distributed to the charities, the trustee shall retain the remaining assets and undistributed income in further trust for the benefit of Child A, the Grantors' child. If Child A is not then living, the trustee shall pay over and distribute (or retain in trust, as applicable) the remaining assets to or for the benefit of the Grantors' living children or lineal descendants of a deceased child, per stirpes.

Article III, paragraph (e) provides that if the net fair market value of the assets comprising the trust is incorrectly determined by the trustee for any taxable year during the trust term, then, within a reasonable period after the final determination of the correct value, the trustee shall pay to the charities, in the case of an undervaluation, on the basis as to each charity of the pro rata amount of the undervaluation as it relates to the amount of distribution made to such charity, or shall receive from the charities, in the case of an overvaluation, on the basis as to each charity of the pro rata amount of the overvaluation as it relates to the amount of the distribution made to such charity, an amount equal to the difference between the unitrust amount actually paid, plus interest, and the unitrust amount property payable, plus interest.

Article III, paragraph (f) provides that in computing the net fair market value of the assets comprising the trust during the trust term, there shall be taken into account all assets and liabilities without regard to whether particular items are taken into account in determining the income of the trust. All determinations of the trust's net fair market value shall be in accordance with generally accepted fiduciary accounting principles and any United States Treasury requirements governing charitable lead trusts.

Article IV provides that to the extent permitted by law, no beneficiary shall have any power to dispose of or to charge by way of anticipation any interest given to him or her, and all sums payable to any beneficiary shall be free and clear of his or her debts, contracts, dispositions, and anticipations, and shall not be taken or reached by any legal or equitable process in satisfaction thereof.

Article V, paragraph (c) provides that notwithstanding any provision contained in the trust agreement to the contrary, in no event shall any power provided to the trustee in the trust agreement or pursuant to law be construed to enable the trustee or any other person, to purchase, exchange, or otherwise deal with or dispose of the principal or income of the trust estate for less than adequate or full consideration in money or

PLR-131730-01

money's worth or to enable the trustee or any other person to borrow the principal of the trust directly or indirectly, without adequate interest or security. No person other than the trustee, shall have or exercise the power to vote or direct a voting of a stock or other securities of the trust, to control the investment of the trust either by directing investments or reinvestments or by vetoing opposed investments or reinvestments, or to reacquire or exchange any property of the trust estate by substituting property of an equivalent value.

Under Article V, paragraphs (d) and (f), notwithstanding anything contained in the trust agreement to the contrary, the trustee shall be bound by the prudent investor rule set forth in State statutes. The trustee is specifically empowered to retain as a part of the trust estate any limited partnership interests and shares of stock in any closely-held corporation transferred by either or both Grantors to the trust without liability for depreciation or loss to any beneficiary and without a duty to diversify for investment purposes.

Under Article VI, paragraph (a), in the event of C's death, incompetency or resignation as trustee, the successor trustee or co-trustees shall be such individual(s) or entity(ies) designated in writing by C, which specifically refers to this paragraph (a). In default of a written designation being made by C, or in the event the individual(s) or entity(ies) designated by C die, become incompetent, or resign, the successor trustee is to be D, an attorney. In the event of the death, incompetency or resignation of D as trustee, the successor trustee is to be such individual(s) or entity(ies) designated in writing by D, which specifically refers to paragraph (a). In default of a written designation being made by D, or in the event the individual(s) or entity(ies) designated by D die, become incompetent or resign, the successor trustee is to be E, an attorney. In the event of E's death, incompetency or resignation as trustee, the successor trustee is to be such individual(s) or entity(ies) designated in writing by E, which specifically refers to paragraph (a). In default of a written designation being made by E, or in the event the individual(s) or entity(ies) designated by E die, become incompetent or resign, the successor trustee is to be such individual or entity designated in writing by a majority of the then living adult beneficiaries of the trust who are eligible to receive any current income therefrom and who are not incompetent, so long as such individual or entity that is to become the successor trustee is not a related or subordinate party (as defined in section 672(c)) of either of the Grantors or any adult beneficiary.

Under Article IX, paragraph (e), the trustee is prohibited during the trust term from engaging in any act of self-dealing as defined in section 4941(d), from retaining any excess business holdings as defined in section 4943(c) which would subject the trust to tax under section 4943, from making any investments which would jeopardize the charitable purpose of the trust and subject the trust to tax under section 4944, and from making any taxable expenditures as defined in section 4945(d).

PLR-131730-01

### **Trust 2 and Trust 3**

The provisions of Trust 2 and Trust 3 are identical to those of Trust 1 except that, under Article III, paragraph (d), of Trust 2, on the expiration of the trust term, the trustee shall retain the remaining assets and undistributed income in further trust for the benefit of Child B, if living. Under Article III, paragraph (d), of Trust 3, on the expiration of the trust term, the trustee shall retain the remaining assets and undistributed income in further trust for the benefit of Child C, if living.

### **Requested rulings:**

You have requested the following rulings:

(1) Neither Grantor will be treated as the owner of the Trusts pursuant to sections 671 through 677, and no portion of the income of the Trusts will be taxable to either Grantor.

(2) The unitrust amounts payable under the Trusts will be unitrust interests within the meaning of section 25.2522(c)-3(c)(2)(vii) and, therefore, will meet the deductible interest requirements under section 2522(c)(2)(B), and, accordingly, the Grantors will be allowed a gift tax deduction under section 2522(a) for the present value of each of the unitrust interests.

(3) Neither Grantor has retained any interest or power in or over the Trusts that would cause the Trusts to be included in the Grantor's gross estate for federal estate tax purposes and, therefore, no portion of the assets of the Trusts will be included in a Grantor's gross estate for federal estate tax purposes.

### **Ruling 1**

Section 671 provides that where it is specified in subpart E, part I, subchapter J, chapter 1 that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Sections 673 through 677 specify the circumstances under which the grantor is treated as the owner of a portion of a trust.

Section 673 provides that the grantor shall be treated as the owner of any portion

PLR-131730-01

of a trust in which the grantor has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

Section 674 provides that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(b)(4) provides that section 674(a) shall not apply to a power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions).

Under section 675 and applicable regulations, the grantor is treated as the owner of any portion of a trust if, under the terms of the trust agreement or circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiary of the trust.

Section 676 provides that the grantor shall be treated as the owner of any portion of a trust, whether or not the grantor is treated as such owner under any other provision of part I, subchapter J, chapter 1, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

Section 677 provides that the grantor shall be treated as the owner of any portion of a trust, whether or not the grantor is treated as the owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse, held or accumulated for future distribution to the grantor or the grantor's spouse, or applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Our examination of the Trusts reveals none of the circumstances that would cause the Grantors to be treated as the owners of any portion of the Trusts under sections 673, 674, 676, or 677.

Our examination of the Trusts reveals none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the Grantors under section 675. Thus, the circumstances attendant on the operation of the Trusts will determine whether the Grantors will be treated as the owners of any portion of the Trusts under section 675. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office with responsibility for such examination.

In addition, the ordering of income distributions provided in Article III, paragraph

PLR-131730-01

(b) of the Trusts will not be given effect for federal income tax purposes because the ordering provision has no economic effect on the distributions independent of tax consequences. The Trusts require that the Trusts pay annually a stated unitrust amount to an organization described in sections 170(b)(1)(A), 170(c), 2055(a) and 2522(a), regardless of the amount or character of income earned by the Trusts. Instead, income distributed to the organizations described in sections 170(b)(1)(A), 170(c), 2055(a) and 2522(a) shall consist of the same proportion of each class of the items of income of the Trusts as the total of each class bears to the total of all classes. See § 1.642(c)-3(b)(2) of the Income Tax Regulations.

## **Ruling 2**

Section 2501(a)(1) imposes a tax on the transfer of property by gift. Section 2511(a) provides that the federal gift tax shall apply whether a transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(c) of the Gift Tax Regulations provides, in part, that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title to the property in himself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves.

Section 2522(a) provides that, in computing taxable gifts for the calendar year, there shall be allowed as a deduction the amount of all gifts 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 2522(c)(2)(B) provides that where a transfer is made to both a charitable and a noncharitable person or entity, no deduction shall be allowed for the charitable portion of the gift unless, in the case of interests other than charitable remainder interests, 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) (a unitrust interest).

Section 25.2522(c)-3(c)(2)(vii)(a) states that the term “unitrust interest” means in irrevocable right pursuant to the instrument of transfer to receive a 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 computing the net fair market value of the property which funds the unitrust interest, all assets and liabilities shall be taken into account without regard to whether particular items are taken into account in determining the income from the property. The net fair market value of the property which funds the unitrust interest may be determined on any one date during the year or by taking the average of valuations made on more than one date during the

PLR-131730-01

year, provided that the same valuation date or dates and valuation methods are used each year. Payments under a unitrust interest may be paid for a specified term of years or for the life or lives of certain individuals, each of whom must be living at the date of the gift and can be ascertained at such date.

In this case, under the terms of the Trusts, qualified charitable organizations are given the irrevocable right to receive annually an amount equal to six percent of the net fair market value of the assets in the Trusts determined annually (the unitrust amount). We conclude that the unitrust amounts payable under the Trusts are unitrust interests within the meaning of section 25.2522(c)-3(c)(2)(vii) and, therefore, will meet the deductible interest requirements of section 2522(c)(2)(B). Accordingly, the Grantors will be allowed a gift tax charitable deduction under section 2522(a) for the present value of the unitrust amounts in Trust 1, Trust 2, and Trust 3, value determined as of the date of the funding of Trusts. The amount of the charitable deduction will be determined under section 25.2522(c)-3(d)(2)(v). Although unmarketable assets may be transferred to the Trusts, the Trusts provide that the valuations are to be performed by the trustee and, under the terms of the Trusts, the trustee would be an independent trustee within the meaning of section 1.664-1(a)(7)(i).

### **Ruling 3**

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his/her death.

Under section 2035(a), if the decedent made a transfer (by trust or otherwise) of an interest in property, or relinquished a power with respect to any property, during the 3-year period ending on the date of decedent's death, and the value of such property (or an interest therein) would have been included in the decedent's gross estate under sections 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of death, then the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for life or for any period not ascertainable without reference to the decedent's death or for any period which does not in fact end before the decedent's death—

(1) the possession or enjoyment of, or the right to the income from, the property, or



PLR-131730-01

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 20.2036-1(a) of the Estate Tax Regulations, provides that, for purposes of section 2036, an interest or right is treated as having been retained or reserved by the decedent, if at the time of the transfer there was an understanding, express or implied, that the interest or right would later be conferred.

Section 2037(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and the decedent has retained a reversionary interest in the property and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Section 2039 provides that the value of the gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement if, under such contract or agreement, an annuity or other payment was payable to the decedent during life.

Section 2041(a) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has, at the time of death, a general power of appointment or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which, had the property been owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 through 2038, inclusive.

Section 2041(b)(1) provides that a general power of appointment is a power which is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors, or the creditors of the decedent's estate, except that a power to consume,

PLR-131730-01

invade or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

In the present case, Trust 1, Trust 2, and Trust 3 are irrevocable. A fixed percentage of the value of the respective trust property, determined annually, will be distributed to organizations described in each of sections 170(b)(1)(A), 170(c), 2055(a), and 2522(a) for a 20-year period. Thereafter, the remaining property in the Trusts will pass to or for the benefit of the Grantors' children and their descendants. The Grantors have retained no interest or reversion in the Trusts and no right to alter, amend, or revoke the Trusts, or to receive an annuity or other payment from the Trusts during the Grantors' lives. In addition, the Grantors hold no general power of appointment over the property in the Trusts.

Accordingly, assuming there is no understanding, express or implied between the Grantors and the trustee regarding the disposition of the amounts received by the Trusts, we conclude that no portion of the assets of Trust 1, Trust 2, or Trust 3 will be included in either Grantor's gross estate for federal estate tax purposes.

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 the 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. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code or regulations.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to the Grantors.

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

Sincerely yours,

---

Lorraine E. Gardner  
Assistant to Branch Chief  
Branch 4  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure  
copy for 6110 purposes