

Internal Revenue Service

Department of the Treasury

Number: **200105059**
Release Date: 2/2/2001
Index Number: 2055-12.10

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4/PLR-118221-99

Date:

November 07, 2000

Re:

Legend:

Decedent =

Intervivos Trust =

Trust/Paragraph B Trust =

Date 1 =

Date 2 =

Trust Company =

Dear _____ :

This is in response to your letter dated November 2, 1999, in which you requested rulings under § 2055 of the Internal Revenue Code. Specifically, you requested the following rulings:

1. The interest passing to the charitable organizations under the Paragraph B Trust is a "reformable interest" as defined in § 2055(e)(3)(C).
2. The petition for reformation, when granted, will result in a "qualified reformation" as defined in § 2055(e)(3)(B).
3. An estate tax charitable deduction will be allowed under § 2055(a) for the present value of the remainder interest of the Paragraph B Trust, as reformed.

Facts:

The facts are represented to be as follows:

Decedent executed an intervivos trust (Intervivos Trust) on Date 1 and died on Date 2.

Article Fourth, Paragraph B of the Intervivos Trust provides that at Decedent's death, the trustee is to set aside in a separate trust (Trust/Paragraph B Trust) an amount equal to the lesser of 25 percent of the value of the Intervivos Trust property or the sum of \$250,000. The trustee is to pay the net income of the Paragraph B Trust in specified percentages to six individuals for a period not to exceed 10 years from the establishment of the Trust. If an income beneficiary should predecease Decedent or die during the 10-year period, his or her share of the income is to be added to principal. The Trust is to terminate 10 years from the date of its creation or upon the earlier deaths of all of the income beneficiaries. At the termination of the Paragraph B Trust, the principal and any accumulated or undistributed income is to be added to, and administered as, an integral part of a second separate trust created at Decedent's death under Article Fourth, Paragraph A (Paragraph A Trust) of the Intervivos Trust.

The Paragraph A Trust is a trust which is to be held in perpetuity for the benefit of five designated charitable organizations. At the time the corpus of the Paragraph B Trust is added to the Paragraph A Trust, two additional charitable organizations will become beneficiaries of the Paragraph A Trust.

The Paragraph B Trust does not satisfy the requirements of § 2055(e)(2) for the estate tax charitable deduction. Prior to filing Decedent's estate tax return, Trust Company, as executor of Decedent's estate and trustee of the Intervivos Trust, filed a petition for judicial reformation of the Paragraph B Trust in accordance with § 2055(e)(3). Under the proposed reformation, the Paragraph B Trust will be governed and administered under the following terms:

1. In appointing property to the Paragraph B Trust, the property shall be valued as of the Decedent's date of death.

2. The trustee shall distribute an annuity amount equal to 6.8 percent of the initial fair market value of the Trust's assets on an annual basis to the same individual beneficiaries and in the same specified percentages as set forth in the original Paragraph B Trust for a period not to exceed 10 years from the establishment of the Trust. Such annual payments are to be made at the end of each year, with the first payment to be made no later than the end of the taxable year of the Trust in which occurs the complete funding of the Trust. If income of the Trust is insufficient to pay the annuity amount, the trustee may distribute principal. If net income exceeds the annuity amount in any taxable year, the excess is to be added to principal. If any individual

beneficiary predeceases the Decedent or dies prior to the termination of the 10-year annuity period, his or her share of the annuity amount is to be reapportioned, in equal shares, among the remaining individual beneficiaries.

3. The obligation to pay the annuity 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 the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust 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 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.

4. If the initial net fair market value of the assets constituting the Trust is incorrectly determined, then within a reasonable period after the final determination of the correct value, the trustee shall pay to the individual beneficiaries, in the case of an undervaluation, or recover from the individual beneficiaries, in the case of an overvaluation, an amount equal to the difference between the amount properly payable and the amount actually paid.

5. In the case of a taxable year which is for a period of less than 12 months, the annuity amount which must be distributed shall be the annuity amount, as previously determined, multiplied by a fraction. The numerator of the fraction shall be the number of days in the taxable year of the Trust, and the denominator shall be 365 (or 366 if February 29 is a day included in the numerator). In the case of the taxable year in which the annuity interest terminates, the annuity amount which must be distributed shall be the annuity amount, as previously determined, multiplied by a fraction. The numerator of the fraction shall be the number of days in the period beginning on the first day of such taxable year and ending on the day the annuity interest terminates, and the denominator of the fraction shall be 365 (or 366 if February 29 is included in the numerator).

6. No additional contributions may be made to the Trust after it is funded.

7. Nothing in the Trust instrument shall be construed to restrict the trustee from investing the Trust assets in a manner which could result in the annual realization of a reasonable amount of net income or gain from the sale or disposition of Trust assets.

8. Except for the payment of the annuity amount, in the management, investment, and distribution of the Trust, the trustee shall not (i) engage in any act of

self-dealing as defined in § 4941(d), (ii) retain any excess business holdings as defined in § 4943(c) which would subject the Trust to tax under § 4943, (iii) make any investments which would subject the Trust to tax under § 4944, or (iv) make any taxable expenditures as defined in § 4945(d). To the extent required, the trustee shall distribute the net income, and, to the extent the net income is not sufficient, the principal of the Trust, at such times and in such manner so as not to subject the Trust to tax under § 4942.

9. The annuity payments to the individual beneficiaries shall terminate upon the first of the following events to occur: (a) the expiration of the 10-year period commencing on the Decedent's date of death, or (b) the death of all of the individual beneficiaries. At such time, the principal and any undistributed net income of the Trust shall be divided into seven equal shares, to be held and administered separately, for the benefit of the five charitable organizations designated as the beneficiaries of the Paragraph A Trust in the original Intervivos Trust, and the two charitable organizations which, under the terms of the original Intervivos Trust, were to be added as beneficiaries to the Paragraph A Trust following the expiration of the individuals' interest in the Paragraph B Trust.

10. If any designated charitable beneficiary is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time when any principal or income of the Trust is to be distributed to it, the trustee shall not distribute any principal or income to it from its share. The trustee shall allocate the principal and any accrued income held in the share of such organization, in equal shares, to the other designated charities that are organizations described in §§ 170(c), 2055(a), and 2522(a).

11. The Trust is intended to be a charitable remainder trust within the meaning of § 664(d)(1) and is to be administered in such manner as to qualify for the exemption from taxation provided therein for a charitable remainder trust, and any provision of the Trust instrument inconsistent with this intention, including provisions of state law which are incorporated by reference, shall be of no effect.

Law and analysis:

Section 2055(a) provides, in part, that for estate tax purposes, 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 of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes and for certain other purposes.

Section 2055(e)(2) disallows the estate tax charitable deduction 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 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 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 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, and

(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 section 2055(a) at the time of the decedent's death but for section 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) provides, however, that section 2055(e)(3)(C)(ii) shall 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.

Under § 2055(e)(3)(D), the term “qualified interest” means an interest for which a deduction is allowable under § 2055(a).

In this case, the charitable interest provided in Article Fourth, Paragraph B of the Intervivos Trust is a reformable interest within the meaning of § 2055(e)(3)(C)(i) because the value of the charitable interest is presently ascertainable and, hence, severable from the non-charitable interest. Prior to the enactment of the “split-interest” rules of § 2055(e)(2), such an interest would have been deductible under § 2055(a). See § 20.2055-2(a) of the Estate Tax Regulations. Although the payments to the individual beneficiaries were not expressed in specified dollar amounts or a fixed percentage of the fair market value of the property as required by § 2055(e)(3)(C)(ii), a judicial proceeding was commenced, as provided in § 2055(e)(3)(C)(iii), before the 90th day after the last date (including extensions) for filing Decedent’s estate tax return.

The reformation is a qualified reformation within the meaning of § 2055(e)(3)(B) because (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, i.e., the interest of the individual beneficiaries, terminates at the same time both before and after the qualified reformation; and (3) the reformation is effective as of the date of Decedent’s death.

In addition, the value (as determined under § 7520) of the remainder interest is at least 10 percent of the initial net fair market value of all the property placed in the Trust as required by § 664(d)(1)(D).

Accordingly, provided that the judicial reformation of the Paragraph B Trust conforms with the provisions of the proposed reformation, as state above, and provided that the Paragraph B Trust, as judicially reformed, is a valid trust under applicable state law, we conclude, based on the facts submitted and representations made:

1. The interest passing to the charitable organizations under the Paragraph B Trust is a “reformable interest” as defined in § 2055(e)(3)(C).

2. The petition for reformation, when granted, will result in a “qualified reformation” as defined in § 2055(e)(3)(B).

3. A federal estate tax charitable deduction will be allowed under § 2055(a) for the present value of the remainder interest of the Paragraph B Trust, as reformed.

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. In particular, we express no opinion on the reformation of the Paragraph A Trust.

This ruling letter is directed to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

KATHERINE A. MELLODY
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for § 6110 purposes