

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

July 31, 2000

A =

B =

C =

D =

Trust =

Trustee 1 =

Trustee 2 =

Foundation =

Charity 1 =

Charity 2 =

Charity 3 =

State =

Dear :

This letter responds to a letter dated April 27, 1999, and subsequent correspondence submitted by you on behalf of A and B, as A and B's authorized representative, requesting certain rulings under the Internal Revenue Code.

The information submitted states that A and B are husband and wife. A intends to establish Trust, a charitable lead unitrust (CLUT). The grantor of Trust will be A and the trustee will be Trustee 1. A and B intend to establish Foundation, which will be the initial charitable beneficiary of Trust. The proposed directors of Foundation are B, C, and D. C and D are represented as being individuals unrelated to A or B.

Article 2 of Trust provides that Trust and the trusts established under it are irrevocable, and except as provided in Paragraph 11.15, unamendable.

Paragraph 3.1 provides that the charitable term of Trust shall be for 30 years from the date of Trust.

Paragraph 3.2 provides that, during the charitable term, the trustee shall pay to Foundation each year an amount of the trust equal to seven percent of the net fair market value of the trust property determined as of the date of Trust or in subsequent years the first day of the calendar year ("the unitrust amount"). The unitrust amount shall be payable to Foundation in quarterly installments, at the end of each quarterly period.

Paragraph 3.4 provides that if Foundation is not in existence or is not an organization described in §§ 170(c) and 2055(a) and the applicable subsection of § 2522 of the Internal Revenue Code at the time any property is distributable to it under Trust, the trustee shall instead distribute the trust property to one or more other organizations, each of which is engaged in comparable activities and is then described in §§ 170(c) and 2055(a) and the applicable subsection of § 2522, as the trustee in its sole discretion selects.

Paragraph 4.1 provides that Trust shall terminate at the end of the charitable term.

Paragraph 4.3 provides that, on termination, the trustee shall allocate the trust estate remaining after any prorated unitrust payment in shares of equal value for the children of A and B who are then living, subject to the Child's Separate Trust withholding provisions, and pursuant to Paragraphs 5.3 and 5.4 for any child who is then not living.

Article 5 provides that any trust property allocated for a child of A subject to the Child's Separate Trust withholding provisions shall be added to or used to fund the principal of a Child's separate trust for the child. The trustee shall administer each Child's Separate Trust as provided in Article 5.

Paragraph 5.3 provides that after the child has attained age 35, the trustee shall distribute the principal to any one or more persons and organizations, including the child, as the child from time to time appoints.

Paragraph 5.4 provides that, on the death of the child, the trustee shall distribute the Child's Separate Trust to or for the benefit of such one or more of A's then living descendants in such proportion and subject to such trust powers and conditions as the child directs by will specifically referring to this power of appointment.

Paragraph 5.5 provides that, on the death of the child, the trustee shall distribute the Child's Separate Trust not effectively appointed as follows: (a) if the child has any

descendant living, to the child's then living descendants per stirpes; or (b) if the child has no descendant living but A has any descendant then living, to the trustee to allocate in shares of equal value for A's then living children, subject to the Child's Separate Trust withholding provisions, provided that if a child of A's is not then living but a descendant of the child is living, the trustee shall distribute the share that would have been allocated to the child, if living, per stirpes to the child's then living descendants.

Article 7 provides that, on the death of the last to die of all beneficiaries of any trust established under Trust (the "termination date") any of the trust not otherwise distributable shall be administered as follows: (a) 100 percent to Foundation, or its successor, if it is then in existence, or in the event it does not qualify for a charitable deduction, if applicable pursuant to (c) below, then in accordance with (b) below; (b) in the event Foundation is no longer in existence or Foundation does not qualify for a charitable deduction, if applicable pursuant to (c) below, then as follows: (1) one-third distributed to Charity 1 ; (2) one-third to Charity 2; (3) one-third to Charity 3; and (4) in the event any of the above organizations are no longer in operation then such distribution shall be divided among the remaining organizations; if all the above organizations are no longer in operation then to charities that satisfy the charitable deduction criteria of the Internal Revenue Code, as determined by the trustee; (c) the trustee in applying the charitable intent outlined above shall be authorized to utilize its sole discretion in administering and establishing the parameters and factors to be utilized in determining the distributions. It is A's intent that the above charitable provisions to the extent possible qualify these gifts as charitable deductions to the extent Trust is included in an estate subject to federal estate tax and the trustee may act in its discretion to accomplish this intent. The trustee shall also determine whether or not it is beneficial to retain the money in trust or to establish outside foundations or other entities to accomplish the purposes outlined above or to contribute the money to an established charitable entity to accomplish the intent described above.

Paragraph 8.1 provides that a trustee may resign at any time by written notice to the then living children of A and B, if any, and to the income beneficiaries.

Paragraph 8.2 provides that each acting trustee (unless limited in the instrument in which the trustee was designated) may, by signed instrument filed with the trust records, (a) designate one or more qualified corporations to act with or to succeed the trustee consecutively or concurrently, in any stated combination and on any stated contingency, and (b) amend or revoke the designation before the designated trustee begins to act.

Paragraph 8.3 provides that if at any time no trustee is acting and no designated trustee is able and willing to act, then Trustee 2, or its successor shall be the trustee.

Paragraph 8.4 provides that a corporate trustee may be removed at any time by an instrument signed by a majority of the then living children of A and B, otherwise by the income beneficiaries, but only if on or before the effective date of removal a qualified corporation has been appointed corporate trustee in the same manner.

Paragraph 8.6 provides that in no event may A or B be named as trustee for Trust or any trust created therein.

Paragraph 9.14 provides that the trustee shall not use trust property to satisfy the legal obligations, including the legal obligation of support, that A, B, or any other person may owe individually to a beneficiary of the trust.

Paragraph 9.15 provides that A intends that the income of Trust shall not be taxable to A under §§ 671 through 677. Notwithstanding any other provisions, the trustee shall not lend trust property to A or B, directly or indirectly, and may not use the trust property to pay any premiums of life insurance on the life of A or B.

Article 10 provides the express condition that the trustee shall neither possess nor exercise any power or discretion during the charitable term that would cause trust not to qualify as a charitable lead unitrust.

Paragraph 11.1 provides that mandatory income payments shall be made at least quarterly.

Paragraph 11.11 provides that, notwithstanding any other provision, an individual trustee shall have no incident of ownership or power or discretion with respect to any policy of insurance upon the trustee's life; (b) shall have no discretionary power to allocate or distribute assets to the extent that it would discharge the trustee's legal obligation to support any beneficiary; (c) shall, if the trustee has a beneficial interest in a trust, have no discretionary power to allocate or distribute assets of Trust, directly or indirectly, to or for any beneficiary (including the trustee) unless necessary for the beneficiary's support in reasonable comfort, health care, or education at any level; and (d) shall have no other power or discretion that would be deemed a general power of appointment under § 2041 unless the trustee has the power in other than a fiduciary capacity.

Paragraph 11.12 provides that if an incorrect payment of the unitrust amount is made, the trustee, after the error is

discovered, promptly shall pay to Foundation (in the case of an underpayment) or collect from Foundation (in the case of an overpayment), an amount equal to the difference between the amount should have paid Foundation and the amount the trustee paid Foundation.

Paragraph 11.13 provides that additional contributions may be made to Trust.

Paragraph 11.14 provides that the unitrust amount payable to Foundation shall be paid from current income and, to the extent current income is insufficient, from principal including capital gain. For purposes of Paragraph 11.14, "current income" shall mean income from the current taxable year. Any income in excess of the unitrust amount shall be added to principal in the taxable year received.

Paragraph 11.15 provides that A intends to create a charitable lead unitrust for which a deduction would be allowed under §§ 2055(e)(2)(B) and 2522(c)(2)(B) for the unitrust amount to Foundation, and Trust shall be administered during the charitable term to so qualify. Trust and the trusts established under Trust are unamendable, except that during the charitable term the trustee may amend the terms of Trust solely to ensure that Trust qualifies and continues to qualify as a charitable lead unitrust. The trustee is prohibited from engaging in any act of self-dealing as defined in § 4941(d) and from making any taxable expenditures as defined in § 4945(d). The trustee shall make distributions at such times and in such a manner as not to subject Trust to tax under § 4942. Unless permitted pursuant to § 4947(b)(3), the trustee shall not retain any excess business holdings as defined in § 4943(c) that would subject Trust to tax under § 4943 nor make any investments that would subject Trust to tax under § 4944. Nothing in Trust shall be construed to restrict the trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets. The provisions specifically applicable to Trust during charitable term shall prevail over any other provisions of Trust inconsistent therewith.

Article 3 of the Articles of Incorporation of Foundation provides that the Directors of Foundation are B, C, and D. A represents that A will not be an officer nor Director of Foundation.

Article 4 provides that Foundation is organized exclusively for charitable, educational, religious, literary or scientific purposes and for the prevention of cruelty to children within the meaning of § 501(c)(3) and that also constitutes charitable purposes under State Revised Statutes. It is intended to create a charitable organization that will be exempt from federal income

tax under § 501(c)(3) and that will qualify as a private foundation as described in § 509(a).

Paragraph 5.1 provides that Foundation is not authorized to engage or carry on any activity that is not in furtherance of the activities set forth in the Articles of Incorporation. Furthermore, Foundation is prohibited from engaging in any political campaign activity or legislative activity.

Paragraph 5.2 provides that Foundation shall undertake actions that are consistent with the following provisions: (a) any income for each taxable year is to be distributed at such time and in such manner as not to subject Foundation to tax under § 4942, (b) unless permitted by § 4947(b)(3) Foundation shall not retain any excess business holdings as defined in § 4943(c) that would subject Foundation to tax under § 4943, (c) to prohibit Foundation from engaging in any act of self dealing (as defined in § 4941(d)), (d) from making any investments in such manner as to subject Foundation to tax under § 4944 unless permitted by § 4947(b)(3), and (e) from making any taxable expenditure (as defined in § 4945(d)). References in Paragraph 5.2 shall be amended from time to time or pursuant to any corresponding provisions of any subsequent federal tax laws.

Paragraph 5.3 provides that Foundation shall be dissolved at such time as the Directors determine, in their sole discretion, that the purposes of Foundation have been served. Upon dissolution, and after payment of any provision for liabilities and claims of Foundation, the Directors shall convey any remaining assets and income to such organization or organizations, exempt under § 501(c)(3), as the Directors shall select, or as otherwise provided by the State Revised Statutes.

Article III, Section 6, of the Bylaws of Foundation provides that all of the Board of Directors shall constitute a quorum for the transaction of business at any meeting of the Board of Directors, provided that if less than all of the Directors are present at said meeting, a majority of the Directors present may adjourn the meeting from time to time without further notice.

Article III, Section 7, provides that the act of all of the Directors present at a meeting of the Directors of which a quorum is present shall be the act of the Board of Directors.

Article III, Section 12, provides that Directors as such shall not receive any stated salaries for their services, but reimbursement for ordinary and reasonable expenses may be allowed. Nothing herein contained shall be construed to preclude any Director from serving Foundation in any other capacity and receiving compensation therefor.

Article X, Section 1, provides that Foundation shall have power to indemnify any person who was or is a party or is threatened to be made party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of Foundation) by reason of the fact that he or she is or was a Director, officer, employee or agent of Foundation, or who is or was serving at the request of Foundation as a Director, officer, employee, or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceedings if such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The termination of any action, suit or proceeding by judgment or settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he or she reasonably believed to be in or not opposed to the best interest of the corporation or, with respect to any criminal action or proceeding, that the person had reasonable cause to believe that his or her conduct was unlawful.

Article X, Section 2, provides that Foundation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of Foundation to procure a judgment in its favor by reason of the fact that such person is or was a Director, officer, employee or agent of Foundation, or is or was serving at the request of Foundation as a Director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit if such person acted in good faith and in a manner he or she reasonably believed to be in, or not opposed to, the best interests of Foundation, provided that no indemnification shall be made in respect of any claim, issue or matter as to which such persons shall have been adjudged to be liable for negligence or misconduct in the performance of his or her duty to Foundation, unless, and only to the extent that, the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses as the court shall deem proper. Further, such indemnification shall be in accordance with § 53.4941(d)-2(f)(3).

Article X, Section 3, provides that to the extent that a Director, officer, employee or agent of a corporation has been successful, on the merits or otherwise in defense of any action, suit or proceeding referred to in Article X, Sections 1 and 2, or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him or her in connection therewith.

Article X, Section 4, provides that any indemnification under Article X, Sections 1 and 2 (unless ordered by a court) shall be made by Foundation only as authorized in the specific case, upon a determination that indemnification of the Director, officer, employee or agent is proper in the circumstances because he or she has met the applicable standard of conduct set forth in Article X, Section 1 or 2. Such determination shall be made: (a) by a majority vote of a quorum of the Board of Directors who were not parties to such action, suit or proceeding; or (b) if such a quorum is not obtainable, or, even if obtainable, a quorum of disinterested Directors so directs, by independent legal counsel in a written opinion; or (c) by the Directors entitled to vote, if any.

Article X, Section 5, provides that expenses incurred in defending a civil or criminal action, suit or proceeding may be paid by Foundation in advance of the final disposition of such action, suit or proceedings, as authorized by the Board of Directors in the specific case, upon receipt of any undertaking by or on behalf of the Director, officer, employee or agent to repay such amount, unless it shall ultimately be determined that he or she is entitled to be indemnified by Foundation as authorized in Article X.

Article X, Section 6, provides that the indemnification provided by Article X shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any contract, agreement, vote of Directors or disinterested Directors, or otherwise, both as to action in his or her official capacity and as to action in another capacity and as to action in another capacity while holding such office, and shall continue as to a person who had ceased to be a Director, officer, employee or agent and shall inure to the benefit of the heirs, executor and administrators of such a person.

Article X, Section 7, provides that Foundation shall have power to purchase and maintain insurance on behalf of any person who is or was a Director, officer, employee or agent of Foundation, or is or was serving at the request of Foundation, as a Director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against any liability asserted against such person and incurred by such person in any such capacity, or arising out of his status as

such, whether or not Foundation would have the power to indemnify him or her against such liability under the provisions of Article X. This authorization shall be in accordance with § 53.4941(d)-2(f)(3).

Article XI provides that Foundation shall not undertake any action that shall violate the following provisions: (a) to acquire as income for each taxable year to be distributed at such time and in such manner as not to subject Foundation to tax under § 4942, and (b) to prohibit Foundation from engaging in any act of self dealing (as defined in § 4941(d)), from retaining any excess business holdings (as defined in § 4942(c)), from making any investments in such manner as to subject Foundation to tax under § 4944 and from making any taxable expenditure (as defined in § 4945(d)).

Article XII provides that Foundation shall be dissolved at such time as the Directors determine, in their sole discretion, that the purposes of Foundation have been served. Upon dissolution, and after payment of any provision for liabilities and claims of Foundation, the Directors shall convey any remaining assets and income to such organization or organizations, exempt under § 501(c)(3), as the Directors shall select, or as otherwise provided by the State Revised Statutes.

Article XIV provides that Foundation is organized exclusively for charitable, educational, religious, literary or scientific purposes and for the prevention of cruelty to children within the meaning of § 501(c)(3) and that also constitutes charitable purposes under State Revised Statutes. It is intended to create a charitable organization that will be exempt from the federal income tax under § 501(c)(3) and that will qualify as a private foundation as described in § 509(a).

You have requested the following rulings:

1. Trust is a charitable lead unitrust (CLUT) that will be allowed a deduction under § 642(c) for amounts of gross income paid to Foundation or other charitable beneficiaries described in § 170(c) during the taxable year, or by the close of the following year pursuant to an election under § 1.642(c)-1(b).

2. Trust will not be a grantor trust under § 671.

3. Trust is a CLUT that satisfies the requirements of § 2522 and that a gift tax charitable deduction will be allowed for the present value of the charitable interest in Trust.

4. A's gift to Trust will not be incomplete for purposes of § 25.2511-2(c) of the Gift Tax Regulations because of the fact that B, A's spouse, will serve as a Director and officer of Foundation. The transfer to Trust will be a completed gift to

the children of A and B, the value of which will equal the value of the remainder interest in Trust.

5. A has not retained any interest in or power over Trust that would cause Trust property to be included in A's gross estate.

6. That the Service will provide the necessary factors pursuant to Table D of § 1.664-4(e)(6) in order to determine the value of the various interests transferred by A.

7. Trust meets the requirements of § 4947(a)(2) and as a split interest trust meets the requirements of § 508(e) and contains the restrictions necessary to avoid the taxes imposed by §§ 4941 through 4945.

8. Foundation contains the appropriate language that satisfies the requirements of § 508(e).

9. A's transfer to Trust does not constitute a generation skipping tax transfer pursuant to § 2601.

ISSUE 1

Section 642(c)(1) provides the general rule that, in computing its taxable income, a trust is allowed a deduction for any amount of gross income, which pursuant to the terms of the governing instrument, is paid during the taxable year for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)). Section 642(c)(4) provides that the deduction allowed for a trust is subject to § 681 (relating to unrelated business income).

Section 681(a) provides that no charitable deduction is allowable to a trust under § 642(c) for any amounts allocable to the trust's "unrelated business income" for the taxable year. The term "unrelated business income" means an amount under § 512, if the trust were exempt from tax under § 501(a) by reason of § 501(c)(3), that would be computed as its unrelated business income under § 512.

ISSUE 2

Section 671 provides that where it is specified in subpart E 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.

Under § 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 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 § 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.

Under § 1.677(a)-1(d), the grantor shall be treated as the owner of the portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in the discharge of a legal obligation of the grantor.

ISSUE 3

Section 2501(a) imposes a tax on the transfer of property by gift. Section 2511 provides that the gift tax shall apply whether the 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 2522(a) provides that, in computing an individual's taxable gifts for the calendar year, a deduction shall be allowed for 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 an interest other than a charitable remainder 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 annually).

Section 25.2522(c)-3(c)(1) of the Gift Tax Regulations provides that if a donor transfers an interest in property for charitable purposes and an interest in the same property is transferred for private purposes, no deduction is allowed under section 2522 for the value of the interest which is transferred for charitable purposes unless the interest is a deductible interest described in § 25.2522(c)-3(c)(2).

Section 25.2522(c)-3(c)(2)(vii) provides that an interest in property is deductible where the interest is a unitrust interest, whether or not such interest is in trust. Section 25.2522(c)-3(c)(2)(vii) defines a unitrust interest as an irrevocable 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.

ISSUE 4

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 25.2511-2(f) provides that the relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event that completes the gift and causes the tax to apply.

ISSUE 5

Under § 2035(a), as amended by the Taxpayer Relief Act of 1997, if the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property during the 3-year period ending on the date of the decedent's death, and the value of such property (or an interest therein) would have been included in the decedent's gross estate under §§ 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

Section 2036 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 he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (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 an interest or a right is treated as having been retained or reserved if at the time of the transfer there was an understanding, express or implied, that the interest or right would later be conferred.

Section 20.2036-1(b)(3) provides that the phrase "right ... to designate the person or persons who shall possess or enjoy the transferred property or the income therefrom" includes a reserved power to designate the person or persons to receive the income from the transferred property during the decedent's life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death. With respect to such a power it is immaterial (i) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; and (iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death. The phrase does not apply to a power held solely by a person other than the decedent, but, for example, if the decedent reserved the unrestricted power to remove or discharge a trustee at any time and appoint himself as trustee, the decedent is considered as having the powers of the trustee.

In Rev. Rul. 72-552, 1972-2 C.B. 525, the decedent, prior to his death, transferred property to a charitable corporation. Decedent was an officer of the corporation who had the discretionary power to select the charitable recipients of distributions from the organization. The revenue ruling concludes that, as an officer of the corporation, the decedent retained the power to determine the ultimate beneficiaries of the transferred property. Accordingly, the transferred property was includible in his gross estate under § 2036.

Section 2037 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, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving

the decedent, and (2) 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. Under § 2037(b), the term "reversionary interest" includes a possibility that property transferred by the decedent (1) may return to him or his estate, or (2) may be subject to a power of disposition by him.

Section 2038 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 his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power during the 3-year period ending on the date of the decedent's death.

Section 20.2038-1(a) states that § 2038 does not apply to a power held solely by a person other than the decedent. But, for example, if the decedent had the unrestricted power to remove or discharge a trustee at any time and appoint himself trustee, the decedent is considered as having the powers of the trustee.

Section 2039 provides that 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 entered into after March 31, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

Under § 2041, 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 his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2042 provides that the proceeds of life insurance are includible in the gross estate in two instances: First, to the extent of the amount receivable by the executor as insurance under policies on the life of the decedent, and, second, to the

extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person.

ISSUE 6

With an adjusted payout rate of 7.0 percent times .953258 or 6.673 percent, and with quarterly payments at the end of each quarter for which they are paid, the present value of the remainder interest in a unitrust which pays for 30 years certain is \$0.12601 for each \$1.00 on initial trust corpus. The present value of the right to receive these payments is \$1.00 minus \$0.12601 or \$0.87399 for each \$1.00 of initial trust corpus. These factors are based on an interest rate of 8.0 percent.

ISSUES 7 AND 8

Section 508(e) provides that a private foundation shall not be exempt under § 501(a) unless its governing instrument includes provisions the effects of which are: (A) to require its income for each taxable year to be distributed at such time and in such manner as not to subject the foundation to tax under § 4942, and (B) to prohibit the foundation from engaging in any act of self-dealing (as defined in § 4941(d)), from retaining any excess business holdings (as defined in § 4943(c)), from making any investments in such manner as to subject the foundation to tax under § 4944, and from making any taxable expenditures (as defined in § 4945(d)).

Section 4947(a)(2) classifies trusts which are not exempt from tax under § 501(a), not all of the unexpired interests in which are devoted to purposes described in § 107(c)(2)(B), and which have 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 as split-interest trusts and provides with respect to such trusts that §§ 507, 508(e) (to the extent applicable), 4941, 4943, 4944, and 4945 shall apply as if such trusts were private foundations.

If Trust is created and operated as described above, it will be described in § 4947(a)(2). First, it will not be exempt from tax under § 501(a). Second, the trust instrument will provide for a remainder interest that serves only a private interest. Third, assuming that Foundation applies for and receives a determination that it is described in § 501(c)(3), the trust instrument will provide for the payment of a guaranteed annual payment devoted exclusively to charitable purposes for which a charitable deduction would be allowable.

The governing instruments of both Trust and Foundation contain provisions effectively prohibiting the organizations from engaging in transactions that could result in the imposition of excise taxes under §§ 4941 through 4945.

ISSUE 9

Section 2601 imposes a tax on every generation-skipping transfer made by a "transferor." Under § 2652(a) a "transferor" is defined, generally, as the last person with respect to whom the property was subject to the estate or gift tax.

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Under § 2612(a), the term "taxable termination" means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Under § 2612(b), the term "taxable distribution" means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Under § 2612(c), the term "direct skip" means a transfer subject to the estate tax or the gift tax of an interest in property to a skip person.

Under § 2613, the term "skip person" means --

(1) a natural person assigned to a generation that is two or more generations below the generation assignment of the transferor, or

(2) a trust --

(A) if all interests in such trust are held by skip persons, or

(B) if --

(i) there is no person holding an interest in such trust, and

(ii) at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a non-skip person.

Section 2631 provides that every individual shall be allowed a GST exemption of \$1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. In calendar years after 1998, the \$1,000,000 amount will be adjusted for inflation. The allocation, once made, is irrevocable.

Accordingly, we rule as follows:

1. Except to the extent that Trust has unrelated business income under § 681(a), and except to the extent that contributions are nondeductible under §§ 508(d) or 4948(c)(4), Trust will be allowed deductions in accordance with § 642(c)(1) for amounts of gross income paid to Foundation during that taxable year, or by the close of the following taxable year if the trustees make an election under § 1.642(c)-1(b). Because the deduction under § 642(c)(1) is limited to amounts of gross income, no deduction will be allowed for a distribution of principal except to the extent that the amount distributed has been included in the gross income of Trust and provided no deduction was allowed for any previous taxable year for the amount distributed.

2. Our examination of the Trust reveals none of the circumstances that would cause A to be treated as the owner of any portion of Trust under §§ 673, 674, or 676.

Our examination of the Trust reveals none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of A under § 675. Thus, the circumstances attendant on the operation of the Trust will determine whether A will be treated as the owner of any portion of the Trust under § 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 of the District Director with which the parties file their tax returns.

Paragraph 9.14 of Trust specifically prohibits distributions to satisfy the legal obligations of A or B. Paragraph 9.15 of Trust specifically prohibits distributions to pay any premiums of life insurance on the life of A or B. Based on all the facts and circumstances, A will not be treated as the owner of any portion of Trust under § 677.

3. In the present case, under the terms of Trust, Foundation is given the irrevocable right to receive, during each year of the Trust's term, 7 percent of the net fair market value of the Trust assets, valued annually on the first day of the calendar year. Therefore, based on the facts submitted and representations made, we conclude that a gift tax charitable deduction will be allowed for the present value of the charitable

interest in the Trust, valued as of the date of transfer to the Trust.

4. In the present case, it is represented that A is not an officer or director of Foundation. Based on the representations made, we conclude that the gift to Trust will be a completed gift for purposes of § 25.2511-2(c). The fact that B will serve as director and an officer of Foundation will not cause A's gift to Trust to be incomplete for purposes of § 25.2511-2(c). In addition, the transfer to the Trust will be a completed gift to A's children, the value of which will equal the value of the remainder interest in the Trust.

5. In the present case, Trust will be irrevocable. A will retain no interest in or power over the Trust, and no right to alter, amend, or revoke the Trust. A has no right to receive an annuity or other payment from the Trust during A's lifetime. In addition, A holds no general power of appointment over the Trust property. Accordingly, based on the facts submitted and representations made, and assuming there is no understanding, express or implied, between A and the officers and directors of Foundation regarding the distribution of payments to Foundation by the Trust, we conclude that the value of the Trust will not be includible in A's gross estate.

6. Based on the information submitted and the representations made, the present value of the remainder interest in Trust is \$0.12601 for each \$1.00 on initial trust corpus. The present value of the unitrust amount is \$0.87399 for each \$1.00 of initial trust corpus.

7. Trust will be a split-interest trust within the meaning of § 4947(a)(2) and will meet the requirements of § 508(e).

8. Foundation's governing document, if drafted as described above, will contain language that satisfies the requirements of § 508(e).

9. In this case, Foundation, which is not a skip person, will receive the unitrust interest for 30 years. Any income of the Trust which exceeds the unitrust amount will be added to corpus. At the end of the 30-year term, the Trust corpus will be divided into equal shares for the children of A and B, who are not skip persons. As each child reaches age 35, he or she will be given a general power of appointment over the assets in his or her separate trust. Therefore, the child will be considered the transferor for GST purposes of any further transfers from the child's separate trust. If, however, a child of A dies before reaching age 35 (whether before or after the termination of the 30-year charitable term), his or her separate share of the corpus will pass pursuant to the child's limited testamentary power of appointment to any one or more of A's living descendants. In

default of the exercise of the power, the child's share will pass to the child's living descendants, per stirpes. If the child has no living descendants, his or her share will pass to the children of A in equal shares, including a share for each deceased child which is to be further divided among the deceased child's living descendants, per stirpes. Consequently, at the termination of the 30-year charitable term, some of the Trust assets may pass from A to a skip person. In such case, the termination of Foundation's unitrust interest will be a taxable termination within the meaning of § 2612(a) and will be subject to the tax imposed under § 2601. Therefore, A may allocate all or a portion of A's GST exemption to the Trust.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision 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.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to A and B.

Sincerely yours,
J. THOMAS HINES
Acting Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2

Copy of this letter

Copy for § 6110 purposes