Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-164346-02
Date:
JUNE 17, 2003

Re:

LEGEND:

Taxpayer	=
A	=
B	=
C	=
D	=
E	=
Trust	=
x	=
y	=

Dear :

This is in response to your letter dated November 20, 2002, in which you request rulings regarding the effect of the creation of the proposed charitable "lead" trust for federal gift and income tax purposes.

Taxpayer proposes to create an irrevocable trust (Trust) to continue for a period of 30 years for the benefit of charitable organizations. The remaindermen are to be Taxpayer's children. Taxpayer will transfer to Trust cash and property valued at $x at the date of contribution. A and B will serve as trustees.

Article Second, Paragraph A, subparagraph 1, of Trust provides that up to and including that date thirty years from the date of execution of Trust, the trustees are to distribute (in cash or in kind, valued at the date of distribution, or partly in each) an annuity of $y per year to qualified charities in such proportions (or all to one) as the trustees shall select. The annuity is to commence from the date of execution of Trust and be paid not less frequently than annually. If Trust is executed on a day that the first fiscal year will not be a full year (or if the termination date is other than the end of a

year), the amount distributable for the first year (or the last year) will be determined as a pro rata portion of the annuity amount. For each taxable year, the annuity amount will be paid from current income, and to the extent current income is insufficient, from accumulated income, and to the extent accumulated income is insufficient, from principal. Any income not distributed may be added to principal in the trustees' sole discretion.

Article Second, Paragraph A, subparagraph 4, provides that the annuity interest shall not be commuted or prepaid prior to the termination date.

Article Second, Paragraph A, subparagraph 2, provides that the term "qualified charities" means only organizations described in § 170(c) and § 2522(a) of the Internal Revenue Code, gifts to which qualify for a charitable deduction under both the federal gift tax and federal income tax laws. If, 15 days before the close of the year, the trustees have not selected a qualified charity or charities to which to distribute the annuity or a portion of the annuity, the annuity or portion is to be paid in equal shares to two specified charities, but only if, in each case, the charity is then a qualified charity.

Article First, Paragraph (X), provides that, notwithstanding any other provision of the trust, no trustee or other person acting on behalf of the trust shall:

(1) engage in any act of self-dealing as defined in § 4941(d) or corresponding provisions of any subsequent federal tax laws,

(2) cause any excess business holding, as defined in § 4943(c) or corresponding provisions of any subsequent federal tax laws, to be retained,

(3) cause any investment to be acquired or retained in a manner that subjects the trust to tax under § 4944 or corresponding provisions of any subsequent federal tax laws; or

(4) make any taxable expenditures as defined in § 4945(d) or corresponding provisions of any subsequent federal tax laws.

Article Second, Paragraph B, provides that, at the termination date, the trustees are to distribute the remaining trust estate in equal shares so as to provide one such share to each of Taxpayer's children, A, B, C, D, and E, her or his heirs, personal representatives and administrators.

You have requested the following rulings:

1. The annuity interest in Trust will be a guaranteed annuity interest within the meaning of § 2522(c)(2)(B) and § 25.2522(c)-3(c)(2)(vi) of the Gift Tax Regulations and a gift tax deduction will be allowed to Taxpayer pursuant to § 2522 equal to the value of the guaranteed annuity.

2. The trust will be allowed a deduction under § 642(c) each taxable year in an amount equal to the annuity amount paid from the trust's gross income during the taxable year in accordance with the terms of the trust.

3. No portion of the trust's income will be taxable to Taxpayer under §§ 671 through 678.

GIFT TAX RULING

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during the calendar year by any individual.

Section 2522(a) provides that, in computing taxable gifts for the calendar year, there is allowed a deduction in the amount of all charitable gifts made during the calendar year.

Section 2522(c)(2) provides that where a donor transfers an interest in property (other than an interest described in §170(f)(3)(B)) to a person, or for a use, described in § 2522(a) or (b), and an interest in the same property is transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in § 2522(a) or (b), no deduction is allowed for the interest that is, or has been transferred to the person, or for the use, described in § 2522(a) or (b), unless

(A) in the case of a remainder interest, the interest is in a trust that is a charitable remainder annuity trust or a charitable remainder unitrust (described § 664) or a pooled income fund (described in § 642(c)(5)), or

(B) in the case of any other interest, the 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 25.2522(c)-3(c)(2)(vi)(a) provides that the term "guaranteed annuity interest" means an irrevocable right pursuant to the instrument of transfer to receive a guaranteed annuity. A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for the life or lives of certain individuals. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer can be ascertained as of the date of the gift. For example, the amount to be paid may be a stated sum for a term.

Section 25.2522(c)-3(c)(2)(vi)(e) provides that where a charitable interest in the form of guaranteed annuity interest is in trust and the present value on the date of the gift of all income interests for a charitable purpose exceeds 60 percent of the aggregate

fair market value of all amounts in the trust (after payment of liabilities), the charitable interest will not be a guaranteed annuity interest unless the governing instrument prohibits both the acquisition and retention of assets which would give rise to a tax under § 4944 if the trust acquired such assets.

In this case, based on the information submitted and the representations made, the annuity payable under the terms of Trust satisfy the requirements of § 25.2522(c)-3(c)(2)(vi)(a). Therefore, the annuity will be a guaranteed annuity for purposes of § 2522(c)(2)(B). Accordingly, Taxpayer will be entitled to a gift tax deduction under § 2522, based on the actuarial value of the guaranteed annuity payable to the charities from the trust, determined under § 25.2522(c)-3(d)(2)(iv), as of the date of the gift.

INCOME TAX RULINGS

Section 642(c)(1) provides, in part, that in the case of a trust, there shall be allowed as a deduction in computing its taxable income any amount of gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in §170(c). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee may elect to treat such contribution as paid during such taxable year.

Section 681(a) provides, in part, that in computing the deduction allowable under § 642(c) to a trust, no amount otherwise allowable under § 642(c) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to its unrelated business income for such year. Further, the term “unrelated business income” refers to an amount equal to the amount which, if such trust were exempt from tax under § 501(a) by any reason of § 501(c)(3), would be computed as its unrelated business taxable income under § 512 (relating to income derived from certain business activities and from certain property acquired with borrowed funds).

Section 644(a)(1) provides that if a trust (or another trust to which the property is distributed) sells or exchanges property as a gain not more than 2 years after the date of the initial transfer of the property in trust by the transferor and the fair market value of such property at the time of the initial transfer in trust by the transferor exceeds the adjusted basis of such property immediately after such transfer, an additional tax is imposed in accordance with § 642(a)(2) on the includible gain recognized on such sale or exchange. Section 644 provides, among other things, rules for determining the amount of this additional tax, the year for which the tax is imposed, the amount of the includible gain and the character of the includible gain, as well as various special rules and exceptions.

Section 671 provides the general rule that, in cases in which the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits those items of income,

deductions, and credits against tax on the trust that are attributable to that portion of the trust to the extent that such items would be taken into account in computing the taxable income and credits against the tax of an individual.

Sections 673 through 678 of subpart, E, part 1, subchapter J, specify the circumstances under which the grantor or another person is regarded as the owner of a portion of a trust.

Based solely on the facts as presented in this ruling request, viewed in light of the applicable law and regulations, we conclude that, except to the extent that Trust has unrelated business income within the meaning of § 681(a), and subject to the limitations set forth in § 642(c)(4), the trust will be allowed a deduction in accordance with § 642(c)(1) for the amount of gross income paid out to charitable beneficiaries described in § 170(c) during its taxable year or by the close of the following taxable year. Because the deduction under § 642(c)(1) is limited to amounts of gross income paid for a purpose specified in § 170(c), no deduction will be allowed under § 642(c) for a distribution from the trust principal, whether made in property or money, except to the extent that such property or money has been included in the Trust's gross income and provided no deduction was allowed for any previous taxable year for the amount so paid. The trust will be subject to the rules of § 644 to the extent such rules would be applicable.

Further, based upon the fact as submitted, Taxpayer will not be treated as the owner of the trust under §§ 673, 674, 676, 677, or 678. Therefore, no portion of the trust's income will be taxable to Taxpayer under these provisions.

The trust does not authorize any power that would cause administrative control of the trust to be considered exercisable primarily for the benefit of Taxpayer under § 675. However, whether Taxpayer will be treated as the owner of Trust under § 675 will depend upon the circumstances attendant upon the operation of the trust. This is a question of fact, the determination of which must necessarily be deferred until the federal income tax returns of the parties involved have been examined by the office of the Area Director in which the returns are filed.

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 set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or

any other provision of the Code.

A copy of this letter should be attached to any income or gift tax returns that the taxpayer may file relating to these matters.

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,

George Masnik
Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for 6110 purposes