Internal Revenue Service

Department of the Treasury
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-147087-10

Attn:

Date:
April 26, 2011

Trust =

A =

B =

Date1 =

Date2 =

Bank =

x =

State Court =

Dear :

This is in response to your letter, dated November 12, 2010, and subsequent correspondence, in which you requested rulings on behalf of Trust under §§ 664 and 4941 of the Internal Revenue Code.

Facts

The information submitted states that A created Trust under a trust agreement effective Date1. A intended to provide B with lifetime annual income of x percent of the principal value of Trust through use of an x percent standard Charitable Remainder Unitrust

(CRUT). A's attorney, however, used a form that created a net income with makeup charitable remainder unitrust (NIMCRUT). Accordingly, Trust by its terms: (1) limits annual distributions to B to the lesser of the net income of Trust or x percent of the principal value of Trust valued as of the first day of the taxable year of Trust, and (2) allows for payments to B of any amount of trust income for such year in excess of x percent of the principal value of Trust to make up for previous years in which the net income of Trust was less than x percent.

A's attorney acknowledges that inclusion of the net-income with makeup provision was a scrivener's error and that A intended that Trust be an x percent standard CRUT from the time it was established. In addition, Trust was administered as an x percent standard CRUT during its initial years while A's attorney and B served as co-trustees of Trust. During this time, even though income generated by Trust was significantly below x percent, Trust made annual distributions to B of x percent of the net fair market value of Trust's assets valued as of the first day of each taxable year of Trust.

On Date2, Bank replaced A's attorney as co-trustee of Trust, and it was discovered that Trust was a NIMCRUT. Thereafter, Bank and B filed a petition in State Court seeking authority to reform Trust *ab initio*, from a NIMCRUT to a standard x percent CRUT. All beneficiaries of Trust consented to the proposed reformation, and State Court issued an order approving the reformation of Trust *ab initio* based upon a mistake at the time Trust was executed. The order was conditioned upon the parties obtaining a favorable private letter ruling from the Service that the reformation would not disqualify Trust as a CRUT under § 664 or result in an act of self-dealing under § 4941.

Law and Analysis

Section 664(d)(2) provides that for purposes of § 664, a charitable remainder unitrust is a trust (A) from which a fixed percentage (which is not less than 5 percent nor more that 50 percent) of the net fair market value of its assets, valued annually, is to be paid not less often than annually, to one or more persons (at least one of which is not an organization described in § 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals, (B) from which no amount other than the payments described in § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c), (C) following the termination of the payments described in § 664(d)(2) (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use, and (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Section 664(d)(3) provides that notwithstanding the provisions of § 664(d)(2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year (A) the amount of the trust income if such amount is less than the amount required to be distributed under § 664(d)(2)(A), and (B) any amount of the trust income which is in excess of the trust amount required to be distributed under § 664(d)(2)(A), to the extent that (by reason of § 664(d)(3)(A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

Section 1.664-1(a)(4) of the Income Tax Regulations provides that for a trust to be a charitable remainder trust, it must satisfy the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Solely for purposes of § 664 and the regulations thereunder, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code (relating to grantors and others treated as substantial owners), but in no event prior to the time property is first transferred to the trust. For purposes of the preceding sentence, neither the grantor nor the grantor's spouse is treated as the owner of the trust under subpart E merely because the grantor or the grantor's spouse is named as a recipient of the annuity or unitrust amount.

Section 1.664-3(a)(4) provides, in part, that a charitable remainder trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than an organization described in § 170(c).

Section 170(c)(2)(B) defines charitable purposes with respect to charitable contributions that are deductible.

Section 507(d)(2)(A) defines a substantial contributor as any person who contributed or bequeathed an aggregated amount of more than $5000 to a private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also includes the creator of the trust.

Section 4941 imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1) defines "self-dealing" to include any direct or indirect:

(A) sale or exchange, or leasing of property between a private foundation and a disqualified person;
(B) lending of money or other extension of credit between a private foundation and a disqualified person;

(C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;
(D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person; or
(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) provides that the term "disqualified person," with respect to a private foundation includes a person who is:

(A) a substantial contributor to the foundation,
(B) a foundation manager,
(C) an owner of more than 20 percent of (i) the total combined voting power of a corporation, (ii) the profits interest of a partnership, or (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,
(D) a member of the family of any individual described in § 4946(a)(1)(A), (B), or (C),
(E) a corporation of which persons described in § 4946(a)(1)(A), (B), (C), or (D) own more than 35 percent of the total combined voting power,
(F) a partnership in which persons described in § 4946(a)(1)((A), (B), (C), or (D) own more than 35 percent of the profits interest, or
(G) a trust or estate in which persons described in § 4946(a)(1)(A), (B), (C), or (D) hold more than 35 percent of the beneficial interest.

Section 4946(d) provides that, for purposes of § 4946(a)(1), the family of any individual shall include only his spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Section 4947(a)(2) provides that split-interest trusts shall be treated as private foundations and, therefore, shall be subject to the sections applicable to private foundations. A "split-interest trust" is defined, in part, as a trust which is not exempt under § 501(a), not all of the unexpired interests in which are devoted to one or more purposes described in § 170(c)(2)(B).

Section 4947(a)(2)(A) provides, in part, that § 4941 is inapplicable to any amounts payable under the terms of a split interest trust to income beneficiaries. Example (1) of Treas. Reg. § 53.4947-1(c)(2)(ii) illustrates this concept and reiterates that the payment of such income would not constitute an act of self-dealing.

A person who contributes in excess of $5,000 to a private foundation, if such amount exceeds 2 percent of the contributions for the taxable year in which such a contribution is made, is considered a substantial contributor under § 507(d)(2)(A). A substantial contributor is a disqualified person under § 4946(a)(1)(A). A member of a substantial

contributor's family, which as defined in § 4946(d) includes his children, is also a disqualified person under § 4946(a)(1)(D). As the creator of and sole contributor to Trust of an amount in excess of $5,000, A is a disqualified person under § 4946(a)(1)(A) with respect to Trust. B, as A's son, is "family" of A within the meaning of § 4946(d). Therefore, B is also a disqualified person with respect to Trust under § 4946(a)(1)(D).

Section 4947(a)(2) provides that, for purposes of § 4941 and other sections applicable to private foundations, "split-interest" trusts shall be treated as private foundations. Not all of the interests of Trust are devoted to purposes described in § 170(c)(2)(B), as some of the interests of Trust are for the benefit of the income beneficiary. Therefore, Trust is a split-interest trust within the meaning of § 4947(a)(2) and is treated as a private foundation for purposes of § 4941.

Section 4941(d)(1)(E) includes in the definition of an act of self-dealing a transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation. Because B is a disqualified person and Trust is treated as a private foundation for purposes of § 4941, a payment from Trust to B could potentially constitute an act of self-dealing.

Section 4947(a)(2)(A) provides, however, that the provisions of § 4947(a)(2) do not apply with respect to the amounts payable under the terms of a split-interest trust to income beneficiaries. Because B is an income beneficiary, there is not an act of self-dealing with respect to an amount of income paid to B pursuant to the existing terms of Trust.

Trust in its current form is a NIMCRUT, which by definition, allows for make-up payments to the income beneficiary above x percent of the principal of Trust to make up for previous years in which the net income of Trust was less than x percent. Thus, in a given year, the income beneficiary could receive less than x percent or more than x percent. In any event, the amount paid out to the income beneficiary would not exceed x percent. Currently, the payments to the income beneficiary are not subject to § 4941 because they are excepted under § 4947(a)(2)(A).

As reformed Trust would provide the income beneficiary with an annual payment of x percent of the value of Trust (valued as of the first day of each taxable year). Because reformation of Trust based on the scrivener's error will have the effect of increasing the annual amount payable to the income beneficiary from less than x percent to x percent, reformation could give rise to an act of self-dealing under § 4941(d)(1)(E).

The circumstances presented indicate, however, that there is no self-dealing, and we are satisfied that the signatory parties to Trust never intended to create a NIMCRUT. Certain evidence supports this intent: (1) A's attorney submitted an affidavit stating that A intended to create a standard five percent CRUT rather than a NIMCRUT and the creation of Trust as a NIMCRUT was a scrivener's error, (2) A's attorney as trustee

administered Trust as a standard x percent CRUT for the initial years of its existence despite income from Trust of less than x percent, (3) B stated in an affidavit that, on several occasions, A simultaneously told A's attorney and B that A intended for B to receive annual distributions of x percent of Trust assets for B's life, and (4) there is no evidence that the income beneficiary is reducing his own taxes or using the benefit of hindsight in making the change to Trust.

Conclusion

Based solely on the facts and representations submitted, we conclude that the judicial reformation of Trust from a NIMCRUT into a standard x percent CRUT *ab initio* does not violate § 664. Further, the judicial reformation of Trust will not adversely affect Trust's qualification as a valid CRUT under § 664, so long as within 120 days of the date of this letter Trust distributes all amounts to B that should have been distributed to B in prior years under § 662(d)(2). A copy of this letter should be attached to Trust's tax return for the tax year in which such distributions are made. If Trust fails to make the required distributions, this ruling is null and void.

We further conclude that the judicial reformation of Trust from a NIMCRUT to an x percent standard CRUT will not result in an act of self-dealing under § 4941.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether Trust qualifies as a valid CRUT under § 664(d)(2) and the corresponding regulations.

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

James A. Quinn
Senior Counsel, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter
Copy for § 6110 purposes