

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-102743-99

District Director

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Years Involved:

Date of Conference:

LEGEND:

Decedent:

Date 1:

Date 2:

Date 3:

Date 4:

Date 5:

Date 6:

Date 7:

Date 8:

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Date 9:

Date 10:

Date 11:

X:

ISSUE:

Does the charitable remainder trust created under Decedent's Trust satisfy the requirements of § 2055(e) of the Internal Revenue Code so that Decedent's estate is eligible for a deduction under § 2055 for the present value of the remainder interest of the charitable remainder trust?

CONCLUSION:

Because the charitable remainder trust created under Decedent's Trust is not in the form required in § 2055(e)(2) and is not a reformable interest under § 2055(e)(3), Decedent's estate is not eligible for a charitable deduction under § 2055 for the present value of the remainder interest of the charitable remainder trust.

FACTS:

On Date 1, Decedent established Decedent's Trust. As originally drafted on Date 1, Decedent's Trust provided for a revocable trust during Decedent's lifetime. Paragraph IV A of Decedent's original revocable trust provided that on Decedent's death, the trustee was to create a marital deduction trust for Decedent's spouse, to pay Decedent's debts, taxes and expenses, to make a specific pecuniary bequest and to create a charitable remainder unitrust with the remainder of the original revocable trust principal and any unpaid income of the original revocable trust.

Under the terms of Decedent's Trust, as originally drafted, trustee was to pay a unitrust amount equal to five percent of the net fair market value of the trust assets valued as of the first day of each taxable year of the unitrust. The terms of the original revocable trust provided that the trustee pay the unitrust amount to Decedent's spouse for life. On the death of Decedent's spouse, the trustee was to pay the unitrust amount proportionally to thirteen individual beneficiaries for ten years or life, whichever was shorter. Upon the death of the last survivor of those beneficiaries or at the end of the ten-year term (whichever occurred first), trustee was to distribute the entire trust principal and any unpaid income to thirteen charitable organizations.

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Decedent amended Decedent's Trust 8 times, on Date 2, Date 3, Date 4, Date 5, Date 6, Date 7, Date 8, and Date 9. The amendments to Decedent's Trust deleted the original post-death dispositive provisions and added new dispositive provisions. In particular, the amendments to Decedent's Trust deleted the dispositive provisions related to the charitable remainder unitrust.

Decedent died testate on Date 10. On Date 10, Decedent's Trust became irrevocable. The final terms of Decedent's Trust, as amended, required trustee to "pay [trust] income annually for life in equal shares" to four beneficiaries, if those beneficiaries survived Decedent. In the event any of the four beneficiaries predeceased Decedent, their life interest in the income lapsed and their life interest was to be divided and distributed to the survivors. At the death of the last remaining member of the class of income beneficiaries, the terms of Decedent's Trust provide that the trust will terminate, and the trust property and accrued income shall be distributed outright to several enumerated charities that are "tax-exempt" charities.

A federal estate tax return for Decedent's estate was filed timely on Date 11. On Schedule O of the return, the estate claimed a charitable deduction of x dollars. Taxpayer represents that this figure is the present value of the remainder interest in the charitable remainder trust established under Decedent's Trust dated Date 1.

LAW:

Section § 2055(a) provides, in part, that 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, and transfers to or for a corporation or certain other organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Congress added § 2055(e)(2) to the Code in § 201(d)(1) of the Tax Reform Act of 1969, 1969-3 C.B. 1 at 51. Language in the legislative history indicates that Congress was concerned that, under law prior to 1969, taxpayers were allowed a charitable deduction for a gift of a remainder interest in trust to a charity and the charitable deduction was substantially in excess of the amount of the gift the charity ultimately received. Section 2055(e) was added to the Code to prevent this perceived abuse by allowing a charitable deduction for bequests of partial interests in property only if the bequests are in a prescribed form. H. R. Rep. 99-413, 1969-3 C.B. 237, 238.

Section 2055(e)(2) provides that where an interest in property (other than an interest described in § 170(f)(3)(B) passes or has passed from decedent to a person, or for a use, described in § 2055(a) and an interest (other than an interest that 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 § 2055(a), no deduction shall be

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allowed under § 2055 for the interest that passes or has passed to the person, or for the use, described in § 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 § 664), or a pooled income fund (described in § 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 664(d)(1), as in effect for transfers in trust on or before Date 10, provides that a charitable remainder annuity trust is a trust-

(A) from which a sum certain (which is not less than 5 percent of the initial net fair market value of all property placed in trust) 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 section 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)(1)(A) may be paid to or for the use of any person other than an organization described in § 170(c), and

(C) following the termination of the payments described in § 664(d)(1)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use.

Section 664(d)(2), as in effect for transfers in trust on or before Date 10, provides that a charitable remainder unitrust is a trust-

(A) from which a fixed percentage (which is not less than 5 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 section 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) may be paid to or for the use of any person other than an organization described in section 170(c), and

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(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 section 170(c) or is to be retained by the trust for such a use.

Section 642(c)(5) provides that a pooled income fund is a trust—

(A) to which each donor transfers property, contributing an irrevocable remainder interest in such property to or for the use of an organization described in § 170(b)(1)(A) (other than in clauses (vii) or (viii)), and retaining an income interest for the life of one or more beneficiaries (living at the time of such transfer),

(B) in which the property transferred by each donor is commingled with property transferred by other donors who have made or make similar transfers,

(C) that cannot have investments in securities that are exempt from income tax,

(D) that includes only amounts received from transfers which meet the requirements of § 642(c)(5),

(E) that is maintained by the organization to which the remainder interest is contributed and of which no donor or beneficiary of an income interest is a trustee, and

(F) from which each beneficiary of an income interest receives income, for each year for which he is entitled to receive the income interest referred to in § 642(c)(5)(A), determined by the rate of return earned by the trust for such year.

Section 2055(e)(3) provides rules under which interests in a trust may be reformed to comply with § 2055(e)(2). Section 2055(e)(3)(A) provides that a deduction is allowed under § 2055(a) for any qualified reformation.

Section 2055(e)(3)(B) defines the term "qualified reformation" to mean a change of a governing instrument by reformation, amendment, construction, or otherwise that 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,

(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

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(iii) the 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 § 2055(a) at the time of the decedent's death but for § 2055(e)(2).

Section 2055(e)(3)(C)(ii) provides that generally 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 § 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 that § 2055(e)(3)(C)(ii) shall not apply to any interest if a judicial proceeding is commenced to change the interest into a qualified interest not later the 90th day after --

(1) if an estate tax return is required to be filed, the last date (including extensions) for filing such return, or

(2) if no estate tax return is required to be filed, the last date (including extensions) for filing the income tax return for the 1st taxable year for which such a return is required to be filed by the trust.

Section 2055(e)(3)(C)(iv) provides that, in the case of any interest passing under a will executed before January 1, 1979, or under a trust created before such date, § 2055(e)(3)(C)(ii) shall not apply.

Section 2055(e)(3)(D) defines the term "qualified interest" to mean an interest for which a deduction is allowable under § 2055(a).

ANALYSIS:

Section 2055(e)(2)(A) disallows an estate tax charitable deduction for the remainder interest in a charitable remainder trust unless the trust is in the form of a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)).

Under § 2055(e)(3), a "reformable interest" (meaning an interest for which a deduction would have been allowable at the time of the decedent's death under § 2055(a) but for § 2055(e)(2)) may be converted into a "qualified interest" (meaning an interest that meets the requirements of § 2055(e)(2)) by a "qualified reformation."

Section 2055(e)(3)(C)(ii) provides that, generally, a "reformable interest" does not include any interest unless, before the remainder vests in possession, all payments

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to the noncharitable beneficiaries 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) and (iv), however, provides two exceptions to the general rule. First, § 2055(e)(3)(C)(iii) provides, in part, that § 2055(e)(3)(C)(ii) does not apply to any interest if not later than 90 days after the last date (including extensions) for filing an estate tax return a judicial proceeding is commenced to change the interest into a qualified interest. Second, § 2055(e)(3)(C)(iv) provides that, in the case of any interest passing under a will executed before January 1, 1979, or under a trust created before such date, § 2055(e)(3)(C)(ii) shall not apply.

Section 1.664-1(a)(4) provides that, for purposes of § 664 and the regulations thereunder, a trust is 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). Under the rules contained in § 1.664-1(a)(4), Decedent's Trust is 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. In this case, because Decedent retained the power to revoke, alter, and amend Decedent's Trust until her death, Decedent was treated as the owner of the entire trust corpus under the grantor trust rules until her death on Date 10, a date after December 31, 1978. See § 1.664-1(a)(6), example (1). Thus, the charitable remainder trust created under Decedent's Trust, as amended, is considered to be created on Date 10.

Further, Decedent amended Decedent's Trust several times after December 31, 1978. The amendments to Decedent's Trust deleted the original post-death dispositive provisions, including the dispositive provisions creating the charitable remainder unitrust, and added new charitable dispositive provisions that were not in the form required in § 2055(e)(2)(A) or (B).

Based on the facts presented, the charitable remainder trust created under Decedent's Trust is not a "reformable interest" as that term is defined in § 2055(e)(3)(C) because the payments from the charitable remainder trust to the noncharitable beneficiaries are not expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property and the requirements in the two special rules that are exceptions to the general rule are not satisfied. The special rule contained in § 2055(e)(3)(C)(iii) is not satisfied, because a timely judicial proceeding was not commenced within the time limit prescribed in § 2055(e)(3)(C)(iii) which, under the facts of this case, requires the proceeding to be commenced not later than the 90th day after the last date for filing the estate tax return (including extensions). Further, the special rule contained in § 2055(e)(3)(C)(iv) applicable to any interest passing under a will executed before January 1, 1979, or under a trust created before January 1, 1979 is not applicable in this case, because the charitable interest passed under a trust created after December 31, 1978, for purposed of § 2055(e)(3).

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Because the charitable remainder trust created under Decedent's Trust, as amended, is not in the form required in § 2055(e)(2) and because the trust is not a reformable interest, we conclude that Decedent's estate is not eligible for a charitable deduction under § 2055 for the present value of the remainder interest of the charitable remainder trust.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.