

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

December 7, 1999

Legend: Taxpayer:

Child 1:

Child 2:

Child 3:

Child 4:

\$X:

\$Y:

Charity 1:

Charity 2:

Bank:

Dear

We received the, request and later submissions requesting rulings concerning the income, estate, and gift tax consequences of the proposed creation of a trust. This letter responds to that request.

The facts and representations submitted are as follows. Taxpayer proposes to create a trust, Trust, intended to qualify as a charitable lead annuity trust. Pursuant to the terms of Trust as proposed, Taxpayer's children, Child 1, Child 2, Child 3, and Child 4 are designated as the initial trustees of Trust. Taxpayer proposes to transfer to Trust cash and other assets totaling roughly \$X.

Article FIRST (X)(1) of Trust provides that, any provision of Trust notwithstanding, no trustee or other person acting on behalf of Trust shall engage in any act of self-dealing as defined in § 4941(d).

Article FIRST (X)(2) of Trust provides that, any provision of Trust notwithstanding, no trustee or other person acting on behalf of Trust shall cause any excess business holding, as defined in § 4943(c), to be retained.

Article FIRST (X)(3) of Trust provides that, any provision of Trust notwithstanding, no trustee or other person acting on behalf of Trust shall cause any instrument to be acquired or retained in a manner that subjects Trust to tax under § 4944.

Article FIRST (X)(4) of Trust provides that, any other provision of Trust notwithstanding, no trustee or other person acting on behalf of Trust shall make any taxable expenditures as defined in § 4945(d).

Article SECOND (A)(1) of Trust provides that, up to and including the date thirty (30) years from the date of execution of Trust, the trustees shall distribute (in cash or in kind, valued at the date of distribution, or partly in each, in the trustees' sole discretion) an annuity at the rate of \$Y per year to and among qualified charities (as defined in Trust) in such proportions (or all to one) as the trustees shall from time to time select. The trustees are authorized in such selection to commit irrevocably the entire annuity or any payment or payments thereof to one or more qualified charities in advance of payment and (or) the year and to evidence such commitment by promissory note or otherwise. Said annuity shall commence on and accrue from the date of execution of Trust and may, in the trustees' discretion, be paid in convenient installments (but not less frequently than annually). In the event that Trust is executed on such a day that the first fiscal year of Trust shall not be a full year (or, if the termination date shall be other than the end of a year), said amount distributable for that first year (or last year) shall be determined as a pro-rata portion of said annuity amount, taking into account the number of days Trust is in force. For each taxable year, said annuity amount shall be paid from current income, and to the extent current income shall be insufficient, from accumulated income, and to the extent current income shall be insufficient, from principal (including, but not limited to, capital gains). Any income not so distributed may be added to principal in the trustees' sole discretion.

Article SECOND (A)(2) of Trust provides that in the event that, on or before that date fifteen days prior to the close of the year, the trustees shall not have selected the qualified charity or charities to receive any portion (or all) of said annuity for that year, then such portion shall be paid in equal shares to such of Charity 1 and Charity 2, which are then qualified charities, but only if either is then a qualified charity.

Article SECOND (A)(3) of Trust provides that, for purposes of Trust, the term "qualified charities" shall mean and include only such organizations as are described (at the time of determination) in both § 170(c) and § 2522(a), gifts to which qualify for charitable deduction under both the federal gift tax and federal income tax laws for comparable treatment under any subsequent federal tax laws.

Article SECOND (A)(4) of Trust provides that, any provision of Trust to the contrary notwithstanding, the annuity interest shall not be commuted or prepaid prior to the termination date.

Article SECOND (B) of Trust provides that at the termination date, the trustees shall distribute the entire trust estate remaining in equal shares so as to provide one such share to each of Taxpayer's children, her or his heirs, executors, and administrators. It is intended that each such remainder to be distributed to one of Taxpayer's said children is vested (and shall not be subject to divestiture) in Taxpayer's said child and that, accordingly, each of Taxpayer's said children shall have the powers accorded by law to a vested remainderman in his or her share of the trust estate.

Article SECOND (C) of Trust provides that, until the termination date and during Taxpayer's lifetime, Taxpayer shall have the right, acting in a non-fiduciary capacity without the approval or consent of any other person to reacquire any portion (or all) of the trust corpus by substituting other property of an equivalent value.

Article THIRD (B) of Trust provides that any trustee may appoint (by last will and testament or by written instrument delivered to a co-trustee or successor trustee) his own successor trustee or a succession of trustees to become such at any time after his death, resignation, incapacity, or refusal further to act. The trustees or trustee serving may appoint (by written instrument delivered to the appointee) a co-trustee to increase the number of trustees or to fill any vacancy caused by the failure of any individual to appoint a successor. In so appointing a successor trustee or co-trustee, the appointing trustee(s) may provide such terms and conditions as to term, bond, compensation, and other matters affecting his or their appointee or appointees as the appointing trustee(s) deem(s) appropriate.

Article THIRD (C) of Trust provides that if at any time fewer than two trustees are serving (or provided for) with respect to any trust and no corporate trustee is then serving, Bank shall become co-trustee (so as to increase to two (2) the number serving) or sole trustee of such trust (if none other is then serving pursuant to the terms of Trust).

Article THIRD (K) of Trust provides that neither Taxpayer nor any spouse of Taxpayer shall be appointed (or shall serve as) a trustee or co-trustee of any trust created under Trust.

Article FIFTH of Trust provides that, anything in Trust to the contrary notwithstanding, unless sooner terminated pursuant to the provisions in Trust, (and every trust created under the terms of Trust) Trust shall terminate no later than twenty-one (21) years after the death of the last to die of Taxpayer and Taxpayer's descendants living at the date of execution of Trust. At such termination, the trust estate, both principal and income, shall be distributed and paid over absolutely and free from trust as if such time were the termination date as set out in Article SECOND.

Article SIXTH of Trust provides that Trust shall be irrevocable. Taxpayer expressly acknowledges that he shall have no right or power, either alone or in conjunction with others, or in whatever capacity, to alter, amend, revoke, or terminate Trust, or any terms of Trust, in whole or in part, or to designate the persons who shall possess or enjoy Trust property or the income during the continuance of Trust.

The following rulings are requested:

1. The annuity interest in Trust will be a guaranteed annuity interest within the meaning of § 2522(c)(2)(B) of the Internal Revenue Code 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. No portion of Trust assets will be includible in Taxpayer's gross estate;
3. Taxpayer will be treated as the owner of Trust at the time of its creation pursuant to §§ 671 and 675 of the Code; and,
4. Taxpayer will be allowed a deduction under § 170(f)(2)(B) in the taxable year in which Trust is created in an amount equal to the value of the guaranteed annuity on the date of contribution, subject to the restrictions set forth in that section if Taxpayer should cease at a later date to be treated as the owner of Trust for any reason.

Ruling Request 1:

Section 2501 provides that a tax, computed as provided in § 2501, is imposed for each calendar year on the transfer of property by gift, during such calendar year by any individual, resident or nonresident.

Section 2511(a) provides, in part, that subject to limitations contained in chapter 12, the tax imposed by § 2501 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, educational purposes, and certain other fraternal organizations.

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 retained by the donor, or is transferred or has been 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 in § 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(a) provides that if a trust is created or property is transferred for both a charitable and a private purpose, a deduction may be taken for the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

Section 25.2522(c)-3(c)(2)(vi)(a) provides that a deductible interest is a charitable interest in property only where the charitable interest is a guaranteed annuity whether or not the interest is in trust. For purposes of § 25.2522(c)-3(2)(vi), the term "guaranteed annuity" 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 or for the life or lives of a named individual or individuals each of whom must be living at the date of the gift and can be ascertained at that date. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer is ascertainable as of the date of the gift. For example, the amount to be paid may be a stated sum for a term, or for the life of an individual, at the expiration of which it may be changed by a specified amount, but it may not be redetermined by reference to a fluctuating index such as the cost of living index. In further illustration, the amount to be paid may be expressed as a fraction or percentage of the cost of living index on the date of the gift.

Section 25.2522(c)-3(c)(2)(vi)(b) provides that a charitable interest is a guaranteed annuity interest but only if it is a guaranteed annuity interest in every respect. For example, if the charitable interest is the right to receive from a trust each year a payment equal to the lesser of a sum certain or a fixed percentage of the net fair market value of the trust assets, determined annually, the interest is not a guaranteed annuity interest.

Section 25.2522(c)-3(c)(2)(vi)(e) provides that where a charitable interest in the form of a guaranteed annuity interest is in trust and the present value of all income interests for charitable purposes 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 considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and retention of the assets which would give rise to a tax under § 4944 if the trust acquired such assets.

Based on the information submitted and the representations made, under the terms of Trust, a qualified charitable organization or organizations are given the irrevocable right to receive a determinable amount annually, for a specified term. We conclude that the annuity payable under the terms of the proposed trust satisfies the requirements of § 25.2522(c)-3(c)(2)(vi) and, therefore, will be a guaranteed annuity for purposes of § 2522(c)(2)(B). Accordingly, we conclude that Taxpayer will be entitled to a gift tax deduction under § 2522(a). Under § 25.2522(c)-3(d)(2)(iv), the amount of the deduction is the present value of the guaranteed annuity determined in accordance with § 25.2512-5.

Ruling Request 2:

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2035(a) provides that if: (1) 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 (2) 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(a) 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 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 2038(a)(1) 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 the 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 his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Based upon the information submitted and the representations made, Trust will be irrevocable. A fixed amount will be distributed annually from Trust to Qualified Charities during the thirty year charitable lead term. Thereafter, the corpus and remaining income will pass outright for Taxpayer's descendants. Taxpayer retains no interest or reversion in Trust, and no right to alter, amend, or revoke the trust. Taxpayer cannot serve as trustee of Trust.

Accordingly, we conclude that, upon Taxpayer's death, no portion of the principal of Trust will be includible in Grantor's gross estate for federal estate tax purposes under s 2033, 2035, 2036, or 2038.

Ruling Request 3:

Section 671 of the Code provides that if the grantor or another person is treated as the owner of any portion of a trust, there shall 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 in computing the taxable income or credits against tax of an individual.

Section 1.671-3(b) of the Income Tax Regulations provides that if a grantor is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus. Section 1.671-3(b)(3) provides that if the grantor is treated as an owner under § 675 of the Code because of a power over corpus, then the grantor includes both ordinary income and other income allocable to corpus in the portion the grantor is treated as owning.

Section 675(4) of the Code provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of § 675(4), the term "power of administration" includes a power to reacquire the trust corpus by substituting other property of an equivalent value.

Section 1.675-1(a) provides that the grantor is treated as the owner of any portion of a trust if, under the terms of the trust instrument or circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust.

Section 1.675-1(b)(4) provides that the circumstances that cause administrative controls to be considered exercisable primarily for the benefit of the grantor are the existence of certain powers of administration exercisable in a nonfiduciary capacity by any nonadverse party without the approval or consent of any person in a fiduciary capacity. The term "powers of administration" means, among other powers, a power to reacquire the trust corpus by substituting other property of an equivalent value. If a power is exercisable by a person as trustee, it is

presumed that the power is exercisable in a fiduciary capacity primarily in the interest of the beneficiaries. This presumption may be rebutted only by clear and convincing proof that the power is not exercisable primarily in the interest of the beneficiaries. If a power is not exercisable by a person as trustee, the determination of whether the power is exercisable in a fiduciary or nonfiduciary capacity depends on all the terms of the trust and the circumstances surrounding its creation and administration.

In the present case, the circumstances surrounding the administration of Trust will determine whether the power of administration is exercisable in a fiduciary or nonfiduciary capacity. 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 where the returns are filed. Therefore, we cannot determine at this time whether Grantor will be treated as the owner of Trust under § 675(4) of the Code. Provided that the circumstances indicate that the power of administration is exercisable in a nonfiduciary capacity, Grantor will be treated as the owner of Trust under § 675.

Ruling Request 4:

Section 170(f)(2)(B) provides that no charitable contribution deduction is allowed for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of the interest for purpose of applying § 671. Section 170(f)(2)(B) also provides rules for taxation of the grantor in the event that the grantor ceases to be treated as the owner of the interest.

Section 1.170A-6(c)(2)(i)(A) defines an income interest as a "guaranteed annuity interest" only if it is an irrevocable right pursuant to the governing instrument of the trust 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 or for the life or lives of an individual or individuals, each of whom must be living at the date of the transfer and can be ascertained as of the date of the transfer. An amount is determinable if the exact amount that must be paid under the conditions specified in the governing instrument of the trust can be ascertained as of the date of the transfer.

Under § 1.170A-6(c)(2)(i)(D), if the present value on the date of the transfer of all the income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all the amounts in trust (after payment of liabilities), an income interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and the retention of assets that would give rise to a tax under § 4944 if the trustees had acquired the assets.

With exceptions not relevant here, § 1.170A-6(c)(2)(i)(E) provides that an income interest consisting of an annuity transferred in trust after May 21, 1972, will not be considered a guaranteed annuity interest if any amount other than the amount in payment of a guaranteed annuity interest may be paid by the trust for a private purpose before the expiration of all income interests for a charitable purpose.

Section 1.170A-6(c)(3)(i) of the Regulations provides that the deduction allowed by § 170(f)(2)(B) for a charitable contribution of a guaranteed annuity interest is limited to the fair market value of such interest on the date of contribution, as computed under § 20.2031-7.

Section 170(e)(1)(A) provides that the amount of any contribution otherwise taken into account for purposes of computing the charitable deduction shall be reduced by the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution). Section 170(e)(1)(B)(ii) further provides that, in the case of a contribution to or for the use of a private foundation (subject to the exception of § 170(e)(5) for qualified appreciated stock), the amount of any contribution also shall be reduced by the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution). Section 170(e)(2) and § 1.170A-4(c)(1) provides basis allocation rules to be used in applying the reduction rules of § 170(e)(1) in the case of a taxpayer making a charitable contribution of less than the taxpayer's entire interest in appreciated property.

Section 170(b)(1)(B) provides that any charitable contribution, other than a charitable contribution to which § 170(b)(1)(A) applies, shall be allowed to the extent that the aggregate of such contributions does not exceed the lesser of : (1) 30 percent of the taxpayer's contribution base for the taxable year, or (2) the excess of 50 percent of the taxpayer's contribution base for the taxable year over the amount of charitable contributions allowable under § 170(b)(1)(A) without regard to § 170(b)(1)(C).

Section 170(b)(1)(D)(i) provides that, in the case of a contribution of capital gain property to or for the benefit of a charity that is not a public charity described in § 170(b)(1)(A), the total amount of such contributions of such property taken into account for determining the income tax deduction shall not exceed the lesser of: (1) 20 percent of the taxpayer's contribution base for the taxable year, or (2) the excess of 30 percent of the taxpayer's contribution base for the year over the amount of contributions of capital gain property to which § 170(b)(1)(C) applies. Under § 170(b)(1)(C)(iv), "capital gain property," with respect to any contribution, means any capital asset the sale of which at its fair market value at the time of contribution would have resulted in gain that would have been long-term capital gain.

In the instant case, Trust provides that the income interest to be paid to one or more charitable organizations is an irrevocable right to receive a specified amount determined as of the date of the transfer of property to Trust. The income interest is to be paid annually for a period

that will terminate at either the expiration of a specified term or the death of persons living at the date of the transfer. The income interest meets the requirements of § 1.170A-6(c)(2)(i)(A) because Trust prohibits both the acquisition and the retention of assets that would give rise to a tax under § 4944 if the trustees had acquired the assets. The income interest meets the requirements of § 1.170A-6(c)(2)(i)(E), because Trust does not permit the payment of any amount other than amounts in payment of the annuity to charitable organizations. Accordingly, the interest is a guaranteed annuity interest within the meaning of § 1.170A-6(c)(2)(i)(A).

Provided that Taxpayer is treated as the owner of the income interest under § 671, Trust will qualify as a charitable lead annuity trust for purposes of the income tax charitable deduction under § 170(f)(2)(B), subject to the rules of that section in the event that Taxpayer ceases to be treated as the owner of the interest under § 671.

Taxpayer may deduct for federal income tax purposes the fair market value of the annuity interest set forth in Trust as determined on the date of the contribution, reduced as provided by § 170(e) and subject to the percentage limitations of § 170(b).

Trust provides that potential donees are restricted to organizations described in § 170(c), which includes a private foundation. Accordingly, any contribution by Taxpayer of property to Trust, the sale of which at fair market value would result in long-term capital gain, would be subject to the reduction rules of § 170(e)(1)(B)(ii). The reduction rules of § 170(e)(1)(A) would also apply.

Similarly, because Trust provides that potential donees are restricted to organizations described in § 170(c), which includes organizations not within § 170(b)(1)(A), the amount of Taxpayer's contribution is subject to the percentage limitations of § 170(b)(1)(B) and (D)(i).

Except as we have specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under the cited provisions or under any other provisions of the Code.

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

Sincerely yours,

James C. Gibbons
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Assistant to the Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs & Special Industries)

Enclosures: Copy for § 6110 purposes