

**Internal Revenue Service**

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Department of the Treasury

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CC:PSI:B04

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Date: APRIL 14, 2006

Legend

Husband =

Wife =

Son 1 =

Son 2 =

Daughter =

Trust =

a =

b =

x =

Foundation =

Date 1 =

State =

Company 1 =

Company 2 =

Case 1 =

Case 2 =

Dear :

This is in response to your May 9, 2005 letter and other correspondence concerning the gift and income tax consequences of Husband's and Wife's proposed

renunciation of their interests in Trust and Husband's proposed irrevocable designation of the charitable remainder beneficiary or beneficiaries in Trust.

The facts and representations are summarized as follows. Husband established Trust, a charitable remainder unitrust (CRUT), on Date 1. Trust was funded with a shares of Company 1 stock and b shares of Company 2 stock. The trustees of Trust are Husband's children, Son 1, Son 2, and Daughter.

Paragraph FIRST (1) of Trust provides that in each taxable year of Trust, the Trustees shall pay Husband during his lifetime and, after his death, Wife, for such time as she survives, a unitrust amount equal to the lesser of: (a) Trust income for the taxable year, as defined in section 643(b), and (b) c percent of the net fair market value of the assets of Trust valued as of the first day of each taxable year of Trust. The unitrust amount for any year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) above to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as c percent of the net fair market value of Trust assets on the valuation dates.

Paragraph FIRST (4) provides that upon the death of the survivor of Husband and Wife, the Trustees shall distribute all of the then principal and income of Trust (other than any amount due either of Husband or Wife or their estates) to such one or more organizations described in sections 170(c), 2055(a) and 2522(a), in such proportions or amounts, (i) as Husband while living and legally competent and/or, (ii) if Wife survives Husband, then as a majority of Wife and Husband's children, Son 1, Daughter, and Son 2, from time to time living and legally competent, shall at any time and from time to time designate by written instrument, duly executed and acknowledged, and delivered to the Trustees. If more than one designation has been delivered to the Trustees by Husband and/or Wife and children, then the last such designation so delivered shall govern. If organization(s) named in the last designation delivered to the trustees is not an organization described in sections 170(c), 2055(a) and 2522(a) at the time when any principal or income of Trust is to be distributed to it, then the Trustees shall distribute such principal and income to the remaining one or more organizations which are described in sections 170(c), 2055(a) and 2522(a), if any, proportionately, but if none of such organizations is an organization described in sections 170(c), 2055(a) and 2522(a) at the time when any principal or income of Trust is to be distributed to it, or if no such designation is made by either Husband or Wife and children, then the Trustees shall distribute such principal and income to Foundation, a State not-for-profit corporation. If Foundation is not an organization described in sections 170(c), 2055(a) and 2522(a) at the time when any principal or income of Trust is to be distributed to it, then the Trustees shall distribute such principal and income to such one or more organizations described in sections 170(c), 2055(a) and 2522(a) as the Trustees shall select in their sole discretion.

Paragraph FIRST (8) provides that the operation of Trust shall be governed by the laws of State.

It is represented that at the time Trust was created, Husband and Wife had no intention to divide the unitrust and remainder interests as a method to avoid the partial interest rules in section 170(f).

Under State Law, if Husband and Wife renounce their interests in Trust, the renunciation of their unitrust interests will accelerate the remainder interest. See Case 1 and Case 2.

Husband, Wife, and their children propose the following transaction. First, Wife, Son 1, Son 2, and Daughter will each irrevocably release their contingent right to designate one or more charitable organizations described in sections 170(c), 2055(a) and 2522(a) as the remainder beneficiary or beneficiaries of Trust (Irrevocable Renunciation). Second, Wife will renounce her only other interest in Trust, i.e. her right to receive unitrust distributions from Trust in the event that Wife survives Husband (Irrevocable Renunciation). Third, Husband will renounce all of his remaining interests in Trust, i.e. his right to receive any future unitrust distributions from Trust and his right to make any further charitable beneficiary designations and, then, Husband will irrevocably designate one or more specific charitable organizations described in sections 170(c), 2055(a) and 2522(a) as the remainder beneficiary or beneficiaries of Trust (Irrevocable Renunciation and Designation).

Husband and Wife, and their children, as trustees of Trust, will file an action with the probate court having jurisdiction over Trust requesting that the court rule that they have the right to renounce their unitrust interests in Trust and that, as a result of the renunciation, the remainder interest will be accelerated and all principal and income remaining in Trust at the time of Husband's renunciation (other than the final prorated unitrust amount that is due and payable to Husband or Wife) will be immediately payable to the charitable organization(s) irrevocably designated by Husband as the remainder beneficiary or beneficiaries.

You have requested the following rulings:

- 1) Husband will be entitled to a gift tax deduction under section 2522 for the value of his unitrust interest and the remainder interest in Trust transferred as a result of his execution of the Irrevocable Renunciation and Designation.
- 2) Wife will be entitled to a gift tax deduction under section 2522 for the value of her unitrust interest in Trust transferred as a result of her execution of the Irrevocable Renunciation.

- 3) Husband will be entitled to an income tax deduction under section 170 for the value of his unitrust interest in Trust transferred as a result of his execution of the Irrevocable Renunciation and Designation.
- 4) Wife will be entitled to an income tax deduction under section 170 for the value of her unitrust interest in Trust transferred as a result of her execution of the Irrevocable Renunciation

## LAW AND ANALYSIS

Section 170(a)(1) of the Internal Revenue Code allows as an income tax deduction any contribution or gift to or for the use of organizations described in section 170(c), payment of which is made within the taxable year.

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 a fixed percentage distributed annually of the fair market value of the trust property, determined annually, and the grantor is treated as the owner of the interest for purposes of applying section 671 (relating to grantor trusts).

Section 170(f)(3)(A) provides that a contribution (not made by a transfer in trust) of less than the taxpayer's entire interest in property is not allowed as a charitable contribution deduction except to the extent that the value of the interest contributed would be allowable as a deduction had such interest been transferred in trust.

Sections 1.170A-6(a)(2) and 1.170A-7(a)(2)(i) of the Income Tax Regulations provide that a deduction is allowed for a contribution of a partial interest in property if such interest is the taxpayer's entire interest in the property, such as an income interest or a remainder interest. If, however, the property in which such partial interest exists was divided in order to create such interest and thus avoid sections 170(f)(2) and (f)(3)(A), the deduction is not allowed.

Section 1.170A-1(c)(1) provides that, if a charitable contribution is made in property other than money, the amount of the contribution is generally the fair market value of the property at the time of the contribution.

Section 1.170A-1(e) provides that if as of the date of the gift a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.

Section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511(a) provides that the tax imposed by section 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 25.2511-2(c) of the Gift Tax Regulations provides, in part, that a gift is incomplete if and to the extent a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. Thus, a gift would be incomplete to the extent the donor retains the power to designate the beneficiaries of the gift, even if the power retained is limited to designating charitable beneficiaries. See e.g., Rev. Rul. 77-275, 1977-2 C.B. 346.

Section 25.2511-2(f) provides, in part, 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 which completes the gift and causes the tax to apply.

Section 2522(a)(2) provides that, in computing taxable gifts for the calendar year, there shall be allowed as a deduction the amount of all gifts made during such year to or for the use of a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 2522(c)(2) provides that where a donor transfers an interest in property (other than an interest described in section 170(f)(3)(B)) to a person, or for a use, described in section 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 section 2522(a) or (b), no deduction shall be allowed under this section for the interest which is, or has been, transferred 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 section 664) or a pooled income fund (described in section 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).

Situation 1 of Rev. Rul. 86-60, 1986-1 C.B. 302, considers whether a transfer to charity by the grantor, A, of a charitable remainder annuity trust of A's entire retained annuity interest qualifies for the gift tax charitable deduction. Following the transfer, A did not retain any interest in the trust, and neither at that time nor at any prior time did A

make a transfer from the trust for private purposes. Although the transfer of the remainder interest to charity divided A's prior interest, that transfer was for charitable, not private purposes. Consequently, A's transfer of the annuity interest to charity was not required to be in a form described in sections 2522(c)(2)(B) and 25.2522(c)-3(c)(2) in order to qualify for the charitable deduction. Accordingly, A's transfer of A's annuity interest to charity qualifies for a deduction under section 2522(a). Further, A's transfer qualifies for an income tax charitable deduction under section 170 because although A had previously divided the interest A held in the property, the division was not to avoid section 170(f)(2)(A). Thus, under section 1.170A-7(a)(2)(i), A's transfer of A's entire life annuity interest qualifies for an income tax deduction under section 170.

Situation 2 of Rev. Rul. 86-60, 1986-1 C.B. 302, considers whether a transfer to charity by a secondary life annuitant, B, of a charitable remainder annuity trust of B's entire contingent life annuity interest in the trust qualifies for the gift tax charitable deduction. Following the transfer, B did not retain any interest in the trust, and at no time had B made a transfer of an interest in the trust for a private purposes. Consequently, there is no requirement that the transfer to charity be in a form described in section 25.2522(c)-3(c)(2), and B's transfer of B's annuity interest to charity qualifies for a deduction under section 2522(a). Further, B's transfer qualifies for an income tax charitable deduction under section 170. The secondary life annuity interest was the only interest in the trust that B owned at the time of the transfer. Therefore, under section 1.170A-7(a)(2)(i), B's transfer of B's entire secondary life annuity interest qualifies for an income tax deduction under section 170.

In the instant case, on Date 1, Husband established Trust, a charitable remainder unitrust. Husband is the beneficiary of the first life unitrust interest and Wife is the beneficiary of the second life unitrust interest. Because Husband, Wife, Son 1, Son 2, and Daughter retained the right to designate the charitable remainder beneficiary or beneficiaries of Trust, Husband did not make a completed gift to charity of the remainder interest, for gift tax purposes, at the time Trust was created.

Under the proposed transaction, Wife, Son 1, Son 2, and Daughter will each irrevocably release their contingent right to designate one or more charitable organizations as the remainder beneficiary or beneficiaries of Trust. Wife will renounce her unitrust interest in Trust and as in Situation 2 of Rev. Rul. 86-60, Wife's transfer will qualify for the gift tax charitable deduction under section 2522(a).

Subsequently, Husband will renounce his unitrust interest in Trust. Under State law, the remainder interest in Trust will accelerate and will become payable outright to the remainder beneficiary or beneficiaries. Then Husband will irrevocably designate a charity or charities as the remainder beneficiary or beneficiaries. When Husband designates the charitable remainder beneficiary or beneficiaries, Husband's gift will become complete for gift tax purposes, and the charity or charities designated will receive the entire interest in Trust outright. As in Situation 1 of Rev. Rul. 86-60,

Husband will donate his entire interest in Trust to charity and, following the transfer, Husband will not retain any interest in Trust. Accordingly, we rule that Husband will be entitled to a gift tax charitable deduction under section 2522(a) for the value for his unitrust interest and the remainder interest in Trust that passes to the charity or charities and Wife will be entitled to a gift tax charitable deduction under section 2522(a) for the value of her unitrust interest passing to charity. Further, we rule that Husband will be entitled to an income tax deduction under section 170 for the value of his unitrust interest and Wife will be entitled to an income tax deduction under section 170 for the value of her unitrust interest.

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

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.

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 an 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.

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.

Sincerely,

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Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes

cc: