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Date of Communication: Not Applicable

Person To Contact: \_\_\_\_\_, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B09  
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Date:  
October 21, 2005

Re: Letter Ruling Request

**LEGEND**

- Date 1 =
- Decedent =
- Trust =
- Date 2 =
- Son's Trust =
- Son =
- Charity 1 =
- Charity 2 =
- Charity 3 =
  
- Charity 4 =
- Nursing Home =
- Public High School =
- Charity 5 =

Dear \_\_\_\_\_ :

This is in response to your authorized representative's letter dated August 9, 2005, and prior correspondence, in which you request rulings regarding the reformation of a trust under § 2055(e)(3) of the Internal Revenue Code.

**FACTS**

The facts submitted and the representations made are summarized as follows: On Date 1, Decedent created Trust, a revocable trust. Decedent died on Date 2.

Article 5(f) of Trust provides that upon the death of Decedent and after paying the proper expenses or charges of Trust, the trustee shall distribute the income of Trust to the trustee of Son's Trust for the duration of Son's life (Son's Trust provides that the

trustee shall distribute so much of the income and/or principal of the trust to or for the benefit of Son as the trustee in her sole discretion determines is required for the health and welfare of Son). Article 5(g) of Trust provides that upon the death of Son, the trustee of Trust shall distribute the trust property, as follows:

1. The net proceeds of certain property described as Parcel A shall be distributed in fractional shares, as follows: one-fifth allocated to certain named private individuals; two-fifths allocated to Charity 1, and; two-fifths allocated to Charity 2.
2. The net proceeds of certain property described as Parcel B shall be distributed in fractional shares, as follows: one-fifth allocated to certain named private individuals; one-fifth allocated to Charity 3; one-fifth allocated to Charity 4 for the benefit of Nursing Home, and; two-fifths allocated to Charity 4 for the benefit Public High School.
3. The net proceeds of certain property described as Parcel C shall be distributed in fractional shares, as follows: one-fifth allocated to certain named private individuals; three-fifths allocated to Charity 5, and; one-fifth allocated to Charity 4 for the benefit of Public High School.
4. The balance of the trust assets shall be distributed to certain named private individuals.

It is represented that each of Charities 1 through 5 are organizations described in §§ 170(c) and 2055(a).

The personal representative of Decedent's estate and the trustee of Trust determined that the charitable remainder interests in Trust, as drafted, do not qualify for the estate tax charitable deduction provided under § 2055(a). In order to qualify Trust for the estate tax charitable deduction, on Date 3, a date prior to the due date of the Decedent's federal estate tax return (including extensions), the personal representative of Decedent's estate and the trustee of Trust commenced a judicial proceeding to reform Trust under the provisions of state law and § 2055(e)(3).

Under the proposed reformation, Trust is to be severed into two separate trusts, Charitable Trust and Non-Charitable Trust, effective as of the Decedent's date of death. One-fifth of Trust's interests in Parcels A, B, and C as well as one hundred percent of any other trust assets will be allocated to Non-Charitable Trust. Four-fifths of Trust's interests in Parcels A, B, and C will be allocated to Charitable Trust. These fractional interests are intended to correspond to the fractional remainder interests to be distributed to private individuals and the fractional remainder interests to be distributed to charitable beneficiaries under the original trust agreement of Trust.

Charitable Trust, as proposed, provides that each year until the death of Son, the trustee is to pay an annuity amount equal to five percent of the initial net fair market value of the trust assets valued as of Decedent's date of death. However, payment of the annuity amount shall be made each year from three separate accounts, with

Parcel A allocated to one account (“Account A”), Parcel B allocated to a second account (“Account B”), and Parcel C allocated to a third account (“Account C”). The portion of the annuity amount payable from each separate account each year shall be based on the initial net fair market value of each parcel. The annual portion payable from Account A is known as the Parcel A Annuity Amount, the annual portion payable from Account B is known as the Parcel B Annuity Amount, and the annual portion payable from Account C is known as the Parcel C Annuity Amount. The parcel annuity amounts are payable each year as follows:

1. From Account A, the trustee shall distribute eighty-four percent of the Parcel A Annuity Amount to Son, eight percent to Charity 1, and eight percent to Charity 2.
2. From Account B, the trustee shall distribute eighty-four percent of the Parcel Annuity Amount for Parcel B to Son, four percent to Charity 3, four percent to Charity 4 for the benefit of Nursing Home, and eight percent to Charity 4 for the benefit of Public High School.
3. From Account C, the trustee shall distribute eighty-four percent of the Parcel Annuity Amount for Parcel C to Son, twelve percent to Charity 5, and four percent to Charity 4 for the benefit of Public High School.

The parcel annuity amounts in the aggregate provide a total annual annuity amount equal to five percent of the initial net fair market value of the assets of Charitable Trust.

Charitable Trust further provides that upon the death of Son, if Parcels A, B, and C have not been previously sold, the trustee shall sell any remaining interests in such property and then distribute all remaining trust income and principal (other than any amount due Son or Son’s estate and the other designated annuity recipients) held in Account A, Account B, and Account C, including the net proceeds of any sale, to the remaindermen, as follows:

1. Fifty percent of the assets of Account A to Charity 1 and fifty percent to Charity 2.
2. Twenty-five percent of the assets of Account B to Charity 3, twenty-five percent to Charity 4 for the benefit of Nursing Home, and fifty percent to Charity 4 for the benefit of Public High School.
3. Seventy-five percent of the assets of Account C to Charity 5 and twenty-five percent to Charity 4 for the benefit of Public High School.

Charitable Trust contains language satisfying the requirements of § 1.664-1(a)(3) (regarding prohibition on restrictions on investments), § 1.664-1(a)(5) (regarding deferral of the annuity amount in the case of testamentary transfers), § 1.664-2(a)(1)(iv) (regarding payment of the annuity in a short taxable year), § 1.664-2(a)(6)(iv) (regarding the selection of alternative remaindermen), and § 1.664-2(b) (regarding prohibition of additional contributions). In addition, under the terms of the trust, the trustee is precluded from engaging in any act of self-dealing, failing to make distributions,

retaining any excess business holdings, or making any taxable expenditures, so as to subject the trust to any tax under §§ 4941, 4942, 4943, 4944, and 4945.

The terms of the proposed Non-Charitable Trust provide that each year until the death of Son, the trustee shall distribute the net income of all trust assets to the trustee of Son's Trust. Upon the death of Son, if Parcels A, B, and C have not been previously sold, the trustee shall sell any remaining interests in such property and then distribute all remaining trust income and principal (including the net proceeds from any sale) to the same named private individual beneficiaries as provided in the terms of Trust.

It is represented that the proposed reformation of Trust will be effective as of Decedent's date of death.

You have requested the following rulings:

1. The charitable interest under Trust is a reformable interest under § 2055(e)(3)(C).
2. The proposed reformation of Trust will result in a qualified reformation under § 2055(e)(3)(B).
3. A federal estate tax charitable deduction under § 2055(a) will be allowed for the present value of the remainder interest of Charitable Trust, as proposed.
4. The annuity interest payable to charity under the terms of Charitable Trust, as proposed, will constitute a guaranteed annuity within the meaning of § 2055(e)(2)(B) and a federal estate tax charitable deduction under § 2055(a) will be allowed for the present value of this interest.
5. Charitable Trust, as proposed, meets the requirements of a charitable remainder annuity trust ("CRAT") under § 664 and will be deemed effective as of the date of death of Decedent for income tax purposes.

## LAW & ANALYSIS

Section 664(d)(1) provides that a CRAT is a trust:— (A) from which a sum certain (which is not less than 5 percent nor more than 50 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 § 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 subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (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 subparagraph (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 or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an

employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g)), and (D) the value (determined under § 7520) of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in the trust.

Section 2055(a) provides that, for purposes of the federal estate tax, 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.

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 the decedent to a person, or for a use, described in § 2055(a), and an interest (other than an interest which 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 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 2055(e)(3)(A) provides, in general, that a deduction shall be allowed under § 2055(a) in respect of any qualified reformation.

Section 2055(e)(3)(B) provides that the term "qualified reformation" means 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 (iii) such change is effective as of the date of the decedent's death.

Section 2055(e)(3)(C)(i) provides that the term "reformable interest" means 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 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, however, that § 2055(e)(3)(C)(ii) shall not apply to any interest if a judicial proceeding is commenced to change such interest into a qualified interest not later than the 90th day after-- (I) if an estate tax return is required to be filed, the last date (including extensions) for filing such return, or (II) if no estate tax return is required to be filed, the last date (including extensions) for filing the income tax return for the first taxable year for which such a return is required to be filed by the trust.

Section 2055(e)(3)(D) provides that the term "qualified interest" means an interest for which a deduction is allowable under § 2055(a).

Section 2055(e)(3)(E) provides that the deduction referred to in § 2055(e)(3)(A) shall not exceed the amount of the deduction which would have been allowable for the reformable interest but for § 2055(e)(2).

Section 20.2055-2(e)(1)(i) provides, in pertinent part, that where an interest in property passes or has passed from the decedent for charitable purposes and an interest (other than an interest that is extinguished upon the decedent's death) in the same property passes or has passed from the decedent for private purposes (for less than an adequate and full consideration in money or money's worth), no deduction is allowable under § 2055 for the value of the interest that passes or has passed for charitable purposes unless the interest in property is a deductible interest described in § 20.2055-2(e)(2).

Section 20.2055-2(e)(2)(v) provides, in part, that a deductible interest is a charitable interest in property where the charitable interest is a CRAT as defined in § 664(d)(1) and § 1.664-2.

Section 20.2055-2(e)(2)(vi)(a) provides, in part, that a deductible interest is a charitable interest in property where the charitable interest is a guaranteed annuity interest. 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, each of whom must be living at the date of death of the decedent and can be ascertained at such date. An amount is determinable if the exact amount which must be paid under the conditions specified in the instrument of transfer can be ascertained as of the appropriate valuation date.

In this case, under the terms of Trust, an interest in the trust will pass for both charitable and non-charitable purposes. Although the charitable interest is in the form of a remainder interest, the provisions of Trust, as drafted, do not meet the requirements of § 664 for a charitable remainder trust or § 642(c) for a pooled income fund. Therefore,

the present value of the charitable interest passing in Trust, as drafted, does not qualify for the estate tax charitable deduction under § 2055(e)(2).

With respect to whether the interest passing to Charities 1 through 5 under the terms of Trust is a “reformable interest” within the meaning of § 2055(e)(3)(C), we conclude that the value of the charitable interest at the date of Decedent's death was ascertainable and, hence, severable from the non-charitable interest. Thus, prior to the enactment of § 2055(e)(2), such an interest would have been deductible under § 2055(a). See § 20.2055-2(a) of the Estate Tax Regulations. Although the payments to Son's Trust were not expressed in specified dollar amounts or a fixed percentage of the fair market value of the property as required by § 2055(e)(3)(C)(ii), a judicial proceeding was commenced, as provided under § 2055(e)(3)(C)(iii), before the 90<sup>th</sup> day after the last date (including extensions) for filing Decedent's estate tax return. Accordingly, we conclude that the interest passing to Charities 1 through 5 under the terms of Trust is a “reformable interest” within the meaning of § 2055(e)(3)(C).

With respect to whether the reformation will be a qualified reformation, we have determined that the difference between the actuarial value (determined as of the date of decedent's death) of the qualified interest and 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. Furthermore, the nonremainder interest will terminate at the same time both before and after the reformation and the reformation will be effective as of the date of Decedent's death. Accordingly, we conclude that the proposed reformation of Trust, as described above, will be a qualified reformation within the meaning of § 2055(e)(3)(B).

Assuming the requirement of § 664(d)(1)(D) is satisfied, Charitable Trust, as reformed, will meet the requirements of a CRAT under § 664(d)(1) and will be deemed effective as of the date of Decedent's death. Accordingly, a charitable deduction will be allowed under § 2055(a) for the present value of the remainder interest in Charitable Trust, determined in accordance with § 20.2055-2(f)(2)(i).

With respect to the portion of the annuity amount that is to be paid annually to Charities 1 through 5 under the terms of Charitable Trust, we have determined that the amount payable will constitute a guaranteed annuity within the meaning of § 2055(e)(2)(B) and § 20.2055-2(e)(2)(vi). See also § 1.170A-6(c) and section 6.02 of Rev. Proc. 2003-57, 2003-2 C.B. 257. Accordingly, we conclude that a charitable deduction will be allowed under § 2055(a) for the present value of the interest, determined in accordance with § 20.2055-2(f)(2)(iv).

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.

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.

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.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Melissa C. Liquerman  
Chief, Branch 9  
Office of Chief Counsel  
(Passthroughs & Special Industries)

Enclosures

Copy for 6110 purposes