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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:4 - PLR-109729-99
Date:

December 13, 1999

Re:

LEGEND:

Husband =

Wife =

B =

C =

D =

E =

F =

G =

X =

State =

Dear _____ :

This is in response to your letter dated May 12, 1999, requesting a ruling concerning the estate, gift and income tax consequences of the creation and funding of a proposed charitable lead annuity trust (Trust) under §§ 170, 671, 675, 2035, and 2522 of the Internal Revenue Code.

The facts and representations submitted are summarized as follows: Husband and Wife propose to create Trust, an irrevocable trust, intended to qualify as a charitable lead annuity trust described in § 2522(c)(2)(B). The trustees of Trust are D and G ("Trustees"). Husband and Wife will transfer marketable securities to Trust upon its creation.

Under the terms of Trust, an annuity amount equal to eight percent of the initial fair market value of the trust assets is payable to X during each taxable year of Trust. Thirteen percent of the amount to be paid to X is to be added to the D and E Family Philanthropic Fund, a component part of X that is a donor advised fund with respect to D and E. X is exempt from federal income taxation under § 501(c)(3).

In the event that any of X and/or the D and E Family Philanthropic Fund is not an organization described in §§ 170(b), 170(c), 2522(a) and 2055(a) at the time any portion of the annuity amount is paid to it, the trustees are to distribute such portion to one or more organizations then described in §§ 170(b), 170(c), 2522(a) and 2055(a) as the trustees select.

In the event that D or G ceases to act as a trustee, E is appointed to succeed either of D or G. In the event any two of such persons fails or ceases to act in such capacity, the remaining trustee may act alone. Neither Husband nor Wife may serve as trustee.

Trust will continue for a period of 15 years from the date of execution of the trust agreement. Upon termination of Trust, fifty percent of the remaining trust property is to be distributed to E, or her estate if she is not then living, and the other fifty percent of the remaining trust property is to be distributed to the trustee of the F Irrevocable Trust Agreement dated October 6, 1998.

The Trust agreement contains the following relevant provisions:

Paragraph 3.1 provides that during the term of Trust, no amount may be paid by the trustee to a private person.

Paragraph 3.2 provides that the annuity amount is to be paid in annual installments at the end of each taxable year.

Paragraph 3.3 provides that the annuity amount is prorated for short taxable years.

Paragraph 3.4 provides that if the initial fair market value of the Trust assets is incorrectly determined by the trustee, then within a reasonable time after the final determination of the correct value, the trustee is to pay the annuity beneficiaries (in the case of an undervaluation) or shall receive from the annuity beneficiaries (in the case of an overvaluation) an amount equal to the difference between the annuity amount properly payable and the annuity amount actually paid.

Paragraph 3.5 provides that no additional contributions may be made to Trust after the initial contribution.

Paragraph 5.4 provides that a "disinterested party" to be designated will have the power, exercisable solely in a non-fiduciary capacity, to acquire or reacquire trust property by substituting therefor other property having a value equivalent to the acquired or reacquired property. Exercise of the power is to be evidenced by a written instrument delivered to the trustee and is to include the certification of the disinterested party that the substituted property is of equivalent value to the property for which it is substituted. The "disinterested party" designated is B. In the event that B fails or ceases to serve in such capacity, C is designated as a successor disinterested party.

Paragraph 5.5 provides that the trustee is prohibited from engaging in any act of self-dealing as defined in § 4941(d), from retaining any excess business holdings as defined in § 4943(c) which would subject the Trust to tax under § 4943, from acquiring or retaining any assets which would subject the trust to tax under § 4944 of the Code if the trustees had acquired such assets, and from making any taxable expenditures as defined in § 4945(d). The trustee is to make distributions at such time and in such manner as not to subject the trust to tax under § 4942.

Paragraph 5.13 provides that no death taxes of any character (including interest and penalties) imposed with respect to the trust shall be payable from the trust. The trustor imposes an obligation upon the estate of the trustor to pay any death taxes from sources other than the trust. This requirement may be enforced by the trustee or any one or more of the organizations receiving all or any portion of the annuity payments.

Paragraph 5.14 provides that the Trust is irrevocable and the trustor shall have no power to modify, amend or revoke the Trust. However, the trustee has power to amend Trust for the sole purpose of complying with the requirements of §§ 170(f)(2)(B), 2055(e)(2)(B) and 2522 and the regulations thereunder.

Paragraph 5.15 provides that all questions of law arising under Trust are to be determined under and according to State law.

It is submitted that Wife is currently a member of the Board of Directors of X. However, the board on which Wife sits has no authority to perform the grant making function of X. This function is performed by another organization.

The following rulings are requested.

1. The funding of Trust will be a completed gift for federal gift tax purposes.
2. The annuity payable under Husband and Wife's proposed Trust will qualify as a guaranteed annuity under § 2522(c)(2)(B).
3. The present value of the annuity payments from Trust will be a charitable deduction with respect to Husband and Wife for federal gift tax purposes.
4. No portion of Trust will be includible in Husband and/or Wife's gross estates for federal estate tax purposes.
5. The present value of the annuity payments from the trust is a charitable contribution within the meaning of § 170(c) of the Internal Revenue Code.
6. The unused portion, if any, of the charitable contribution deduction for the year the trust is funded may be carried forward by the Trustors.
7. Trust will be treated as a grantor trust for income tax purposes.

Issues 1, 2 and 3:

Section 2501 imposes a tax on the transfer of property by gift by any individual. Section 25.2511-1(a) of the Gift Tax Regulations provides that the gift tax applies to every kind of transfer by way of gift, whether direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(a) provides that the gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee at the time of the transfer. The tax is a primary and personal liability of the donor, is measured by the value of the property passing from the donor, and attaches at the time the property passes, regardless of the fact that the identity of the donee may not then be known or ascertainable.

Under § 25.2511-2(b), a gift is complete and subject to the gift tax when the donor has so parted with dominion and control over the property transferred as to leave in the donor no power to change its disposition, whether for the donor's own benefit or for the benefit of another.

Section 25.2511-2(c) provides that a gift is incomplete to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries.

Under § 25.2511-2(e), a donor is considered to have a power if it is exercisable by the donor in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property, such as a trustee.

Section 2522(a) provides that, in computing taxable gifts each year, there is allowed a deduction for: 1) all gifts to or for the use of federal or other government entities for exclusively public purposes; 2) all gifts to or for the use of a corporation or trust operated exclusively for religious, charitable, scientific, literary, or educational purposes; or 3) certain transfers to fraternal or veterans organizations.

Section 2522(c)(2)(B) provides that, where a transfer is made to both a charitable and a noncharitable person or entity, no deduction shall be allowed for the charitable portion of the gift, in the case of any interest other than a remainder trust, unless the interest is in the form of a guaranteed annuity or is a fixed percentage distributed annually of the fair market value of the property determined on an annual basis.

Section 25.2522(c)-3(c)(2)(vi)(a) provides that the term "guaranteed annuity interest" 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 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 date of the gift.

Section 25.2522(c)-3(c)(2)(vi)(e) contains a further requirement for a guaranteed annuity interest in trust, if the present value on the date of gift of all the income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all amounts in the trust. Under these circumstances, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument prohibits both the acquisition and the retention of assets which would give rise to a tax under § 4944 if trustees had acquired the assets.

Under § 25.2522(c)-3(d)(2), the amount of the deduction for a guaranteed annuity interest in trust is limited to the fair market value of the guaranteed annuity interest. The fair market value of an annuity is its present value. Under § 25.2522(c)-3(d)(2)(iv), the present value of a guaranteed annuity interest in trust is to be determined under § 25.2512-5T of the Temporary Gift Tax Regulations (with respect to transfers after April 30, 1999.)

In the present case, for purposes of § 25.2511-2(b), Husband and Wife will retain no power over the property they contribute to Trust. Husband and Wife retain no interest or reversion in Trust and no right to alter, amend, or revoke Trust.

Neither Husband nor Wife can serve as trustee of Trust. In addition, neither Husband nor Wife holds a general power of appointment over the property of Trust. Further, although Wife is a member of the Board of Directors of X, this board has no authority to perform the grant making function of X. This grant making function is performed by another entity. Accordingly, we conclude that, the funding of Trust will result in a completed gift for federal gift tax purposes under §§ 2501 and 2511.

The annuity payable under the proposed terms of 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, based on the facts submitted and the representations made, the charitable interest in Trust will qualify as a guaranteed annuity interest. The funding of Trust will result in a completed gift for federal estate tax purposes under §§ 2501 and 2511. Husband and Wife will be entitled to gift tax charitable deductions under § 2522, based on the present value of the guaranteed annuity payable to charity determined in accordance with § 25.2522-3(d)(1)(iv).

Issue 4:

Section 2033 provides that for the inclusion in the gross estate of any property in which the decedent had an interest at the time of his death.

Section 2035(a) provides that if the decedent transferred property, or relinquished a power with respect to property within three years of death, and the value of the property would have been included in the gross estate under §§ 2036, 2037, 2038, or 2042 if the decedent had retained the property or the power, then the property transferred or subject to the power is includible in the gross estate. Other transfers made within three years of death are not includible in the gross estate. Sections 2036, 2037, and 2038 provide for the inclusion in the gross estate of property of which the decedent has made a transfer and in which the decedent has either retained an interest in the property or a power over the property. Section 2042 provides for the inclusion in the gross estate of the proceeds of life insurance over which the decedent has retained any incidents of ownership.

In the present case, Husband and Wife propose to create a charitable lead annuity trust. A fixed amount will be distributed annually from Trust to a qualified charitable organization during the "trust term." Thereafter, the corpus and remaining income will be divided among Husband and Wife's daughter, E, and an irrevocable trust for the benefit of Husband and Wife's daughter, F. Husband and Wife retain no interest

of reversion in Trust and no right to alter, amend, or revoke Trust. Neither Husband nor Wife can serve as trustee of Trust. In addition, neither Husband nor Wife holds a general power of appointment over the property in Trust, as described in § 2041.

Accordingly, based on the facts submitted and the representations made, no portion of the principal of Trust will be includible in either Husband or Wife's gross estate for federal estate tax purposes under §§ 2035, 2036, 2037, 2038 or § 2041 at the time of Husband's death and Wife's death.

Issue 5:

Section 170(a)(1) of the Code provides that there is allowed as a deduction any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year.

Section 170(c) defines a charitable contribution as a contribution or gift to or for the use of a qualified charity.

Section 170(f)(2)(B) of the Code 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 purposes of applying § 671.

Section 1.170A-1(c)(1) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in § 170(e)(1) and § 1.170A-4(a), or § 170(e)(3) and § 1.170A-4A(c).

Section 1.170A-6(c) of the regulations states that no deduction is allowed under § 170 for the fair market value of a charitable contribution of an income interest in property which is less than the donor's entire interest in property and which the donor transfers in trust unless the income interest is either a guaranteed annuity or a unitrust interest.

Section 1.170A-6(c)(2)(i)(A) of the regulations treats 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. This regulation provides that 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. An amount is determinable if the exact amount which

must be paid under the conditions specified in the governing instrument of the trust can be ascertained as of the date of transfer.

Section 1.170A-6(c)(3)(i) of the regulations provides that the deduction allowed by § 170(f)(2)(B) of the Code 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 § 20.2031-7T or, for certain prior periods, § 20.2031-7A.

With exceptions not relevant here, § 1.170A-6(c)(2)(i)(E) of the regulations provides, in general, 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 an amount in payment of the guaranteed annuity interest may be paid by the trust for a private purpose before the expiration of all the income interests for a charitable purpose. In the present case, paragraph 3.1 of the trust document provides that during the trust term, no amount may be paid by the trustee for a private purpose.

The governing instrument of a charitable lead annuity trust must meet certain requirements. § 1.170A-6(c). Under § 4947(a)(2) and § 508(e), with certain exceptions in § 4947(b)(3), the governing instrument of a charitable lead annuity trust must include provisions the effects of which are to prohibit the trust from engaging in any act of self-dealing (as defined in § 4941(d)), from retaining any excess business holdings (as defined in § 4943(c)), from making any investments in such manner as to subject the trust to tax under § 4944, and from making any taxable expenditures (as defined in § 4945(d)). Paragraph 5.5 of the trust document contains provisions that meet these requirements as to the governing instrument. Section 4947(b)(3)(A) and § 53.4947-2(b) provide, however, that § 4943 and § 4944 do not apply to a trust if (i) all the income interest (and none of the remainder interest) of the trust is devoted solely to a charitable purpose, and (ii) all amounts in such trust for which a deduction was allowed have an aggregate value not more than 60 percent of the aggregate fair market value of all amounts in such trust.

Section 1.170A-6(c)(2)(i)(D) provides that if the present value on the date of transfer of all the income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all amounts in the trust (after the payment of liabilities), the income interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and retention of assets which would give rise to a tax under § 4944 if the trustee had acquired such assets. In the present case, paragraph 5.5 of the trust document prohibits both the acquisition and retention of any assets which would give rise to a tax under § 4944 if the trustee had acquired such assets.

During the 15-year term of the trust, the trustee will in each taxable year of the trust pay an annuity amount equal to eight percent of the initial net fair market value of the trust assets to X. Of the annuity amount that is payable to X, a portion is to be added to the D and E Family Philanthropic Fund, a donor advised fund subject to the

terms and conditions of a letter agreement dated December 23, 1998. In the event that X is not an organization described in §§ 170(b)(1)(A), 170(c), 2522(a) and 2055(a) at the time any portion of an annuity amount is to be distributed to it, the trustee will distribute such portion to one or more organizations then described in §§ 170(b)(1)(A), 170(c), 2522(a) and 2055(a). In addition, the trust document provides that no payments will be made for a private purpose during the trust term. Therefore, a qualified charity will have an irrevocable right to receive the annuity amount. If Husband and Wife are considered the owners of Trust for purposes of § 671, (see Issue 7 below) then the trust will qualify as a charitable lead annuity trust for purposes of the income tax charitable contribution deduction under § 170(f)(2)(B).

Because the trust meets the requirements of § 1.170A-6(c) of the regulations, and if Husband and Wife are treated as the owners of Trust for purposes of § 671, the charitable interest is a guaranteed annuity interest for purposes of the income tax charitable contribution deduction under § 170(f)(2)(B). Husband and Wife will be entitled to an income tax charitable contribution deduction under § 170(f)(2)(B) of the Code for the fair market value, on the date of the contribution, of the guaranteed annuity interest, subject to any applicable limitations of § 170 including § 170(b) and § 170(e)(1) and subject to any applicable limitations under other sections of the Code.

Issue 6:

Section 1.170A-8(a)(2) of the regulations provides that for purposes of § 170, a contribution of an income interest in property, whether or not such contributed interest is transferred in trust, for which a deduction is allowed under § 170(f)(2)(B) or (3)(A) is considered as made "for the use of" rather than "to" the charitable organization.

Section 170(b)(1) limits the amount that an individual may deduct as charitable contributions for a taxable year to percentages of the individual's "contribution base." Section 170(b)(1)(B) provides limits for contributions for the use of charitable organizations, other than contributions of capital gain property. Section 170(b)(1)(D) provides limits for contributions of property that is capital gain property for the use of charitable organizations. Both § 170(b)(1)(B) and § 170(b)(1)(D) allow contributions that exceed the limitations to be carried over to each of the 5 succeeding taxable years in order of time.

Therefore, to the extent the amount of the contribution, for the year the trust is funded, exceeds the percentage limitations of § 170(b), the excess may be carried forward by Husband and Wife.

Ruling #7:

Section 671 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 the grantor is treated as the owner of any 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) provides that if the grantor is treated as an owner under § 675 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) provides the grantor shall be treated as the owner of any portion of a trust in 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. Section 675(4)(C) provides that a power to reacquire the trust corpus by substituting other property of an equivalent value is a power of administration.

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 interests 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 Trust's administration will determine whether the power of administration is exercisable in a fiduciary or a 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 Husband and Wife will be treated as the owner of Trust under § 675(4). Provided that the circumstances indicate that the power of administration is exercisable in a nonfiduciary capacity, Husband and Wife will be treated as the owner of Trust under § 675.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision 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,

Assistant Chief Counsel
(Passthroughs and Special
Industries)

By _____
George Masnik
Branch Chief
Branch 4

Enclosure
Copy of letter for section 6110 purposes