

Private Letter Ruling 9128051, 4/17/1991, IRC Sec(s). 2055

Date: April 17, 1991

CC:P&SI:Br.3 – TR-31-2593-90

Dear ***

This is in response to your letter of September 11, 1990, and prior correspondence, in which you requested a ruling, on behalf of Taxpayers, that the estate of the survivor of the Taxpayers will be entitled to a charitable deduction for assets passing to a charitable lead trust under section 2055(e)(2) of the Internal Revenue Code.

You represent that Taxpayers executed a trust agreement, Trust, containing a charitable lead annuity trust. Trust may be revoked by either of the Taxpayers until the death of the first to die of the Taxpayers. Upon the death of the surviving Taxpayer, the trustee shall add to the corpus of Trust any proceeds from insurance on the life of that Taxpayer which are payable to the trustee and any other amounts added to corpus by that Taxpayer's will or by any other means. The survivor of the Taxpayers has a testamentary power of appointment over all of the property then held in Trust. If Trust is not revoked and the power of appointment is not exercised with respect to all of the property, the remaining property of Trust as reduced by the debts of the second Taxpayer to die shall pass to the charitable lead annuity trust upon the death of the second Taxpayer to die. However, if any descendent of the Taxpayers is alive 30 days after the death of the second Taxpayer, the amount of property passing to the charitable lead annuity trust shall not exceed one-half of the gross estate of the second Taxpayer to die reduced by the debts of such Taxpayer.

If property passes to the charitable lead annuity trust, the trustee is directed to pay an annuity annually at the end of each taxable year for a term of 20 years to two named charitable organizations. As long as each of the named charitable organizations qualifies as an organization described in sections 170(b)(1)(A) and 2055(a) of the Code, it is entitled to receive one-half of each annual payment. Should one of the charitable recipients become ineligible to receive a payment, the trustee is directed to designate a substitute qualifying charitable organization. Upon expiration of the term of the charitable lead annuity trust, the trustee is directed to pay over the property then remaining in the charitable lead annuity trust to another trust exclusively for the benefit of noncharitable beneficiaries. If, however, there are no living lineal descendants of Taxpayers, the property remaining in the charitable lead annuity trust is to be paid in equal portions to the named charitable organizations or their substitutes.

Using values as finally determined for federal estate tax purposes for the estate of the survivor of the Taxpayers, the following formula will be used to determine the annual annuity amount paid by the charitable lead annuity trust:

1. The initial net fair market value of the assets that pass to the charitable lead annuity trust must be determined either with a date of death valuation or the alternative valuation date in accordance with section 2032(b) of the Code.

2. The trustee shall determine the appropriate interest rates available under section 7520 of the Code (or comparable provisions of any subsequent tax statute) at the date of death of the surviving Taxpayer.

3. The trustee shall determine the largest factor from among the available interest rates determined under step 2 for an annuity for a term of 20 years from the tables prescribed by the appropriate provisions of the applicable United States Treasury Regulations and publications issued by the Internal Revenue Service.

4. The trustee shall then divide the result of step 3 into 60, carrying the quotient to two decimal places.

5. The trustee shall then multiply the result of step 4 by the initial net fair market value of the assets that pass to the charitable lead annuity trust as finally determined for federal estate tax purposes in the estate of the survivor of the Taxpayers. This amount is the annual amount payable from the charitable lead annuity trust.

Section 2032(a) of the Code generally provides that an executor may elect to value property included in a decedent's gross estate as of the date six months after the decedent's death or if disposed of within six months of the decedent's death on the date of disposition. Section 2032(b) provides, in part, that if an election under section 2032(a) is made, for purposes of the charitable deduction under section 2055 or section 2106(a)(2), any bequest, legacy, devise, or transfer enumerated therein shall be valued as of the decedent's death with adjustment for any difference in value of the property as of the date six months after the decedent's death (or the date of the property's disposition if disposed of during the six month period after the decedent's death).

If the initial net fair market value of the assets constituting the charitable lead annuity trust is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the trustee shall pay to each recipient (in the case of an undervaluation) or shall receive from each recipient (in the case of an overvaluation) an amount equal to the difference between the amount properly payable to such recipient and the amount actually paid to that recipient.

Section 2055(a) of the Code 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, or transfers to or for the use of charitable organizations.

Section 2055(e)(2), in part, disallows the deduction under section 2055(a) where a lead interest in property passes to a charitable or other organization described in section 2055(a) and a remainder interest in the same property passes to a noncharitable beneficiary, unless the former interest is in the form of a guaranteed annuity or is a fixed percentage of the fair market value of the property determined on a yearly basis and this percentage is distributed annually.

Section 20.2055-2(e)(vi) of the Estate Tax Regulations sets forth the requirements for a "guaranteed annuity interest". A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less 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 death of the decedent and can be ascertained at that 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. Section 20.2055-2(e)(vi) provides, for example, that the amount to be paid may be expressed in terms of a fraction or a percentage of the net fair market value, as finally determined for federal estate tax purposes, of the residue of the estate on the appropriate valuation date.

Section 20.2055-2(e)(vi)(e) of the regulations provides that where a charitable interest in the form of a guaranteed annuity interest is in trust and the present value, on the appropriate valuation date, of all of the income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all amounts in such trust (after the payment of estate taxes and all other liabilities), the charitable 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 which would give rise to tax under section 4944 of the Code if the trustee had acquired such assets.

Section 7520 of the Code provides, in part, that the value of any annuity shall be determined under tables prescribed by the Secretary of the Treasury, and by using an interest rate (rounded to the nearest 2/10ths of one percent) equal to 120 percent of the federal midterm rate in effect for the applicable month. Section 7520 further provides that if an income, estate or gift tax charitable contribution is allowable for any part of the property transferred, the taxpayer may elect to use such federal midterm rate for either of the two months preceding the applicable month.

The applicable federal interest rate under section 7520 of the Code for determining the present value of an annuity, an interest for life, or a term of years, or a remainder or reversionary interest is published monthly in the Internal Revenue Bulletin. Once the interest rate has been determined, the annuity factor based on that interest rate and the term of the annuity can be determined. The annuity factors for determining the present worth of an annuity for a term certain are currently provided in Table B of Publication 1457. The annuity factor is in turn adjusted by another factor based on the frequency and time of payment of the annuity. The adjustment factors are currently published in Table K of Publication 1457.

We conclude that the use of the formula satisfies the requirement that a guaranteed annuity must be a determinable amount. In this case the annuity amount, although not expressly stated, is determinable as of the date of the decedent's death based on the formula contained in the instrument. Since the annuity amount is ascertainable as of the date of the decedent's death (or the alternative valuation date), under the terms of the instrument, we conclude that the instrument satisfies the "guaranteed annuity" requirement provided that debts, expenses, federal estate taxes, state death taxes, and any other liabilities of the estate will be paid from assets other than property passing to the charitable lead annuity trust. To the extent that property does, in fact, pass to the charitable lead annuity trust without being subject to the liabilities of the estate of either Taxpayer, the estate of the survivor of the Taxpayers will be entitled to an estate tax charitable deduction under section 2055 for the present value of the guaranteed annuity.

This ruling is based on the facts and applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect. If Taxpayers are in doubt whether there has been a change in material fact or law, a request for reconsideration of this ruling should be submitted to this office.

Except as specifically set forth above, no opinion is expressed as to the federal tax consequences of the above described facts under any other provision of the Code.

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

Sincerely yours,

Assistant Chief Counsel

(Passthroughs and

Special Industries)

By: William P. O'Shea

Chief, Branch 3

Enclosure

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