Private Letter Ruling 9631021, 8/02/1996, IRC Sec(s). 2055

Date: May 3, 1996

CC:DOM:P&SI:Br4/TR-31-1307-95

Re : ***

LEGEND:

Taxpayer = ***

State = ***

Bank = ***

Dear ***

This is in response to your letter of December 21, 1995, and previous correspondence requesting a ruling regarding the qualification of two charitable lead annuity trusts.

Taxpayer executed a Last Will and Testament on July 27, 1994. On April 25, 1996, Taxpayer executed a revised will.

Article I of the revised will authorizes the Taxpayer's personal representatives to pay Taxpayer's debts, funeral expenses and expenses of last illness. All estate, inheritance and death taxes (including interest and penalties) excluding any generation-skipping tax and including taxes and expenses payable with respect to assets that do not pass under the will, are to be paid out of the portion of the principal of the residuary estate that does not qualify as a charitable devise.

Under Article III of the revised will, Taxpayer bequeaths an amount equal to one-fourth of the residuary of Taxpayer's estate, without reduction for any taxes, fees or other expenses of administration, as a charitable bequest to the trustee named in Article VII. The bequest is to be held under the terms of one of two charitable lead annuity trusts (Annuity Trust I or Annuity Trust II) to be selected by Taxpayer's daughter within 9 months of Taxpayer's death, if she is living at the time of the Taxpayer's death. If the daughter is not living at the time of Taxpayer's death or she is incapacitated, mentally or physically, another individual is given the power to select the trust. In the event that the daughter's limited power of appointment is not exercised or the trust selected does not qualify for a charitable contribution deduction, then Taxpayer's personal representatives are to transfer the charitable bequest directly, to the charities named under Paragraph 6, section B.

The will provides that it is the Taxpayer's intention that the power holder named will choose the charitable lead trust that results in a charitable deduction for federal estate tax purposes with respect to the value of the payments of the annuity amount equal or as close as possible to the value of the trust estate based upon values as finally determined for federal estate tax purposes.

Under Article IV, with respect to Annuity Trust I the amount of the annuity payment and the term of the trust is to be determined by the following steps:

ANNUITY AMOUNT

1. The annuity amount is determined by multiplying the amount

that passes to Annuity Trust I under the terms of Taxpayer's will by

the applicable section 7520 rate plus one percent. The applicable

section 7520 rate is equal to the lowest of the interest rates under

section 7520 for the month in which the applicable valuation date

falls or either of the two months preceding the month in which the

applicable valuation date falls.

TERM OF ANNUITY

1. The Annuity Amount is multiplied by the appropriate

adjustment factor to reflect the quarterly, end of period frequency

of payments.

2. The amount that passes to Annuity Trust I is to be divided by

the amount determined under (1) above.

3. The two terms-of-years annuity factors between which falls

the result determined in (2) above are obtained from Table B of IRS

Publication 1457. Then, the result determined in (2) above is

interpolated between the two terms-of-years annuity factors, in order

to determine the additional number of whole months the Annuity Trust

I is to be in effect in order for the amount of the charitable

deduction to be equal (or nearly equal as possible) to the value of

the amount that passes to Annuity Trust I. The result obtained is the

term of Annuity Trust I.

With respect to Annuity Trust II, the amount of the annuity and the term of Annuity Trust II is determined in the same manner as Annuity Trust I except that the amount that

passes to the Annuity Trust II under the terms of Taxpayer's will is multiplied by the applicable section 7520 rate plus two percent to obtain the annuity amount.

Under the terms of both Annuity Trust I and II, the trustee is to pay the annuity amount at the end of each calendar quarter in specified percentages to five charitable organizations. If any named charity is not, at the time of payment, a charitable organization described in sections 170(b)(1)(A), 170(c), 2055(a) and 2522(a), then the Annuity Amount is to be paid to a charity that the trustee is to select.

Under the terms of both Annuity Trust I and II, at the end of the charitable term, the trustee is to divide the remaining net income, if any, and principal of the trust not required to be paid out in satisfaction of the final annuity amount payment, to the Taxpayer's then living descendants, per stirpes, or if none, to the charities named in the trust in the designated percentages.

Under Article IV, Paragraph (c)(5) the trustee of the Annuity Trust that is selected (I or II), is not permitted to acquire or retain any investments which would subject the trust to tax under section 4944.

Under Article VII, Taxpayer appoints Bank as the trustee of any trust created by her will. Under Article VII, paragraph (F), the Taxpayer's children, and after their death, Taxpayer's living competent descendants, have the right to remove the Bank as trustee and appoint a new bank or trust company as successor trustee, provided that the successor trustee is independent and neither related nor subordinate, within the meaning of section 672(c), to the Taxpayer's children, or upon their death or incapacity, their legally competent descendants.

The following rulings are requested.

1. Annuity Trust I and Annuity Trust II created under

Article IV of Taxpayer's will satisfy the requirements of

section 2055(e)(2)(B) and the regulations thereunder.

2. The limited power of appointment to select between

Annuity Trust I and Annuity Trust II will not prevent the trust

that is selected for funding from satisfying the requirements of

section 2055(e)(2)(B) and the regulations thereunder.

3. The power enumerated in Article VII, Section F of the

Taxpayer's will giving Taxpayer's children, and after their

death, Taxpayer's living competent descendants, the right to

remove the named trustee of the charitable lead trust and

appoint a new and independent trustee, will not prevent Annuity

Trust I or Annuity Trust II from qualifying under section 170(f)(2)(B) and 2055(e)(2)(B) and the regulations thereunder.

4. Upon Taxpayer's death, property passing under Article III, Section B of Taxpayer's will to Annuity Trust I or Annuity Trust II created under Article IV will qualify for the estate tax charitable deduction under section 2055(a).

5. Upon the trust's funding and operation in accordance with the provisions of Article IV of Taxpayer's will, for the purposes of calculating the trust's taxable income pursuant to section 641(b) in each taxable year of the trust, an income tax deduction will be allowed for the amount actually paid to the qualified charitable income beneficiaries in such year, pursuant to section 642(c)(1) or, if section 681 is applicable to the trust, in accordance with the provisions of section 512.

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2055(a) provides that for purposes of the tax imposed by section 2001, the value of the taxable estate is to 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, inter alia, any corporation 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 section 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in section 2055(a), and an interest in the same property passes or has passed (for less than an adequate consideration in money or money's worth) from the decedent to a person, or for a use, not described in section 2055(a), no deduction is allowed under section 2055 for the interest which passes or has passed to the person, or for the use, described in section 2055(a) unless, in the case of an interest other than a remainder interest, such interest is in the form of a guaranteed annuity or is a fixed percentage determined yearly of the fair market value of the property.

Section 20.2055-2(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 20.2055-2(b) provides that if, as of the date of the decedent's death, 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 20.2055-2(e)(2)(vi)(a) provides in part that the term “guaranteed annuity interest” means the 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 an individual or individuals, each of whom must be living at the date of death of the decedent and can be ascertained at such date. The amount to be paid may be expressed in terms of a fraction or a percentage of the net fair market value, as determined for Federal estate tax purposes, of the residue of the estate on the appropriate valuation date.

Under section 20.2055-2(e)(2)(vi)(e), 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 the interests for charitable purposes 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 a tax under section 4944 if the trustee had acquired such assets.

RULING #1. Article IV of the Taxpayer's will provides that the trustee is to determine the amount of the annual annuity payment with respect to Annuity Trust I and Annuity Trust II by multiplying the amount passing to each trust by the applicable section 7520 rate plus one percent (in the case of Annuity Trust I) or two percent (in the case of Annuity Trust II) percent, and then in the case of each trust, by the appropriate adjustment factor to reflect the quarterly frequency of payments. Thus, in each case the amount of the annual annuity payment will be a determinable amount, ascertainable as of the date of the Taxpayer's death.

Under Article IV, a formula is used to determine the specific term of years for which the annuity payments will be made with respect to Annuity Trust I and Annuity Trust II. The computation of the term is based in part on the initial net fair market value of assets passing to the trust as finally determined for federal estate tax purposes. Thus, the provision for determining the term of the trust is permissible because the term, although not expressly stated in the instrument, is determinable as of the date of death, or alternate valuation date, based on a formula or directive in the instrument. Thus, since the term of the trust is ascertainable as of the date of decedent's death (or alternate valuation date), under the terms of the instrument, we conclude that the instrument satisfies the “specified term” requirement of section 20.2055- 2(e)(2)(vi). Accordingly, each of the charitable lead annuity trusts created under Article IV of Taxpayer's will qualifies as a guaranteed annuity charitable under section 20.2055-2(e)(2)(vi).

RULING #2. Section 20.2055-2(a) provides that if a trust is created or property is transferred for both a charitable and a private purpose, an estate tax charitable deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable.

Under Article III, Section B, Paragraph 2 of Taxpayer's will, the Taxpayer's daughter is granted a limited power of appointment to select whether Annuity Trust I or Annuity

Trust II will be funded. In this case, the daughter's limited discretion to select between two charitable lead trusts, both of which satisfy the requirements of section 20.2055-2(e)(2)(vi), both of which will yield the same charitable deduction. We conclude, therefore, that the limited power of appointment to select the charitable lead trust to be funded will not prevent the property passing to the trust that is selected for funding from qualifying for an estate tax charitable deduction under section 2055(a). Compare, Estate of Marine v. Commissioner, 97 T.C. 368 (1991), aff'd, 990 F2d 136 (Fourth Cir. 1993).

RULING #3. Under Article VII, Section F of the Taxpayer's will, the Taxpayer's children, and after their death, Taxpayer's living competent descendants, are given the right to remove the named trustee of the charitable lead trust selected and appoint a new and trustee. However, the trustee appointed must be independent and not related or subordinate (within the meaning of section 672(c)). This power will not result in the Taxpayer's children, living competent descendants, or the trustee having any power to alter the terms of either Annuity Trust I or Annuity Trust II, since the trustee of the charitable lead trust has no discretion in determining the annuity amount that is to be paid to charity and no ability to distribute funds from the trust to the noncharitable beneficiaries prior to the expiration of the charitable term. Thus, the existence of the power does not affect our conclusion that the guaranteed annuity provided under both Annuity Trust I and Annuity Trust II is an arrangement wherein “a determinable amount is paid periodically, but not less often than annually, for a specified term.” Accordingly, we conclude that this power will not prevent either Annuity Trust I or Annuity Trust II from qualifying as a guaranteed annuity under section 2055(e)(2)(B) and the applicable regulations.

RULING #4. Based on the above, we conclude that upon Taxpayer's death, property passing under Article III, Section B of Taxpayer's will to one of the two charitable lead annuity trusts created under Article IV of Taxpayer's will, will qualify for an estate tax charitable deduction under section 2055(a).

RULING #5. Under the terms of Annuity Trust I and Annuity Trust II, the annuity amount is to be paid at the end of each calendar quarter to five charitable organizations in specified percentages. If any named charitable organization is not an organization described in section 170(c) at the time of payment, then the annuity amount payable to such organization is to be paid to one or more organizations selected by the trustee which is, at the time of payment, an organization described in section 170(c). Therefore, upon the Trust's funding and operation in accordance with the provisions of Article IV of Taxpayer's will, for purposes of calculating the trust's taxable income pursuant to section 641(b), in each taxable year of the trust, an income tax deduction will be allowed for the amount actually paid to the qualified charitable income beneficiaries in such year, pursuant to section 642(c)(1) or if section 681 is applicable to the trust, in accordance with the terms of section 512.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provisions of the Code.

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 the ruling take effect, the ruling will have no force or effect. If the taxpayer is 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.

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: George Masnik

Chief, Branch 4

Enclosure

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