**INTERNAL REVENUE SERVICE**
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

February 25, 2002

Number: **200224006**
Release Date: 6/14/2002
Index (UIL) No.: 2055.12-10
CASE MIS No.: TAM-134474-01/CC:PSI:B9

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Date of Death:
Date of Conference:

LEGEND:

| | |
|---|---|
| Decedent | = |
| Trust | = |
| Charitable Trust | = |
| Trustees | = |
| Executors | = |
| Sister 1 | = |
| Sister 2 | = |
| Spouses | = |
| Date 1 | = |
| Date 2 | = |
| Date 3 | = |
| Date 4 | = |
| $a | = |
| $b | = |
| $c | = |
| $d | = |
| $e | = |

State =

Court =

ISSUE(S):

1. Can the Trust created by Decedent's will, which does not meet the requirements of § 2055(e)(2) of the Internal Revenue Code, be the subject of a qualified reformation under § 2055(e)(3)?
2. For purposes of § 2055(e)(3)(B), will the actuarial value of the qualified interests vary from the actuarial value of the reformable interests by more than 5% of the value of the reformable interests, where the sum of the actuarial values of the income and remainder interests to charity before reformation do not vary from the sum of the interests after reformation by more than 5%, but the income interests and the remainder interests taken alone will vary by more than 5%?
3. Was the information sent to the examiner by the attorney on examination "filed subsequently as supplemental information to the return" in compliance with § 20.7520-2(a)(4) of the Estate Tax Regulations, since it was sent to the examiner, rather than the appropriate service center, upon request of the examiner?

CONCLUSION:

1. The Trust created by Decedent's will, as construed by court order, meets the requirements to be the subject of a qualified reformation under § 2055(e)(3).
2. For purposes of § 2055(e)(3)(b), the actuarial value of the qualified interests do not vary from the actuarial value of the reformable interests by more than 5% of the value of the reformable interests, where the sum of the actuarial values of the income and remainder interests to charity before reformation do not vary from the sum of the interests after reformation by more than 5%, even if the income interest and the remainder interest taken alone will vary by more than 5%.
3. When the examiner instructed that the information required by § 20.7520-2(a)(4) be sent to the examiner, and the information was sent where directed by examiner, taxpayer was in compliance with § 20.7520-2(a)(4).

FACTS:

Decedent died testate on Date 1. The Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, filed for his estate was received by the Internal Revenue Service on Date 2, prior to its due date. The return reported that Decedent's estate had a total value of $a, and included a charitable deduction of $b. Schedule O, Charitable, Public, and Similar Gifts and Bequests, was not filed with the return. On Date 3, still prior to the due date of the return, and in response to a letter from the Internal Revenue Service Center, the estate filed Schedule O. The Schedule O reported $b as a single item for "Trust 1 then Trust 2." Nothing in the return indicated

the taxpayer identification numbers of the beneficiaries or computations of the deduction. Upon examination, the examiner called the tax return preparer and requested that the tax return preparer send the missing information to the examiner. The missing information was sent to the examiner as requested.

The corpus of the Trust will be $c. Under the terms of the Trust, the annual payout to the non-charitable beneficiaries would be $d. The Trust established under the terms of the will does not qualify as a charitable remainder annuity trust under § 664(d)(1) because, among other reasons, the annuity amount is less than 5% of the initial fair market value of the trust assets.

Article Tenth, Section A of the will provides that all residue of Decedent's estate is to be placed in the Trust under the following conditions:

> I hereby direct my Trustees to pay from the income only from this Trust the following:
> (a) To Sister 1, the sum of $e per month;
> (b) To Sister 2, the sum of $e per month.
>
> If either of my sisters, above named, predecease me and she has a spouse surviving, or at the death of my sisters if either spouse survives, then that share of income shall go to the sister's spouse. If either of my sisters, above named, predecease me with no surviving spouse or upon the death of their spouses in the event the sister predeceases her spouse, then all of the income directed to each of my sisters shall pass to the Charitable Trust.

Article Tenth, Section C, Subsection 8, provides that Trustees are empowered to make payments under the Trust either from the income or corpus of the Trust.

Article Tenth, Section D, provides that upon the death of all of the designated beneficiaries under the Trust, the Trustees shall distribute all of the principal and income of the Trust to the Charitable Trust. If the Charitable Trust does not qualify as a § 501(c)(3) organization under the Internal Revenue Code, then the Trustees shall distribute such principal or income to one or more organizations as described and qualified under § 501(c)(3).

Due to the apparent conflict between Article Tenth, Section A, which provides that annuity payments to the sisters and their spouses are to be made from income only, and Article Tenth, Section C, Subsection 8, which provides that payments under the Trust may be made from income or corpus, Executors filed a Petition for Construction of Will with Court. On Date 5, Court entered an order construing the will. The order held that under State law the controlling provision was Article Tenth, Section C, Subsection 8. Therefore, under the court order, Trustees are directed to pay the annuity amounts of $e per month from either income or corpus of Trust as the Trustees may find necessary.

The Executor proposes to reform the Trust pursuant to § 2055(e)(3) to qualify as a charitable remainder annuity trust under § 664(d)(1). Under the proposed reformation, in each taxable year Trust will pay an annuity equal to 5% of the initial net fair market value of the assets constituting the Trust, to be paid in equal monthly installments. Such payments are to be made from income, and to the extent such income is insufficient, from principal. From this monthly annuity amount, Sister 1 and Sister 2 will each receive $e per month, for life. Upon the death of Sister 1 or Sister 2, her spouse, if living, shall receive $e per month for the duration of his life. The balance of the monthly annuity will be paid to Charitable Trust until final termination of Trust. The Trust will terminate upon the last to die of Sister 1, Sister 2, and their Spouses. Upon termination, Trustees shall distribute all remaining principal and accumulated income to Charitable Trust, if it is a qualified organization at that time.

LAW AND ANALYSIS:

ISSUE 1

Section 2055(a) provides, in part, that 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 decedent to a person, or for a use, described in § 2055(a) and an interest (other than an interest that 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 that a deduction will be allowed under § 2055(a) for any qualified reformation of a trust to meet the requirements of § 2055(e)(2).

Section 2055(e)(3)(B) provides that a qualified reformation is a change of a governing instrument by reformation, amendment, construction, or otherwise that changes a reformable interest into a qualified interest if the requirements of that section are met.

Section 2055(e)(3)(C)(i) defines the term "reformable interest" to mean 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 generally 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 that § 2055(e)(3)(C)(ii) shall not apply to any interest if a judicial proceeding is commenced to change the interest into a qualified interest not later the 90th day after–

(1) if an estate tax return is required to be filed, the last date (including extensions) for filing such return, or

(2) if no estate tax return is required to be filed, the last date (including extensions) for filing the income tax return for the 1st taxable year for which such a return is required to be filed by the trust.

Section 2055(e)(3)(D) defines the term "qualified interest" to mean an interest for which a deduction is allowable under § 2055(a).

In this case, the Trust established under the terms of the will failed to qualify as a charitable remainder annuity trust under § 664 for a variety of reasons, including there was no provision for a fixed payment at least equal to 5% of the initial fair market value of the trust assets to be paid annually; there was no provision requiring the annuity amount to begin as of the date of Decedent’s death; and there was no provision requiring the secondary life beneficiaries to pay any estate taxes that the trust may be required to pay in order to receive their interests. A deduction would have been allowable under § 2055(a) for the present values of the annuity and remainder interests passing to charity, but for the requirements of § 2055(e)(2).

A judicial proceeding to reform the Trust was not commenced within 90 days after the federal estate tax return was required to be filed. Therefore, in order for the Trust to have a reformable interest under § 2055(e)(3)(C)(ii), all payments to noncharitable persons must be expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property. Under Article Tenth, Section A of the Will the monthly payments to the Sisters and their Spouses are expressed in specified dollar amounts but these amounts may be paid only from income. The income limitation provision is in apparent conflict with Article Tenth, Section C(8), which permits the Trustees to make payments from income or corpus.

On Date 4, Court entered an order construing the will and holding that under State law, the controlling provision was Article Tenth, Section C, Subsection 8. Under Court’s order, Trustees are required to pay the annuity amounts to the Sisters and

their Spouses from either income or corpus of Trust as the Trustees may find necessary. Because, according to the Court's construction of the terms of the will, Trustees are required to make monthly payments of $e to each Sister, from either income or corpus as required, the payments to the noncharitable beneficiaries are expressed in specified dollar amounts. Therefore, we conclude that the Trust meets the requirements of § 2055(e)(3)(C)(ii) to have a reformable interest and may be subject to a qualified reformation.

ISSUE 2

Section 2055(e)(3)(B) defines the term "qualified reformation" to mean 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% 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) the change is effective as of the date of the decedent's death.

In determining the actuarial value of the qualified interests and the reformable interests for purposes of § 2055(e)(3)(B), the present values of the annuity and the remainder interests are aggregated. Therefore, the actuarial value of the qualified interests will not vary from the actuarial value of the reformable interests by more than 5% of the value of the reformable interests, where the sum of the actuarial values of the annuity and remainder interests to charity before reformation do not vary from the sum of the interests after reformation by more than 5%, even if the annuity interest and the remainder interest taken alone will vary by more than 5%.

ISSUE 3

Under 20.7520-2(a)(4), the following information must be attached to the estate tax return (or be filed subsequently as supplemental information to the return) if the estate claims a charitable deduction for the present value of a temporary or remainder interest in property–

(i) A complete description of the interest that is transferred, including a copy of the instrument of transfer;
(ii) The valuation date of the transfer;
(iii) The names and identification numbers of the beneficiaries of the transferred interest;
(iv) The names and birthdates of any measuring lives, a description of any relevant terminal illness condition of any measuring life, and (if applicable) an explanation of how any terminal illness condition was

taken into account in valuing the interest; and
(v) A computation of the deduction showing the applicable § 7520 interest rate that is used to value the transferred interest.

Under § 20.7520-2(a)(5), the place of filing the information required under § 20.7520-2(a)(4) is controlled by § 6091 and the regulations thereunder.

Under § 6091, estate tax returns shall be made to the Secretary–
(i) in the internal revenue district in which was the domicile of the decedent at the time of his death, or
(ii) at a service center serving the internal revenue district referred to in clause (i), as the Secretary may by regulations designate.

Under § 20.6091-1(a), if the decedent was domiciled in the United States at the time of his death, the estate tax return required by § 20.6018-1 shall be filed with:
(1) the service center serving the district in which the decedent was domiciled at the time of his death, if the instructions applicable to the estate tax return provide that the return shall be filed with a service center, or
(2) the district director (or any person assigned the administrative supervision of an area, zone, or local office constituting a permanent post of duty within the internal revenue district of such director) in which district the decedent was domiciled at the time of his death, if paragraph (1) does not apply.

When the examiner instructed that the information required by § 20.7520-2(a)(4) be sent to the examiner, and the information was sent where directed by examiner, taxpayer was in compliance with § 20.7520-2(a)(4).

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.