Internal Revenue Service

Number: **200251010**
Release Date: 12/20/2002
Index Number: 664.00-00, 4941.00-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:3-PLR-157798-01
Date:
September 12, 2002

LEGEND

Trust	=
A	=
B	=
X	=
Attorney	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
State	=
Court	=

Dear :

This letter responds to your letter written on behalf of the Trust, dated October 15, 2001, and subsequent letters, requesting rulings under §§ 664 and 4941 of the Internal Revenue Code.

FACTS

The information submitted states that A created the Trust under a trust agreement effective Date 1, with the intention that the Trust qualify as a charitable remainder unitrust under § 664(d)(2). The Trust was funded on Date 3.

Before the Trust was established, A extensively discussed charitable planning opportunities, including charitable remainder annuity trusts (CRATs) and charitable remainder unitrusts (CRUTs), with professional tax and estate planning advisors. During these discussions sample calculations of the variety of annuity or unitrust payments that might be paid to A and his wife, B, were provided to A. A's primary intent in creating the Trust was to establish a charitable trust that would generate a payout of X percent of the value of the assets of the Trust as revalued each year, with the unitrust amount payable in quarterly installments to A and B in equal shares during their lifetime, and upon the death of the first of them to die, payable to the survivor for life. A was aware that the amount of the income he and B would receive each year from the Trust could fluctuate annually. A was not interested in a CRAT because it generated a fixed income stream. Based on the discussions and the sample calculations, A understood that given his and his wife's ages, an X percent unitrust payment under the terms above would qualify as a CRUT under § 664(d)(2) and would result in a charitable deduction for gift and income tax purposes in the amount of the present value of the charitable remainder interest. A decided that a CRUT would be in his and B's best interests and he asked one of his advisors, Attorney, to provide him with a draft of a charitable remainder trust agreement consistent with their discussions. The trust agreement was drafted by Attorney.

In the first of a series of errors, Attorney prepared a draft of a CRAT rather than a CRUT as intended by A. In an effort to simplify A's review of the trust agreement draft, Attorney provided A with a software-generated synopsis of the agreement. Attorney did not review the provisions of the synopsis in detail to confirm the consistency between the synopsis and the trust agreement. Unbeknownst to Attorney, through a software programming error, the synopsis used the terms "Charitable Remainder Annuity Trust" in its title but described the distribution provisions of the trust agreement draft as if it were a CRUT with quarterly payments rather than a CRAT with annual payments as erroneously drafted. The publisher of the computer program corrected the error in a subsequent version of the program.

When A reviewed the synopsis he approved of the quarterly payout structure, believing that his intent had been properly conveyed to Attorney and properly drafted. Based on this understanding, A approved the agreement and subsequently executed the trust agreement without a detailed review of the agreement itself and without realizing that the agreement was in fact and in form drafted as a CRAT with annual payments, not as a CRUT with quarterly payments.

Subsequently, the Trust was established under an irrevocable trust agreement on Date 1, however, due to another scrivener's error, both A and B were listed as the grantors of the Trust. The Trust was then amended on Date 2 to provide that A was to be the sole donor. At that time, the Trust had not yet been funded. The Trust was funded on Date 3. The trustee of the Trust then sold the assets contributed to the Trust and reinvested the proceeds.

While preparing the first tax return for the Trust, the tax preparer discovered that the Trust was not written as a CRUT as intended, but as a CRAT. Corrective action was immediately taken to place the Trust in the position it would have been in if the

Trust had been administered as a CRUT from its inception and an order for judicial reformation of the Trust was sought in the proper court in State.

On Date 4, the Court ordered that the Trust be reformed ab initio. The reformation will correct the errors by removing the provisions of the Trust that characterize the Trust as a CRAT and replacing them with provisions that will qualify the Trust as a CRUT, as originally intended. The reformation will be effective as of Date 1.

The Trust requests rulings that the judicial reformation of the Trust from its inception: (1) will not violate any provisions under § 664 and the regulations thereunder and (2) will not be an act of self-dealing under § 4941.

LAW

Section 664(d)(2) provides that for purposes of § 664, a charitable remainder unitrust is a trust (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, 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, and (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Section 1.664-1(a)(4) of the Income Tax Regulations provides that for a trust to be a charitable remainder trust, it must satisfy the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Solely for purposes of § 664 and the regulations thereunder, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code (subpart E), but in no event prior to the time property is first transferred to the trust. For the preceding sentence, neither the grantor nor the grantor’s spouse is treated as the owner of the trust merely because the grantor or the grantor’s spouse is named as a recipient of the annuity or unitrust amount.

Section 4941(a)(1) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(a)(2) generally imposes a tax on the participation of a foundation manager in an act of self-dealing knowing that it is such an act, payable by the foundation manager.

Section 4941(d)(1)(E) provides that the term "self-dealing" includes any direct or indirect transfer to, or the use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a) provides the term "disqualified person" with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), a family member of a substantial contributor (including children), and a foundation manager (including a trustee). Under § 4946(d), the term “family members” includes spouses.

Section 4947(a)(2) provides generally that split-interest trusts are subject to the provisions of § 4941 in the same manner as if such trusts were private foundations, but, under § 4947(a)(2)(A), not with respect to any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under § 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

Section 53.4947-1(c)(2)(i) of the Foundation and Similar Excise Taxes Regulations provides that under § 4947(a)(2)(A), § 4941 does not apply to any amounts payable under the terms of a split-interest trust to income beneficiaries unless a deduction was allowed under § 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B) with respect to the income interest of any such beneficiary.

CONCLUSION

After reviewing the facts and relevant documents, and considering the scrivener’s errors that occurred, we conclude that the judicial reformation of the Trust, ab initio, will not violate § 664 of the Code and the regulations thereunder. Accordingly, we conclude that the judicial reformation, ab initio, of the Trust will not adversely affect Trust’s qualification as a charitable remainder unitrust under § 664.

As a charitable remainder unitrust under § 664(d)(2), the Trust is a split-interest trust described in § 4947(a)(2) and, therefore, subject to § 4941, which imposes an excise tax on acts of self-dealing. Under § 4947(a)(2), the self-dealing rules of § 4941 do not apply, however, to any amounts payable under the terms of the split-interest trust to income beneficiaries as long as no deduction was allowed for such income interest under § 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

A is a substantial contributor to the Trust. As such, A and B are each disqualified persons with respect to the Trust.

Because the judicial reformation of the Trust based on a scrivener’s error may have the effect of increasing the annual amount payable to A and B, the judicial reformation could be a transfer to, or use by or for the benefit of, disqualified persons of the income or assets of a private foundation. However, the circumstances presented above indicate that there is no act of self-dealing and we are satisfied that the signatory parties to the Trust never intended to create a charitable remainder annuity trust. Certain evidence supports this intent: (1) Attorney and the trustee submitted affidavits stating that A never intended to create a charitable remainder annuity trust; (2) the documents support A's description of events leading to the errors; and (3) there is no evidence that A is reducing his and his wife's own taxes, or using the benefit of hindsight in making the change to the charitable remainder unitrust. In fact, the Trust represents that the assets of the Trust have decreased in value since the Trust was funded. Therefore, for the foreseeable future, A and B will actually receive smaller payments over the course of a year from the reformed trust (as a unitrust) than they would have received under the provision of the original trust (as an annuity trust). We conclude that the judicial reformation of the Trust will not be an act of self-dealing under § 4941.

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. Specifically, no opinion is expressed as to whether the Trust otherwise qualifies as a CRUT.

Pursuant to a power of attorney on file with this office, copies of this letter are being sent to the taxpayer and the taxpayer's second authorized representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
Jeanne M. Sullivan
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes.

cc: