INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

June 10, 2008

Third Party Communication: None
Date of Communication: Not Applicable

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Index (UIL) No.: 2055.12-10
CASE-MIS No.: TAM-112722-08

Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Decedent	=
State	=
Testamentary Trust	=
A	=
B	=
Court	=
Executor	=
State Statute	=
Date 1	=
Date 2	=

Date 3 =
Date 4 =

ISSUE:

Whether the value of the property distributed to Trust No. 1 pursuant to the non-judicial division of Testamentary Trust under State Statute qualifies for the estate tax charitable deduction under § 2055(a)?

CONCLUSION:

The value of the property distributed to Trust No. 1 pursuant to the non-judicial division of Testamentary Trust under State Statute does not qualify for the estate tax charitable deduction under § 2055(a).

FACTS:

Decedent died testate on Date 1. Decedent's last will was executed on Date 2 and is governed by the laws of State. After providing for certain pre-residuary bequests, Item 16 of the will provides that the residue of Decedent's estate is to be held in trust (Testamentary Trust), as follows:

> During the pendency of this Trust, said Trustees shall pay annually . . . 25% of the net income to [A] during her natural life, and 25% to [B], during her natural life, with net income as used herein to include bonuses and royalties received from the minerals belonging to the trust Estate.
>
> All the rest and residue of the net income received shall be distributed annually to in amounts and at times determined in the best judgment and discretion of the . . . Trustees, to qualified charities. . . .

Testamentary Trust is to continue in existence as long as sufficient income is generated by the properties to justify maintenance of the trust. The will provides, however, that "the Trustees may after the demise of both [A] and [B], terminate this trust and distribute the remaining assets to a charity or charities selected by the Trustees in any proportion they deem proper . . . ."

Decedent named three executors in the will who were also named as the trustees of Testamentary Trust. Item 16 of the will further provides as follows:

> I direct that my Trustees have all the authority of Trustees . . . as provided by the [State] Trust Act . . . with the cumulative authority, if it be greater, to handle, encumber, lease, sell, or otherwise deal with the property as though it were the Trustees' own fee simple property, ...

In addition, Item 14 of the will authorizes the estate executors “to mange, sell, dispose of, deliver, convey, mortgage or reinvest” any portion of the estate.

On Date 3, the executors/trustees filed with Court a document entitled “Notice of Proposed Division of Trust Under [State Statute].” The Notice recites that Testamentary Trust does not satisfy the requirements of § 2055(e)(2) of the Internal Revenue Code and therefore, the interests passing to charity under the terms of the trust would not qualify for the estate tax charitable deduction. Further, the Notice recites that the executors and trustees:

> reasonably believe that splitting the single residue trust . . . into two separate trusts will decrease significantly the potential estate tax due with the 706 Estate Tax Return to be submitted to the Internal Revenue Service.

The Notice provides that in no less than 30 days after the beneficiaries and the State Attorney General receive notice, Testamentary Trust will be divided into two trusts, Trust No.1 and Trust No. 2. Trust No. 1 will be funded with one-half of the net residue of the estate. This trust will be administered in accordance with the instructions for Testamentary Trust contained in the Decedent’s will and the net income of the trust (as defined in the Decedent’s will) will be distributed to qualified charities.

Trust No. 2 will be funded with the other one-half of the net residue of the estate. This trust will be administered in accordance with the instructions for Testamentary Trust contained in the Decedent’s will and the net income of the trust (as defined in the Decedent’s will) will be distributed as follows: 50% of the net income will be distributed to A for her life and after her death this 50% will be distributed to qualified charities; 50% of the net income will be distributed to B for her life and after her death, this 50% will be distributed to qualified charities.

The document recites that Testamentary Trust is being divided pursuant to State Statute.[1] Further, items submitted with the request for technical advice indicate that the State Attorney General was consulted regarding this procedure.

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[1] State Statue, as in effect at the time the Notice of Proposed Division was filed, provided in relevant part, that the trustee may, unless expressly prohibited by the terms of the instrument establishing the trust, divide a trust into two or more separate trusts without a judicial proceeding, if the trustee reasonably determines that the division of the trust could result in a significant decrease in current or future federal income, gift, estate, generation-skipping transfer taxes, or any other tax imposed on trust property. If the trustee divides the trust, the terms of the separate trusts must be identical to the terms of the original trust, but differing tax elections may be made for the separate trusts. The statute was subsequently amended to eliminate the requirement that the

On Date 4, the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, was timely filed for Decedent's estate. On Schedule O of Form 706, the executor claimed a charitable deduction for the date of death value of the assets distributed to Trust No. 1.

LAW AND ANALYSIS:

Section 2055(a) provides for an estate tax charitable deduction for bequests to or for the use of qualifying charitable organizations. Section 2055(e)(2) provides that when an interest in property passes or has passed from a decedent to a charitable organization and an interest in the same property also passes to a noncharitable beneficiary, a deduction is not allowed unless, in the case of a charitable remainder interest, the interest is in the form of a charitable remainder unitrust or annuity trust described in § 664, or a pooled income fund described in § 642(c)(5). In the case of a charitable lead interest, the interest must be in the form of a guaranteed annuity or fixed percentage distributed yearly of the fair market value of the property (determined annually).

Section 2055(e)(3) provides statutory relief in situations where the bequest of a lead or remainder interest to charity is not in the form required under § 2055(e)(2). Under this section, a deduction will be allowed for property passing from the decedent to a charitable trust that does not meet the requirement of § 2055(e)(2), provided the trust is reformed, within the time prescribed by the statute, into one of the qualifying forms specified in § 2055(e)(2)(A).

Notwithstanding the specific statutory requirements for reformation contained in § 2055(e)(3), in certain situations a charitable deduction has been allowed for a nonqualifying charitable remainder bequest that is modified in a manner that does satisfy the requirements of § 2055(e)(3). Rev. Rul. 89-31, 1989-1 C.B. 277, concludes that a charitable deduction is allowable where in settlement of a bona fide will contest, a decedent's estate makes an immediate payment to a qualifying charity in satisfaction of the charity's split interest remainder that would not be deductible under § 2055(e)(2). The revenue ruling cites several court cases that reached the same conclusion. Flanagan v. United States, 810 F.2d 930, 935 (10^{th} Cir. 1987); Estate of Strock v. United States, 655 F. Supp. 1334, 1340-41 (W.D. Penn. 1987); Northern Trust Co., v. United States, 78-1 USTC para. 13,229, 41 AFTR2d 78-1523 (N.D. Ill. 1977). In each of these cases a charity received an outright accelerated payment in lieu of a nondeductible remainder interest as the result of the settlement of a bona fide will contest.

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severed trusts must be identical to the original trust. It appears, based on the effective date of this change that the statute as revised would apply in this case.

Several courts, in addition, have found § 2055(e)(3) inapplicable and allowed a deduction for a direct payment to charity where a nondeductible split interest bequest is terminated because continuation of the trust would result in a breach of a fiduciary duty. See Oetting v. United States, 712 F.2d 358, 361-63 (8th Cir. 1983); Jackson v. United States, 408 F. Supp. 2d 209 (N.D. W. Va. 2005); Estate of Thomas v. Commissioner, T.C. Memo 1988-295.

Conversely, the estate tax charitable deduction was not allowed for a direct payment to charity, where there was no reason independent of tax considerations for terminating the trust; rather, the nondeductible split-interest bequest was terminated solely to avoid the disallowance provisions of § 2055(e). Allowing the deduction under these circumstances would be contrary to the intent of Congress in enacting § 2055(e)(3) and would render § 2055(e)(3) superfluous. See Burdick v. Commissioner, 979 F.3d 1369, 1371-2(9th Cir. 1992); Estate of La Meres v. Commissioner, 98 T.C. 294, 309(1992).

In this case, at Decedent's death, Testamentary Trust did not satisfy the requirements under § 2055(e)(2) and therefore did not qualify for a charitable deduction under § 2055(a). The reformation of under State Statute performed by the executors/trustees did not meet the requirements of § 2055(e)(3), and the time period for commencing a § 2055(e)(3) reformation (prescribed under § 2055(e)(3)(C)(iii)) has expired. Accordingly, since the executors/trustees failed to timely reform Testamentary Trust under § 2055(e)(3), a charitable deduction under § 2055(a) is not allowable for the value of the property distributed to Trust No. 1.

The executors/trustees contend, however, that Decedent's estate is entitled to a charitable deduction for the value of the assets distributed to Trust No. 1. The executors/trustees argue that the courts have recognized that, what the executors/trustees characterizes as "intervening events," occurring between the date of the decedent's death and the filing of the Form 706, can cause an otherwise nonqualifying split-interest to qualify for a charitable deduction under § 2055(a), citing Jackson and Estate of Strock in support of this position.

In Jackson, in concluding that a charitable deduction was allowable for the portion of the terminated trust passing directly to charity, the court determined that if the motivation to terminate is solely to gain a charitable deduction without complying with §§ 2055(e)(2) and (e)(3), then the deduction is not allowed. On the other hand, if the termination is motivated by any nontax reason, then the deduction is allowed. The court set forth four factors to be considered in determining whether a bequest is removed from the disallowance provisions of § 2055(e)(2): (1) whether property is directly transferred to the charitable beneficiary; (2) whether a noncharitable beneficiary maintains an interest in that property; (3) whether the deduction is sought for the actual benefit received by the charitable entity; and (4) whether the estate is concerned solely with gaining a charitable deduction by avoiding the split interest rules under § 2055(e).

In the instant case, the executors/trustees argue that the creation of Trust No. 1 pursuant to State Statute satisfies the criteria outlined in Jackson; that is, (1) Trust No. 1 qualifies as a charitable beneficiary and will receive a direct transfer of 50 percent of the net residue of Decedent's estate; (2) there is no noncharitable beneficiary interest in the assets transferred to Trust No. 1; (3) the deduction sought under § 2055(a) is for the value of the assets distributed to Trust No. 1 from Decedent's estate; and (4) the formation of Trust No. 1 pursuant State Statute "was a legal action done with statutory authority which removed the burden upon Decedent's estate to show some other motivation for the act."

Further, the executors/trustees argue that Testamentary Trust includes oil and gas interests that are described in § 53.4944-1(a)(2)(i) of the regulations as investments subject to special scrutiny in determining if the investments constitute jeopardy investments under § 4944. The executors/trustees argue that if a trust described in § 664 was established, the executors/trustees would have had to sell the oil and gas interests, and that such a sale would have been contrary to the Decedent's intent. Therefore, reformation under § 2055(e)(3) was not an option available to the executors/trustees.

In response, we do not believe this case comes within the purview of Rev. Rul. 89-31 or cases such as Oetting, Jackson, or Estate of Thomas. In the situation described in Rev. Rul. 81-31, if the deduction was not allowed, the executor/trustee would be confronted with the untenable choice of either agreeing to terminate the trust and foregoing the charitable deduction, or continuing the trust and reforming and facing protracted litigation. Similarly, without opining on whether the courts decisions in Oetting, Jackson, and Thompson are correct, the decisions were based on the premise that, under the facts presented in those cases, the trustee was faced with a potential breach of fiduciary duty if the trust at issue was continued.

In the instant case, as discussed above, the only stated explanation for dividing the Testamentary Trust contained in the Date 3 "Notice of Proposed Division of Trust Under [State Statute]" was to decrease the federal estate tax liability. This recital brings this case squarely within the purview of Burdick and Estate of La Meres, where the courts denied the charitable deduction in situations in which a nondeductible split-interest bequest was terminated solely to avoid the disallowance provisions of § 2055(e).

However, the executor now argues that reformation to establish a § 664 trust was not an option based on their view of Decedent's intent that the oil and gas properties not be sold, and that such assets might constitute jeopardy investments under § 4944. However, assuming arguendo that the oil and gas investments held by the Testamentary Trust would be problematic, the Decedent's will gave the executors and the trustees of Testamentary Trust the broad power to sell the estate and trust assets. As noted above, Item 14 of the will authorizes the executors "to mange, sell dispose of, deliver, convey mortgage or reinvest" any portion of the estate. Item 16 empowers the trustees of Testamentary Trust with “all authority as provided by the [State] Trust Act . . . to handle, encumber, lease, sell, or otherwise deal with the property as though it were the Trustees’ own fee simple property.” Thus, the executors/trustees clearly had the authority to sell any objectionable trust investments. We believe it unlikely that the sale of any assets in conjunction with the reformation of Testamentary Trust to achieve an estate tax deduction could be viewed as a breach of fiduciary duty.

Further, we do not believe, as suggested by the executors/trustees**,** that the parties can terminate a trust and avoid the requirements of § 2055(e)(3) by demonstrating any nontax reason for the termination. For example, we do not believe that the parties could terminate a trust and avoid the application of § 2055(e)(3) simply because they prefer to receive immediate lump sum payments, rather than the temporal interests provided under the trust. We do not believe a deduction would be allowed in that situation.

In this regard, as discussed above, the executors/trustees argue that in any event, they do not have to demonstrate a nontax motive for terminating the trust because the division of Testamentary Trust was specifically authorized under State Statute. In effect, the executors/trustees are arguing that State Statute overrides § 2055(e)(3). As discussed above, this argument if followed would, contrary to Congressional intent, render § 2055(e)(3) superfluous. The courts have rejected such an argument. See Burdick v. Commissioner, 979 F.3d at 1372 (“Congress only permitted taxpayers to modify decedents' wills to obtain a charitable deduction for an otherwise nondeductible split-interest by following the provisions of IRC § 2055(e)(3)”); Estate of La Meres v. Commissioner, 98 T.C. at 309.(“[W]e must also recognize that Congress provided very specific statutory means for reforming nonqualifying charitable trusts.”)

In summary, we conclude that the value of the estate assets distributed to Trust No. 1 does not qualify for the estate tax charitable deduction under § 2055(a).

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.