Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:7-PLR-115942-98
Date:
April 6, 1999

Legend:

Taxpayer =

Termination Date =

a =

b =

Charity 1 =

Charity 2 =

Charity 3 =

A =

B

Dear Sir:

We received your letter, dated , requesting several rulings concerning the income and gift tax consequences of a charitable lead trust. This letter responds to your request.

The facts and representations submitted are summarized as follows: Taxpayer proposes to establish a trust that will qualify as a charitable lead trust under § 2522 of the Internal Revenue Code. Article First Paragraph (W) of the proposed trust instrument provides that notwithstanding anything in the trust instrument to the contrary, no power enumerated in the trust instrument or accorded to the trustees generally pursuant to law is to be construed to enable Taxpayer, Taxpayer's spouse (if any), or the trustees, or any of them, or any other person to purchase, exchange, or otherwise deal with or dispose of all or any part of the corpus or income of the trust for less than an adequate consideration in money or money's worth, or to enable Taxpayer or Taxpayer's spouse (if any) to borrow all or any part of the corpus or income of the trust, directly or indirectly. No person other than the trustees acting in a fiduciary capacity is to have or exercise the power to vote or direct or authorize the voting of any shares or other securities of the trust, to control the investment of the trust either by directing investments or to reacquire or exchange any property of the trust by substituting other property of an equivalent value. The trustees are not to pay premiums on (or purchase) any policy of insurance on the life of Taxpayer or Taxpayer's spouse.

Article First Paragraph (X) of the proposed trust instrument provides that, notwithstanding any other provision of the trust instrument to the contrary, no trustee or other person acting on behalf of the trust is to:

(1) Engage in any act of self-dealing as defined in § 4941(d) of the Internal Revenue Code or corresponding provision of any subsequent federal tax laws;

(2) Cause any excess business holding, as defined in § 4943(c) or corresponding provision of any subsequent federal tax laws, to be retained;

(3) Cause any investment to be acquired or retained in a manner that subjects the trust to tax under § 4945(d) or corresponding provision of any subsequent federal tax laws; or

(4) Make any taxable expenditures as defined in § 4944 or corresponding provision of any subsequent federal tax laws

Article Second Paragraph (A)(1) of the proposed trust instrument provides that up to and including the Termination Date, the trustees are to distribute (in cash or in kind, valued at the date of distribution, or partly in each, in the trustees' sole discretion) an annuity at the rate of a per year to and among such qualified charities in such proportions (or all to one) as the trustees shall from time to time select. The trustees are authorized in the selection to commit irrevocably the entire annuity or any payment or payments to one or more qualified charities in advance of the payment and (or) the year of payment and to evidence the commitment by promissory note or otherwise. The annuity is to commence on and accrue from the date of the execution

of the trust agreement and may, in the trustees' discretion, be paid in convenient installments (but not less frequently than annually).

In the event that the trust agreement is executed on such a day that the first fiscal year of the trust is not a full year (or if the Termination Date is other than the end of the year), the amount distributable for that first year (or last year) is to be determined as a pro rata portion of the annuity amount, taking into account the number of days remaining in the first year (or last year) using the date the trust agreement is executed as the first of the remaining days (or the Termination Date as the last remaining day). For each taxable year, the annuity is to be paid from current income, and to the extent current income is insufficient, from accumulated income, and to the extent accumulated income is insufficient, from principal (including, but not limited to, capital gains). Any income not distributed may be added currently to principal in the trustees' sole discretion.

Article Second Paragraph A)(2) of the proposed trust instrument provides that in the event that, on or before that date b days prior to the close of the year, the trustees have not selected the qualified charities or charity to receive any portion (or all) of the annuity for that year (the selection is to be evidenced either by payment prior to that date or by written instrument signed by a majority of the trustees prior to that date), then the portion is to be paid in equal shares to such of Charity 1, Charity 2, and Charity 3 that are then qualified charities (but only if either is then a qualified charity).

Article Second Paragraph (A)(3) of the proposed trust instrument provides that the term "qualified charities" means and includes only those organization that are described in both §§ 170(c) and 2522(a) of the Internal Revenue Code of 1986, as amended (or corresponding provisions of any subsequent federal tax laws), gifts to which qualify for charitable deduction under both the federal gift tax and federal income tax laws or for comparable treatment under any subsequent federal tax laws. In the event, however, that for any year, no applicable federal tax law contains provision for reduction of tax on account of a charitable gift, no annuity payment is to be made for that year.

Article Second Paragraph (A)(4) of the proposed trust instrument prohibits commutation or prepayment of the annuity prior to the Termination Date.

Article Second Paragraph (B) of the proposed trust instrument provides that at the Termination Date, the trustees are to distribute the entire trust estate remaining in equal shares so as to provide one share to each of Taxpayer's daughters, A and B, their heirs, executors, and administrators.

Article Sixth of the proposed trust instrument provides that the trust is to be irrevocable. Taxpayer will expressly acknowledge that Taxpayer will have no right or

power, either alone or in conjunction with others, or in whatever capacity to alter, amend, revoke, or terminate the trust or any of the terms of the trust instrument, in whole or in part, or to designate the persons who are to posses or enjoy the trust property or the income from the trust during its continuance.

You have requested the following rulings:

1. The annuity interest in the trust will be a guaranteed annuity interest within the meaning of § 2522(c)(2)(B) and § 25.2522(c)-3(c)(2)(vi) of the Gift Tax Regulations and that a gift tax deduction will be allowed to Taxpayer pursuant to § 2522 equal to the value of the guaranteed annuity.

2. The trust will be allowed a deduction under § 642(c) each taxable year in an amount equal to the annuity amount paid from the trust's gross income (except to the extent that the trust has unrelated business income under § 681(a) and except to the extent that contributions are nondeductible under §§ 508(d) or 4948(c)(4) during the taxable year in accordance with the terms of the trust.)

3. No portion of the trust's income will be taxable to Taxpayer under §§ 671-678.

Gift Tax Ruling:

Section 2501(a)(1) imposes for each calendar year a tax on the transfer of property by gift during the calendar year by any individual, resident or nonresident.

Section 2522(a) provides that, in computing taxable gifts for the calendar year, there is allowed a deduction for: (1) all gifts to or for the use of federal or other government entities for exclusively public purposes, (2) all gifts to or for the use of a corporation or trust operated exclusively for religious, charitable, scientific, literary, or educational purposes, or (3) certain transfers to fraternal or veterans organizations.

Section 2522(c)(2) provides that where a donor transfers an interest in property (other than an interest described in § 170(f)(3)(B)) to a person, or for a use, described in § 2522(a) or (b) and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in § 2522(a) or (b), no deduction is allowed for the interest that is, or has been transferred to the person, or for the use, described in § 2522(a) or (b), unless—

(A) in the case of a remainder interest, the interest is in a trust that 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, the 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 25.2522(c)-3(a) provides that if a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

Section 25.2522(c)-3(c)(2)(vi)(a) provides that a deductible interest is a charitable interest in property only where the charitable interest is a guaranteed annuity whether or not the interest is in trust. For purposes of § 25.2522(c)-3(2)(vi), the term "guaranteed annuity" means an irrevocable 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 a named individual or individuals each of whom must be living at the date of the gift and can be ascertained at that date. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer is ascertainable as of the date of the gift. For example, the amount to be paid may be a stated sum for a term, or for the life of an individual, at the expiration of which it may be changed by a specified amount, but it may not be redetermined by reference to a fluctuating index such as the cost of living index. In further illustration, the amount to be paid may be expressed as a fraction or percentage of the cost of living index on the date of the gift.

Section 25.2522(c)-3(c)(2)(vi)(b) provides that a charitable interest is a guaranteed annuity interest but only if it is a guaranteed annuity interest in every respect. For example, if the charitable interest is the right to receive from a trust each year a payment equal to the lesser of a sum certain or a fixed percentage of the net fair market value of the trust assets, determined annually, the interest is not a guaranteed annuity interest.

Section 25.2522(c)-3(c)(2)(vi)(e) provides that where a charitable interest in the form of guaranteed annuity interest is in trust and the present value of all income interests for charitable purposes exceeds 60 percent of the aggregate fair market value of all amounts in the trust (after payment of liabilities), the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and retention of the assets which would give rise to a tax under § 4944 if the trust acquired such assets.

Based on the information submitted and the representations made, the annuity payable under the terms of the proposed trust satisfies the requirements of § 25.2522(c)-3(c)(2)(vi) and, therefore, will be a guaranteed annuity for purposes of

§ 2522(c)(2)(B). Accordingly, we conclude that Taxpayer will be entitled to a gift tax deduction under § 2522, based on the actuarial value of the guaranteed annuity payable to the charities from the trust, determined under § 25.2522(c)-3(d)(2)(iv).

Income Tax Rulings:

Section 642(c)(1) provides that in the case of an estate or trust, there is allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170(a), relating to the deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is during the taxable year, paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the taxable year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year. The election is to be made at such time and in such manner as the Secretary prescribes by regulations.

Section 1.642(c)-3(b)(2) of the Income Tax Regulations provides that in determining whether the amounts of income so paid, permanently set aside, or used for a purpose specified in § 642(c)(1), (2), or (3) include particular items of income of an estate or trust not included in gross income, the specific provision controls if the governing instrument specifically provides as to the source out of which amounts are to be paid, permanently set aside, or used for such purpose. In the absence of specific provisions in the governing instrument, an amount to which § 642(c)(1), (2), or (3) applies is deemed to consist of the same proportion of each class of the items of income of the estate or trust as the total of each class bears to the total of all classes.

Section 671 provides the general rule that when the grantor or another person is treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing taxable income or credits against the tax of an individual.

Sections 673 through 677 specify the circumstances under which the grantor is regarded as the owner of a portion of a trust.

Section 681 provides that in computing the deduction allowable under § 642(c) to a trust, no amount otherwise allowable under § 642(c) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to its unrelated business income for such year. For purposes of the preceding sentence, the term "unrelated business income" means an amount equal to the amount which, if such trust were exempt from tax under § 501(a) by reason of § 501(c)(3), would be computed as its unrelated business taxable income under § 512 (relating to income

derived from certain business activities and from certain property acquired with borrowed funds).

Except to the extent that the trust has unrelated business income within the meaning of § 681, the trust will be allowed deductions under § 642(c)(1) for amounts of gross income paid out to charitable beneficiaries described in § 170(c) during the taxable year, or by the close of the following taxable year if the trustees so elect under § 1.642(c)-1(b). Because the deduction under § 642(c)(1) is limited to amounts of gross income, no deduction will be allowed for a distribution of an amount of trust principal except to the extent that the amount distributed has been included in the trust's gross income and provided no deduction was allowed for any previous taxable year for the amount distributed.

Our examination of the proposed trust instrument reveals none of the circumstances that would cause the grantor to be treated as the owner of the trust under §§ 673, 676, or 677.

Section 674(a) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(b)(4) provides that § 674(a) does not apply to a power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified is § 170(c).

The power given to the trustees in Article Second Paragraph (A)(1) of the proposed trust is not a power that would cause the grantor to be treated as the owner of any portion of the trust under § 674(a).

None of the circumstances that cause administrative controls to be considered exercisable primarily for the benefit of the grantor under § 675 are authorized under the proposed trust instrument. Thus, whether the grantor will be treated as the owner of the trust under § 675 will depend on the circumstances attendant upon the operation of the trust. This is a question of fact, the determination of which necessarily must be deferred until the federal income tax returns of the parties involved have been examined by the Office of the District Director in which the returns are filed.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision of the Code.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Taxpayer.

Sincerely yours,

Christine E. Ellison
Chief, Branch 7
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)