Internal Revenue Service

Department of the Treasury

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Date:
August 31, 1999

Legend

Taxpayer =

Trust 1 =

Trust 2 =

Foundation =

Son =

Daughter-in-law =

Grandson =

Granddaughter =

a =

b =

Date 1 =

Date 2 =

We received a letter dated April 12, 1999, from your authorized representative requesting rulings under §§ 642, 2055, and 2518 of the Internal Revenue Code. This letter responds to that request.

On Date 1, Taxpayer executed her Will. Son and Grandson are to be the personal representatives under Taxpayer's Will and both intend to serve in that

capacity.

Under Article V of Taxpayer's Will, assets with a fair market value on the date of distribution of $a are to be placed in Trust 1. Paragraph (a)(1) of Article V provides that, commencing with the date of Taxpayer's death, in each taxable year, and continuing for a period of twenty years, the Trustee is to pay to Foundation an annuity. If Foundation is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time when any portion of the annuity is to be distributed to it, then the Trustee is to distribute the annuity or portion thereof to such one or more organizations then qualifying as charitable organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select in the Trustee's sole discretion. Paragraph (a)(2) provides that the annuity amount is to be equal to that percentage of the initial net fair market value of the assets of Trust 1 ($a) as shall produce a guaranteed charitable annuity interest and estate tax deduction equal (or nearly equal as possible) in value to b% of the initial net fair market value of the entire trust fund, and is to be determined according to the formula set forth in that paragraph.

Upon the termination of Trust 1, the Trustee is to distribute the remaining principal and undistributed income outright to Son if he is then living, or to his estate if he is not then living. Son is to be the Trustee of Trust 1.

Paragraph (b) of Article V provides that the Trustee shall not engage in any act of self-dealing as defined in § 4941(d), nor make any taxable expenditures as defined in § 4945(d). Except to the extent provided in § 4947(b)(3), the Trustee shall not retain any excess business holdings (as defined in § 4943(c)) that would subject the trust to tax under § 4943, nor shall the Trustee acquire any assets that would subject the trust to tax under § 4944 or retain any assets that would, if acquired by the Trustee, subject the trust to tax under § 4944. If § 4942 is at any time applicable to trust, the Trustee shall make such distributions at such time and in such manner as not to subject the trust to tax under § 4942. No estate, inheritance or other death taxes imposed under the laws of any jurisdiction, including federal estate taxes and state death taxes, are to paid out of the trust property.

Under Article VII of Taxpayer's Will, Taxpayer bequeaths and devises the residuary estate to Son, if he survives her, and if he does not survive her, then to Son's surviving issue per stirpes. Article VII further provides that if Taxpayer's Son or a grandchild is a beneficiary under the Will and makes a qualified disclaimer under § 2518 of all or any part of an interest, then that disclaimed interest is devised to Trust 2. Son intends to disclaim a portion of his interest in Taxpayer's residuary estate.

The terms of Trust 2 are substantially identical to those of Trust 1 except that upon expiration of the charitable lead term, the remaining principal and undistributed income of Trust 2 is to be distributed outright to Daughter-in-law, if she is then living, or if not, then to her estate. In addition, Trust 2 contains specific provisions regarding distributions to Foundation. Under these provisions, all funds distributed to Foundation

from Trust 2 are to be set aside by Foundation in a separate fund, not to be commingled with other Foundation assets under any circumstances. Further, any beneficiary who made the qualified disclaimer with respect to the residuary estate shall not have any power or authority in any capacity over the separate funds, and also shall not participate in any manner in the redistribution or allocation of benefits of the separate funds or the direction or selection of charitable beneficiaries. Any person who disclaimed property that passes to Trust 2 is prohibited from remaining as a trustee of Trust 2. Grandson is to be the trustee of Trust 2.

Foundation is a private foundation organized by Taxpayer on Date 2 as a charitable nonprofit corporation without members and currently qualifies as a tax-exempt charitable organization under § 501(c)(3). Foundation is operated and managed by its Board of Directors. The current Directors and officers are Taxpayer as President, Son as Vice President, Grandson as Secretary, and Granddaughter as Vice President. The bylaws of Foundation provide for the segregation of separate disclaimed property to be managed in all aspects by Directors who have not made disclaimers with respect to such property.

The following rulings have been requested:

1. The annuity interest in Trust 1 will be a guaranteed annuity interest within the meaning of § 2055(e)(2)(B) and an estate tax deduction will be allowed to Taxpayer's estate under § 2055(a) for the present value of the charitable annuity interest as of the Taxpayer's date of death (or alternate valuation date) and that such deduction should equal b% of the value of the assets transferred to Trust 1.

2. The annuity interest in Trust 2 will be a guaranteed annuity interest within the meaning of § 2055(e)(2)(B) and an estate tax deduction will be allowed to Taxpayer's estate under § 2055(a) for the present value of the charitable annuity interest as of the Taxpayer's date of death (or alternate valuation date) and that such deduction should equal b% of the value of the assets transferred to Trust 2.

3. In view of the provisions in Taxpayer's Will with respect to distributions to Foundation from Trust 2 and the bylaws of Foundation, a disclaimer by Son of residuary property will satisfy the requirements of § 2518(b)(4) and the applicable regulations thereunder.

4. Trust 1 and Trust 2 will each be allowed a deduction under § 642(c) for each taxable year in an amount equal to the annuity amount paid from each trust's gross income during such taxable year in accordance with the trust's terms.

Rulings 1 and 2

Section 2055(a) provides that, for purposes of the Federal estate tax, the value of the taxable estate is determined by deducting from the value of the gross estate all

bequests to or for the use of certain governmental entities, certain corporations organized and operated exclusively for religious, charitable, scientific, literary, or education purposes, and certain other fraternal and veterans organizations.

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 the 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 is allowed under § 2055(a) for the interest that passes to the person, or for the use, described in § 2055(a) unless, in the case of interests other than charitable remainder interests described in § 664 or pooled income funds described in § 642(c)(5), 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 20.2055-2(e)(2)(vi)(a) of the Estate Tax Regulations provides that a charitable interest is a guaranteed annuity interest, whether or not the interest is in trust. 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 as of such date. For example, the annuity may be paid for the life of A plus a term of years. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer can be ascertained as of the appropriate valuation date. Paragraph (b) provides that a charitable interest is a guaranteed annuity interest only if it is a guaranteed annuity interest in every respect.

Section 20.2055-2(e)(2)(vi)(e) provides that 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 income interests for a charitable purpose 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 that would give rise to a tax under § 4944 if the trustee had acquired such assets.

Based on the above, we conclude that the use of the formula set forth in Articles V and VIII of Taxpayer's Will satisfies the requirement that a guaranteed annuity must be a determinable amount. In this case, the annuity amounts, although not expressly stated, are determinable as of the date of Taxpayer's death based on the formula contained in the instrument. Since the annuity amounts are ascertainable as of the date of the Taxpayer's death (or the alternate valuation date) under the terms of the instrument, we conclude that the instrument satisfies the "guaranteed annuity"

requirements. Therefore, the charitable interests qualify as guaranteed annuity interests for Federal estate purposes, for any years in which Trust 1 and Trust 2 continue to meet the definition of and function exclusively as charitable lead annuity trusts. Because the charitable interests qualify as guaranteed annuity interests, an estate tax charitable deduction is allowed under § 2055(a).

Ruling 3

Section 2518(a) provides that, if a person makes a qualified disclaimer with respect to any interest in property, Subtitle B (relating to the estate, gift and generation-skipping transfer taxes) shall apply with respect to such interest as if the interest had never been transferred to such person.

Section 2518(b) provides that the term "qualified disclaimer" means an irrevocable and unqualified refusal by a person to accept an interest in property but only if—

(1) such refusal is in writing,
(2) such writing is received by the transferor of the interest, the transferor's legal representative, or the holder of the legal title to the property to which the interest related not later than the date which is 9 months after the later of—
  (A) the date on which the transfer creating the interest in such person is made, or
  (B) the day on which such person attains age 21,
(3) such person has not accepted the interest or any of its benefits, and
(4) as a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either—
  (A) to the spouse of the decedent, or
  (B) to a person other than the person making the disclaimer.

Section 25.2518-2(d)(2) of the Gift Tax Regulations provides that if a beneficiary who disclaims an interest in property is also a fiduciary, actions taken by such person in the exercise of fiduciary powers to preserve or maintain the disclaimed property shall not be treated as an acceptance of such property or any of its benefits. Under this rule, for example, an executor who is also a beneficiary may direct the harvesting of a crop or the general maintenance of a home. A fiduciary, however, cannot retain a wholly discretionary power to direct the enjoyment of the disclaimed interest. For example, a fiduciary's disclaimer of a beneficial interest does not meet the requirements of a qualified disclaimer if the fiduciary exercised or retains a discretionary power to allocate enjoyment of that interest among members of a designated class.

Under § 25.2518-2(e)(1), in order to constitute a qualified disclaimer, the disclaimed interest must pass without any direction on the part of the person making the disclaimer to a person other than the disclaimant. The requirements of a qualified disclaimer under § 2518 are not satisfied if the disclaimant, either alone or in conjunction with another, directs the redistribution or transfer of the property or interest

in property to another person (or has the power to direct the redistribution or transfer of the property or interest in property to another person unless such power is limited by an ascertainable standard).

In Rev. Rul. 72-552, 1972-2 C.B. 525, the decedent, who was the president and director of a corporation organized for purposes specified under § 501(c)(3) transferred property to the corporation. The corporation's bylaws controlled the actions of the corporate directors in selecting beneficiaries to receive corporate property. Based on the bylaws, the board of directors authorized the decedent, as president of the corporation, to direct the disposition of its funds for charitable purposes. The ruling holds that the property the decedent transferred to the corporation is includible in his gross estate under § 2036 because he had the power to direct the disposition of the funds.

Based on the above, we conclude that in view of the terms of Taxpayer's Will with respect to Trust 2 and the bylaws of Foundation requiring segregation of disclaimed funds, Son's disclaimer with respect to Taxpayer's residuary estate resulting in the distribution of the disclaimed property to Trust 2, will satisfy the requirements of § 2518 (b)(4) and the regulations cited above.

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Ruling 4

Section 642(c)(1) provides the general rule that in the case of an estate or trust (other than a trust meeting specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170(a), relating to 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)(20(A)).

Section 642(c)(4) provides that in the case of a trust, the deduction allowed by § 642(c) is subject to § 681 (relating to unrelated business income).

Section 681(a) 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. The term "unrelated business income" means an amount under § 512, if the trust were exempt from tax under § 501(c) by reason of § 501(c)(3), that would be computed as its unrelated business taxable income under § 512.

Section 1.642(c)-3(b)(2) of the Income Tax Regulations provides that, in determining whether the amounts of income 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.

Therefore, based solely on the facts submitted and the representations made, we conclude as follows:

Except to the extent that Trust has unrelated business income under § 681(a), and except to the extent that contributions are nondeductible under §§ 508(d) or 4948(c)(4), Trust will be allowed deductions in accordance with § 642(c)(1) for amounts of gross income paid to Foundation during the taxable year, or by the close of the following taxable year, if the trustee makes an election under § 1.642(c)-1(a)(1)(b).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code. We note that Article V, ¶ (a)(5) and Article VIII, ¶ (a)(5) provide certain ordering rules for the distribution of income from Trust 1 and Trust 2 respectively. This ordering of the income distributions will not be given effect for Federal income tax purposes because the ordering provisions have no economic effect independent of the tax consequences. The trusts are required to pay annually a stated annuity amount to Foundation, regardless of the amount or character of income that Trust 1 or Trust 2 earn. Accordingly, income distributed to Foundation shall consist of the same proportion of each class of items of income as the total of each class bears to the total of all classes. See § 1.642(c)-3(b)(2).

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 this ruling take effect, the ruling will have no force or effect. If 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(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,
Assistant Chief Counsel
(Passthroughs and Special Industries)

By_____
George Masnik
Chief, Branch 4

Enclosure
Copy for § 6110 purposes