

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

October 14, 1999

Trust =

A =

B =

C =

Foundation =

Bank =

Company =

Court =

State =

D1 =

D2 =

Year 1 =

Year 2 =

Dear :

This letter responds to the letter dated June 7, 1999, and subsequent correspondence submitted by Trust's authorized representatives on behalf of Trust, requesting rulings under §§ 170 and 664 of the Internal Revenue Code concerning the effect of a proposed reformation of Trust on the qualification of Trust as a charitable remainder unitrust under § 664 and the applicable deduction to A and B under § 170.

The information submitted states that on D1, A and B, husband and wife, executed and funded Trust. A and B funded Trust with shares of Company, which are represented as being non-publicly traded stock and thus not "qualified appreciated stock" as defined in § 170(e)(5)(B). Trust is represented to be a charitable remainder unitrust (CRUT). The governing instrument of Trust names C and Bank as trustees. As executed, Trust is required to pay annually to A and B, or the survivor, a unitrust amount equal to the lesser of (a) the amount of the trust income or (b) a fixed percentage of the net fair market value of the trust estate, provided that the unitrust amount shall also include any amount of trust income that is in excess of the fixed percentage of the net fair market value of the trust estate to the extent that the aggregate of the unitrust amounts paid in prior years was less than the aggregate of the unitrust amounts computed as a fixed percentage of the net fair market value of the trust estate. As executed, Trust further provides that upon the death of the survivor of A and B, the remaining assets of the trust estate shall be distributed to one or more charitable remaindermen, each of which must be a type of charity described in each of §§ 170(c), 170(b)(1)(A), 2055(a) and 2522(a). The charitable remaindermen are designated in a schedule, attached to the governing instrument of Trust and incorporated by reference into Trust, to receive the remaining trust estate in the percentages specified in the schedule. If a charitable remainderman is not an organization described in §§ 170(c), 170(b)(1), 2055(a) and 2522(a) at the time the distribution is required to be made to it, then the trustee shall distribute such respective amount of the trust estate to one or more other organizations described in those sections, as the trustee, in its sole discretion, deems appropriate.

C, as trustee of Trust, represents that the proposed reformation of Trust is necessary to allow Trust to convert from a net income method CRUT (NIMCRUT) to a fixed percentage CRUT which will be required to pay to A and B, or the survivor, a unitrust amount equal to a fixed percentage of the net fair market value of the trust estate, effective D2, the date of the triggering event.

C further represents that the proposed reformation of Trust is necessary due to a scrivener's error that makes it impossible for A and B to designate Foundation as the charitable remainderman of Trust as originally intended. Foundation is a private foundation, represented as being an organization described in § 170(c) but not in § 170(b)(1)(A). To establish their original intent, A and B have provided the schedule executed D1 designating Foundation as the 100 percent charitable remainderman of Trust, and an affidavit from their former representative who drafted the governing instrument of Trust. These documents indicate that A and B intended for Foundation to be the charitable remainderman of Trust.

On D2, Court issued a judgment reforming the governing instrument of Trust by changing the method of the payment of the unitrust amount, above, and by deleting references to § 170(b)(1)(A). This judgment is the triggering event for the proposed conversion of the method of payment of the unitrust amount, above. This judgment is subject to and effective upon the receipt by the trustees of a private letter ruling from the Internal Revenue Service finding that the proposed reformation will not adversely affect Trust's qualification as a CRUT under § 664 and the applicable regulations.

C represents that none of the necessary parties objected to the reformation and that the Attorney General of State has been given notice of the proceeding in accordance with State law, and has waived the right of intervention.

A and B represent that they are prepared to amend their Year 1 and Year 2 federal income tax returns to reflect the additional income tax and interest that is payable due to the difference in allowable deductions for a remainder interest passing to a charitable organization qualifying under § 170(b)(1)(A) and a charitable organization qualifying under § 170(c).

Section 1.664-3(a)(1)(i)(f)(3) of the Income Tax Regulations provides that, notwithstanding § 1.664-3(a)(1)(i)(f)(2), if a trust either provides for payment of the unitrust amount under a combination of methods that is not permitted under § 1.664-3(a)(1)(i)(c), or provides for payment of the unitrust amount under only the method prescribed in § 1.664-3(a)(1)(i)(b), then the trust may be reformed to allow for a combination of methods permitted under § 1.664-3(a)(1)(i)(c) without causing the trust to fail to function exclusively as a charitable remainder unitrust under § 1.664-1(a)(4) or to engage in an act of self-dealing under § 4941 if the trustee begins legal proceedings to reform by June 8, 1999. The triggering event under the reformed governing instrument may not occur in a year prior to the year in which the court issues the order reforming the trust, except for

situations in which the governing instrument prior to reformation already provided for payment of the unitrust amount under a combination of methods that is not permitted under § 1.664-3(a)(1)(i)(c) and the triggering event occurred prior to the reformation.

Section 1.664-1(a)(1)(iii)(a) provides that the term "charitable remainder trust" means a trust with respect to which a deduction is allowable under §§ 170, 2055, 2106, or 2522 and which meets the description of a charitable remainder annuity trust (as described in § 1.664-2) or a charitable remainder unitrust (as described in § 1.664-3).

Section 1.664(a)(1)(i) provides that, generally, a charitable remainder trust is a trust that provides for a specified distribution, at least annually, to one or more beneficiaries, at least one of which is not a charity, for life or for a term of years, with an irrevocable remainder interest to be held for the benefit of, or paid over to, charity. The specified distribution to be paid at least annually must be a sum certain that is not less than 5 percent of the initial fair market value of all property placed in trust (in the case of a charitable remainder annuity trust) or a fixed percentage that is not less than 5 percent of the net fair market value of the trust assets, valued annually (in the case of a charitable remainder unitrust).

Section 1.664-3(a)(3)(ii) provides that a trust is not a charitable remainder unitrust if any person has the power to alter the amount paid to any named person other than an organization described in § 170(c) if such power would cause any person to be treated as the owner of the trust, or any portion thereof, if subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code were applicable to such trust.

In regard to charitable remainder unitrusts, § 1.664-3(a)(4) provides, in part, that the trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than an organization described in § 170(c). Notwithstanding the preceding sentence, the grantor may retain the power exercisable only by will to revoke or terminate the interest of any recipient other than an organization described in § 170(c).

Section 170(e)(1)(B) generally limits the amount of a contribution to a private foundation to the donor's basis in the property.

Section 170(f)(2) provides that no deduction is allowed under § 170 for the value of a remainder interest unless the

trust is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664).

Under Rev. Rul. 76-8, 1976-1 C.B. 179, a trust that otherwise qualifies as a charitable remainder unitrust may provide that the grantor or a recipient of the unitrust amount may have the power to designate the remainder beneficiary if the remainder beneficiary must be a charitable organization described in §§ 170(c), 2055(a) and 2522(a). The ruling does not require that the remainder beneficiary must also be an organization described in § 170(b)(1)(A).

Under Rev. Rul. 79-368, 1979-2 C.B. 109, the deduction allowed for the value of the remainder interest in property transferred to a charitable remainder unitrust is subject to the percentage limitations set forth in § 170(b)(1)(B) where the grantor or a recipient of the unitrust amount has the power to designate a remainder beneficiary that must be a charitable organization described in § 170(c) but need not be an organization described in § 170(b)(1)(A). Because the remainder beneficiary may be a private foundation other than a private foundation described in § 170(b)(1)(E), the deduction may also be limited by § 170(e)(1)(B)(ii).

Based solely on the facts and representations submitted, we conclude that the proposed reformation will not violate §§ 1.664-1(a), 1.664-3(a)(3)(ii) and 1.664-3(a)(4) or any provisions under § 664 and the remaining regulations thereunder. Because of a scrivener's error in the original trust agreement and evidence presented by A and B that clearly indicates that the proposed reformation is in accordance with A and B's original intent, the proposed reformations will not be treated as violating the requirement that the remainder interest to charity must be irrevocable. Accordingly, we conclude that the proposed reformation of Trust will not adversely affect Trust's qualification as a charitable remainder unitrust if it otherwise meets the requirements of § 664 and the applicable regulations.

However, the proposed reformation of Trust will affect A and B's income tax deduction under § 170 allowable for the charitable contribution made to Trust. The deduction is subject to the provisions of § 170(e)(1)(B)(ii) because the exception provided in § 170(e)(5)(B) for "qualified appreciated stock" does not apply. Under § 170(e)(1)(B)(ii), the value of the contribution will be determined using the taxpayers' adjusted basis, rather than the fair market value, in the contributed stock. In addition, under § 170(b)(1)(D)(i)(I) the taxpayers' charitable contribution deduction for the Year 1 and Year 2 taxable years will now be limited to 20 percent of the taxpayer's contribution base. This ruling is conditioned on A and B's filing timely

amended returns for the Year 1 and Year 2 taxable years, reporting reduced charitable deductions for the D1 contribution. This ruling is also conditioned on A and B timely paying the increased tax and any interest due for the Year 1 and Year 2 taxable years. In their amended returns, A and B must report a reduced charitable deduction in the taxable years which include the D1 deduction because of the limitation of the deduction to the value of the remainder interest in the basis, rather than fair market value, of the property and because of the 20 percent limitation for contributions of property to a private foundation.

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

Pursuant to a power of attorney on file with this office, copies of this letter are being sent to Trust's authorized representatives.

Sincerely yours,

J. THOMAS HINES
Senior Technician Reviewer
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of this letter
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