Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
February 18, 2000

In Re:

Legend

Taxpayer -
Trust -
x dollars -
y dollars -
Date 1 -
Child 1 -
Child 2 -
Child 3 -
State X -

Dear :

This is in response to your letter dated September 14, 1999, in which you requested rulings concerning the income and gift tax treatment of the establishment of a proposed charitable “lead” trust.

Taxpayer, a resident of State X, has three adult children, Child 1, Child 2, and Child 3, who are currently Taxpayer’s only descendants. You represent that Taxpayer proposes to establish an irrevocable trust (Trust), for the benefit of charitable organizations and Taxpayer’s three children. The trustees of Trust will be two unrelated individuals and an unrelated corporation. Taxpayer proposes to fund Trust with cash and property valued at x dollars at the date of contribution.

The dispositive provisions of the Trust will be as follows:

Article SECOND of the proposed trust instrument provides that, beginning in the year that Trust is established and continuing through Date 1, the trustees will distribute an annuity of y dollars each year to one or more “qualified charities” that the trustees will select each year. The distribution may be made in cash or in kind, or partly in each, at the trustees discretion, and may be paid in installments, but not less frequently than annually. The annuity may not be commuted or prepaid prior to the termination date.

For each taxable year, the annuity will be paid first from current income, and to the extent that current income is not sufficient, from accumulated income. To the extent that accumulated income is not sufficient, the annuity will be paid from principal (including capital gains). Any income not distributed may be added to principal in the trustees' discretion. In the event that, 15 days before the end of the taxable year, the trustees have not selected a qualified charity or charities to which to distribute the annuity, the annuity will be paid to two specified charities. If either organization is not a qualified charity, the annuity is to be distributed in its entirety to the other organization.

The term "qualified charities" is defined as only such organizations described in both sections 170(c) and 2522(a) of the Internal Revenue Code gifts to which qualify for a charitable deduction for Federal income and gift tax purposes.

Article SECOND, Paragraph B, provides that Trust will terminate on Date 1, in the year 2034, at which time the corpus will be distributed in equal shares, one share for each of the Taxpayer's children, A, B, and C, his or her heirs, executors, or administrators. Article FIFTH provides that, unless terminated sooner, Trust will terminate no later than 21 years after the death of the last to die of Taxpayer's descendants living on the date Trust is created.

Article SECOND, Paragraph A(4), provides that the annuity interest provided in Article SECOND cannot be commuted or prepaid prior to the termination date of the Trust.

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 shall:

(1) engage in any act of self-dealing as defined in section 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 section 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 section 4944 or corresponding provision of any subsequent federal tax laws; or

(4) make any taxable expenditures as defined in section 4945(d) or corresponding provision of any subsequent federal tax laws.

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 a gift tax deduction will be allowed to Taxpayer pursuant to § 2522 equal to the present 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(c)(2)(vi)(a) provides that the term "guaranteed annuity interest" 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)(a) 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 the general rule that in the case of an estate or trust (other than a trust meeting the 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)(2)(A)).

Section 642(c)(4) provides that in the case of a trust, the deduction allowed by

§ 642(c) shall be 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) 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).

After applying the law to the facts submitted and the representations made, we conclude that 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), the Trust will be allowed deductions in accordance with § 642(c)(1) for amounts of gross income paid to "qualified charities" during the taxable year, or by the close of the following taxable year, if the trustees make an election 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 principal except to the extent that the amount distributed has been included in the gross income of the trust and provided no deduction was allowed for any previous taxable year for the amount distributed as provided in § 1.642(c)-1(b).

Section 671 provides that where the grantor or another person is treated as the owner of any portion of a trust, there shall 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 that are attributable to that portion of the trust to the extent that such items would be taken into account under Chapter 1 of the Code in computing taxable income or credits of an individual.

Section 673 through 678 specify the circumstances under which the grantor or another person will be regarded as the owner of a portion of a trust. Our examination of the trust agreement reveals none of the circumstances that would cause the Taxpayer to be treated as the owner of any portion of the Trust under §§ 673, 674, 676, or 677 or would cause any other person to be treated as the owner under § 678.

Under § 675 and the applicable regulations, the grantor of a trust is treated as the owner of any portion of the trust if under the terms of the trust agreement or circumstances attendant on its operation, administrative control is exercised primarily for the benefit of the grantor rather than the beneficiaries of the trust.

After applying the law to the facts submitted and representations made, neither the Taxpayer nor any other person will be treated as the owner of the Trust or any portion thereof under §§ 673, 674, 676, 677 or 678. Our examination of the trust

agreement reveals none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the Taxpayer under § 675. However, this is a question of fact, the determination of which must be made by the appropriate District Director. If the circumstances attendant to the operation of the Trust do not require the Taxpayer to be treated as the owner, neither the Taxpayer nor any other person will be treated as the owner of the Trust.

A copy of this letter should be attached to any income or gift tax returns that you may file relating to these matters.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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 provision of the Code.

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

Sincerely,
Assistant Chief Counsel
(Passthroughs and Special Industries)
By George Masnik
Chief, Branch 4

Enclosure
Copy for 6110 purposes