

Internal Revenue Service

Department of the Treasury

Number: **200140027**
Release Date: 10/5/2001
Index Numbers: 0170.12-03; 0664.00-00;
2522.02-03

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:4-PLR-111789-00

Date:

June 29, 2001

Re:

LEGEND:

- Taxpayer =
- Spouse =
- Trust =
- Shares =
- Trustee =
- Date =
- Charity =
- State =
- x =
- Trust A =
- Trust B =
- Notification =
- Assignment =
- Statute =

Dear :

This is in response to your letter of May 30, 2001, and other correspondence requesting rulings concerning the proposed transfer of a unitrust interest in Trust to Charity.

Taxpayer created the Trust, a charitable remainder unitrust, on Date. Trust was funded by Taxpayer with Shares, and Trustee was designated as the trustee.

Under Article III, Paragraph 3.1. of the Trust, during Taxpayer's lifetime, the trustee is to pay to Taxpayer, in each taxable year of the Trust, a unitrust amount equal to 5 percent of the net fair market value of the trust assets valued on the first day of each taxable year of the Trust. The unitrust amount is to be paid in equal semi-annual installments from income and, to the extent that income is not sufficient for that purpose, from principal. Any Trust income in excess of the unitrust amount is to be

PLR-111789-00

added to principal.

On Taxpayer's death, the unitrust interest was payable to Spouse if living, for her life. Taxpayer reserved the power, exercisable by will, to revoke and terminate Spouse's interest.

Under Paragraph 3.2. of Article III of the Trust, on the death of the last to die of Taxpayer and Spouse, or on Taxpayer's death if he revokes Spouse's unitrust interest, the trustee is to distribute all of the then principal and income of Trust to and among certain named organizations. However, Taxpayer may, from time to time, change the amounts or percentages which are to be distributed or may designate other charitable organizations to which distributions are to be made. However, no organization may be designated as a beneficiary unless the organization is described in §§ 170(b)(1)(A), 2055(a) and 2522(a).

Spouse has died and her interest in the Trust was extinguished.

Trustee proposes to divide the Trust into two separate trusts, Trust A and Trust B, on a fractional basis of 85 percent and 15 percent respectively, allocating assets to each that are fairly representative of the relative basis of the assets in the Trust prior to the division together with accruals. Both Trust A and Trust B will be governed by the provisions of the Trust. Taxpayer will execute the "Notification" pursuant to which Taxpayer will irrevocably designate Charity, an organization described in §§ 170(b)(1)(A), 2055(a), and 2522(a), as the remainder beneficiary of Trust B. Taxpayer will then execute the "Assignment" under which he assigns to Charity his unitrust interest in the assets segregated as Trust B. Taxpayer and Charity consented to the distribution to Charity of all of the assets in Trust B, after the above transactions..

Under applicable local law, unless the instrument of transfer manifests a contrary intent, the renunciation or release of an interest for life accelerates the succeeding interests. Statute. Further, Taxpayer represents that, under State law, the segregation of assets into Trust B, the designation of Charity as the remainder beneficiary of Trust B, and the assignment to Charity of the unitrust interest in Trust B will result in a merger of the unitrust and remainder interests in Trust B, and Charity will be entitled to an outright distribution of the Trust B corpus.

It is represented that, at the time the Trust was established, there was no intention on the part of Taxpayer or Trustee to divide the income and remainder interests as a method to avoid the partial interest rules in § 170(f).

REQUESTED RULINGS:

PLR-111789-00

You have asked for the following rulings:

(1) Taxpayer will be entitled to an income tax deduction under § 170 for the value of the unitrust payment transferred to Charity.

(2) Taxpayer will be entitled to a gift tax deduction under § 2522 for the value of the transfer to Charity.

(3) The gift of the unitrust interest in Trust B will not cause Trust A to cease to be a qualified charitable remainder unitrust described in § 664(d)(2).

RULING REQUEST 1

Section 170(a)(1) of the Internal Revenue Code provides that there shall be allowed as a deduction any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year.

Section 170(f)(3)(A) provides that a contribution (not made by a transfer in trust) of less than the taxpayer's entire interest in property is not allowed as a charitable contribution deduction except to the extent such contribution would have been allowed as a deduction had it been transferred in trust.

Section 170(f)(3)(B)(ii) provides that § 170(f)(3)(A) does not apply to a contribution of an undivided portion of the taxpayer's entire interest in property.

Section 1.170A-6(a)(2) and § 1.170A-7(a)(2)(i) of the Income Tax Regulations provide that a deduction is allowed for a contribution of a partial interest in property if such interest is the taxpayer's entire interest in the property, such as an income interest or a remainder interest. If, however, the property in which such partial interest exists was divided in order to create such interest and thus avoid certain provisions of § 170(f), the deduction will not be allowed.

Rev. Rul. 86-60, 1986-1 C.B. 302, Situation 2, considered whether a donation qualifies for the charitable contribution deduction under § 170, if a taxpayer, A, who is the grantor/life beneficiary of a charitable remainder annuity trust (CRAT) donates A's annuity interest in the CRAT to the remainder beneficiary of the CRAT. In 1980, A had created a CRAT described in § 664(d)(1). A retained an annuity interest in the CRAT for life. Although A had previously divided the interest A held in the property, the division was not to avoid § 170(f)(2)(A). The remainder beneficiary was X, a charitable organization described in § 170(c). In 1984, A transferred the annuity interest in the CRAT to X. Rev. Rul. 86-60 concludes, based on §§ 1.170A-6(a)(2) and 1.170A-7(a)(2)(i), that the gift by A, the grantor, to the remainder beneficiary of A's retained life annuity in the CRAT qualifies for a charitable contribution deduction under § 170.

PLR-111789-00

The present case is analogous to the situation in Rev. Rul. 86-60. In the present case, Taxpayer retained a unitrust interest in the Trust which he created x years ago on Date. Now, he proposes to transfer a portion of his unitrust interest to Charity, which will also be the remainder beneficiary of the Trust. Unlike the situation in Rev. Rul. 86-60, the Trust will be divided into two trusts, Trust A and Trust B. Taxpayer proposes to contribute his interest in Trust B, which will be segregated from the Trust, instead of all of his interest in the Trust. Taxpayer represents that Charity's unitrust and remainder interests will merge, and Charity will be entitled to an immediate distribution of the Trust B corpus.

It is represented that Taxpayer did not divide his interest in the property originally transferred to the Trust on Date to avoid the partial interest rules. Taxpayer's representation is creditable in part because of the x-year period between the creation of the Trust and the proposed contribution. Taxpayer now intends in effect to contribute an undivided portion of his entire current interest in the property to Charity. Taxpayer intends to do this by dividing the Trust into two trusts, Trust A and Trust B, and then contributing his interest in Trust B to Charity. Similar to taxpayer A in Rev. Rul. 86-60, Taxpayer would be entitled to a charitable contribution deduction for a contribution of an undivided portion of his unitrust interest in the Trust to Charity under the rule in § 170(f)(3)(B)(ii). That Taxpayer will divide the Trust before making the contribution does not adversely affect the charitable contribution deduction, because Taxpayer is not dividing the Trust in order to avoid the partial interest rule of § 170(f)(3). Therefore, Taxpayer's transfer of his interest in Trust B will qualify for a charitable contribution deduction under § 170.

The value of Taxpayer's gift under § 170 will be the present value of the right to receive unitrust payments equal to 5 percent of the value of the Trust B assets payable in equal semi-annual installments at the beginning of each semi-annual period determined annually for a term starting on the date of the transfer of the gift to Charity and ending on Taxpayer's date of death. The deduction will be subject to any applicable limitations under § 170 including § 170 (b) and subject to any applicable limitations under other sections of the Code.

RULING REQUEST 2

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511(a) provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that as to any property

PLR-111789-00

of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.

Section 25.2511-2(c) provides that a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

Section 2522 provides that, in computing taxable gifts for the calendar year, there shall be allowed as a deduction the amount of all gifts made during such year to or for the use of organizations described in § 2522(a).

Section 2522(c)(2) provides that where a donor transfers an interest in property, other than an interest described in § 170(f)(3)(B) (remainder interest in a farm or residence, or an undivided portion of the donor's entire interest) to or for a charity and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in subsection (a) or (b), no deduction shall be allowed under § 2522 for the interest which is transferred unless, in the case of any interest other than a remainder interest, the interest is in the form of a guaranteed annuity or a fixed percentage distributed yearly of the annual fair market value of the property to be determined yearly (a unitrust interest).

Section 25.2522(c)-3(c)(1)(i) provides that if a donor transfers an interest in property for charitable purposes and an interest in the same property is retained by the donor, or is transferred or has been transferred for private purposes after such date, no deduction is allowed for the value of the interest which is transferred or has been transferred for charitable purposes unless the interest in property is a deductible interest described in § 25.2522(c)-3(c)(2).

Section 25.2522(c)-3(c)(2)(i) provides that a deductible interest is a charitable interest in property where the charitable interest is an undivided portion, not in trust, of the donor's entire interest in property. An undivided portion of a donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in the property and must extend over the entire term of the donor's interest in the property.

Section 25.2522(c)-3(c)(2)(vii) provides that a deductible interest is a "unitrust interest." The term unitrust interest means an irrevocable right pursuant to the instrument of transfer to receive payment, not less often than annually, of a fixed percentage of the net fair market value, determined annually, of the property which funds the unitrust interest.

PLR-111789-00

Situation 1 of Rev. Rul. 86-60, *supra*, considers a situation where the grantor of a charitable remainder annuity trust transfers his entire retained interest to the charitable remainderman. Following the transfer, the grantor did not retain any interest in the trust, and neither at that time nor at any prior time did he make a transfer from the trust for private purposes. Although the transfer of the remainder interest to charity divided the grantor's prior interest, the transfer was for charitable, not private interests. Consequently, the grantor's transfer of the annuity interest to charity was not required to be in a form described in § 2522(c)(2)(B) and § 25.2522(c)-3(c)(2) in order to qualify for the charitable deduction. Accordingly, the grantor's transfer of the annuity interest to charity qualifies for a deduction under § 2522(a).

In this case, Taxpayer created the Trust, a charitable remainder unitrust, on Date, retaining a unitrust interest in the Trust, payable for his lifetime. In addition, Taxpayer's spouse received a secondary life interest, with respect to which Taxpayer retained a revocation right. Finally, Taxpayer reserved the right to designate the charitable remainder beneficiaries and their proportionate interests. Accordingly, Taxpayer did not make a completed gift of the remainder interest, for gift tax purposes, at that time. See Rev. Rul. 77-275, 1977-2 C.B. 346; § 25.2511-2(c). Similarly, because Taxpayer retained the right to revoke Spouse's successor interest, he did not make a completed gift for private purposes within the meaning of § 2522(c)(2). See Rev. Rul. 79-243, 1979-2 C.B. 343.

Taxpayer proposes to divide Trust into two trusts, Trust A (85 percent of Trust assets) and Trust B (15 percent of Trust assets) and irrevocably designate Charity as the remainder beneficiary of Trust B. Upon the irrevocable designation, Taxpayer's transfer of the remainder in Trust B will be a completed gift. Taxpayer also proposes to transfer to Charity his lifetime unitrust interest in Trust B.

Thus, Taxpayer's transfer to Charity, for gift tax purposes, will constitute a transfer not in trust of a fraction or percentage of each and every interest and right owned by Taxpayer in the property. See Rev. Rul. 79-295, 1979-2 C.B. 349. Accordingly, we conclude that Taxpayer will be entitled to a gift tax charitable deduction under § 2522(a) for the present value of the unitrust and remainder interest in Trust B passing to Charity.

RULING REQUEST #3

Section 1.664-3(a)(4) provides that the governing instrument may provide that any amount other than the unitrust amount shall be paid (or may be paid in the discretion of the trustee) to an organization described in § 170(c) provided that, in the case of distributions in kind, the adjusted basis of the property distributed is fairly representative of the adjusted basis of the property available for payment on the date of the payment.

PLR-111789-00

The regulations, therefore, authorize the current distribution of unitrust assets to a charitable organization. In this case, it is represented that under State law, upon Taxpayers' transfer of his Trust B unitrust payment to Charity, Charity's interest in the unitrust payment and Charity's interest in the Trust B remainder will merge. Although a termination of Trust B will occur, Trust A will continue to be in the form of, and will function as, a charitable remainder unitrust within the meaning of § 664(d)(2). Accordingly, the gift of the undivided partial interest in the unitrust will not cause Trust A to cease to be a trust described in § 664(d)(2).

No opinion is expressed concerning the federal tax consequences of the proposed transaction under any other provisions of the Code. A copy of this ruling should be attached to Taxpayer's federal income and gift tax returns for the tax years affected.

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 yours,
George Masnik
Branch Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
copy for § 6110 purposes