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April 21, 2009

LEGEND

Taxpayer =

Trust =

Charity =

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

State =

State Court =

Case 1 =

Case 2 =

Dear :

This is in response to your letter dated December 23, 2008, and subsequent correspondence, in which you requested rulings regarding the proposed reformation of a charitable remainder unitrust (CRUT).

The facts presented and representations made are as follows: On Date 1, Taxpayer created Trust. By its terms, Trust is an irrevocable net income with makeup charitable remainder unitrust (NIMCRUT). Charity is the trustee of the Trust.

As originally executed, Article 2.01 of Trust provides that in each taxable year of the trust until Taxpayer's death, the trustee shall pay the Unitrust Amount to Taxpayer. After Taxpayer's death, the Unitrust Amount is to be paid to Taxpayer's Spouse until death, if the spouse survives the Taxpayer. Article 1.02(E) defines the Unitrust Amount as (1) the lesser of (i) the trust income for the taxable year (as defined in § 643(b)) and (ii) X percent of the net fair market value of the trust assets, valued as of the first day of each taxable year of the trust, plus (2) any amount of income of the Trust that is in excess of X percent for such taxable year, but only to the extent that the aggregate of the Unitrust Amounts paid in prior taxable years was less than the aggregate X percent determined for all such prior taxable years (the "NIMCRUT provisions").

Article 2.03 provides that upon termination of the noncharitable interests, the trustee shall distribute all of the remaining principal and income of the trust to Charity. It further provides for the selection of alternate charitable beneficiaries in the event Charity is not an organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) upon the termination of the noncharitable interests.

During the planning stages which lead to the creation of the Trust, the Taxpayer desired to create a CRUT with certain appreciated assets. At the time of contribution, the contributed assets were illiquid and did not generate the X percent return desired by the Taxpayer. The Taxpayer acknowledged that the NIMCRUT provisions contained in Article 2.01 were necessary while the trust held the contributed assets, but the Taxpayer requested that the NIMCRUT provisions only be effective so long as the Trust held the contributed property. A draft trust agreement that contained these NIMCRUT conversion provisions was sent to the Taxpayer for review.

Due to miscommunications between the Taxpayer and the Taxpayer's advisors, a revised trust agreement was prepared and executed that did not contain the provision providing that the NIMCRUT provisions were only applicable so long as the Trust held the contributed property, resulting in an executed trust agreement that operated as a NIMCRUT for its entire term.

In attempting to administer the terms of the Trust, the Charity, in its capacity as trustee, discovered the discrepancies between the expressed intent of the Taxpayer and the actual terms of the Trust.

On Date 2, the Charity, in its capacity as trustee, and with the permission and cooperation of the Taxpayer, filed a petition with the State Court requesting a reformation of the Trust to add a new provision at the end of Article 1.02(E). The requested reformation to Article 1.02(E) provided that once certain contributed property was sold by the Trust, the Unitrust Amount during the remaining Unitrust Period shall be an amount equal to X percent of the net fair market value of the Trust assets, valued as of the first day of each taxable year of the Trust.

On Date 3, State Court granted the request to reform the Trust to include the revised version of Section 1.02(E) converting the NIMCRUT provisions to an amount based solely on the value of Trust assets on the date certain assets contributed to the Trust were sold. The reformation was effective on Date 4.

You now request the following rulings:

Ruling 1. The judicial reformation of Trust, ab initio, does not violate § 664.

Ruling 2. The continuing qualification of Trust under § 664 is not adversely affected by the judicial reformation.

Ruling 3. The judicial reformation of Trust does not result in an act of self-dealing.

Rulings 1 and 2

Section 664(d)(2) provides that for purposes of § 664, a charitable remainder unitrust is a trust -- (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent of the initial net fair market value of all property placed in trust) is to be paid, not less frequently than annually, to one or more persons (at least one of which is not an organization described in § 170(c) and, in the case of individuals, only to an individual who is living at the time of creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals; (B) from which no amount other than the payments described in § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c); (C) following termination of the payments described in § 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in § 664(g)(4)), all or a part of such securities are to be transferred to an employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined in § 664(g)); and (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of the remainder interest passing to charity is at least 10 percent of the initial net fair market value of all property placed in the trust.

Section 664(d)(3) provides that notwithstanding the provisions of § 664(d)(2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year -- (A) the amount of the trust income, if such amount is less than the amount required to be distributed under § 664(d)(2)(A), and (B) any amount of the trust income which is in excess of the trust amount required to be distributed under § 664(d)(2)(A), to the extent that (by reason of § 664(d)(3)(A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

Section 1.664-3(a)(4) of the Income Tax Regulations provides, in part, that a charitable remainder 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).

In Commissioner v. Estate of Bosch, 387 U.S. 456, 87 S. Ct. 1776, 18 L. Ed. 2d 886 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

Under State law, trial courts have the power to reform a trust agreement under certain conditions, including when doing so will reflect the settlor's intent and true desires. Case 1; Case 2.

A modification or reformation of a charitable remainder trust does not violate § 664 if the modification or reformation is necessary to conform the trust instrument to the grantor's intent. In this case, an examination of the trust instrument and the other evidence presented indicates that the provisions of the Trust, as originally drafted, are contrary to the intent of Taxpayer.

Based on an analysis of the facts submitted and the representations made, we have determined that State Court's Date 3 reformation of Trust is consistent with applicable state law, as it would be applied by the highest court of the state. We therefore conclude that the judicial reformation of Trust does not violate § 664. Further, the judicial reformation of Trust will not adversely affect Trust's qualification as a valid CRUT under § 664.

Ruling 3

Section 4941(a) of the Code imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(E) of the Code provides that the term “self dealing” means any direct or indirect transfer to or for the use of, or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a) of the Code provides that the term “disqualified person” with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), the foundation manager (including a trustee) and the members of the family of those individuals.

Section 4947(a)(2) of the Code provides, in pertinent part, that in the case of a trust which is not exempt from tax under § 501(a), not all of the unexpired interests in which are devoted to one or more charitable purposes, and which has amounts in trust for which a charitable deduction was allowed, § 4941 applies as if such trust were a private foundation.

Section 4947(a)(2)(A) of the Code provides that § 4947(a)(2) shall not apply with respect to any amounts payable under the terms of such trust to non-charitable income beneficiaries, unless a deduction was allowed under certain sections of the Code.

Section 53.4947-1(c)(2)(ii) of the Foundation and Similar Excise Taxes Regulations provides, in essence, that payments of income by a charitable remainder unitrust to its individual income beneficiaries do not result in any tax on self-dealing by virtue of the application of § 4947.

The analysis is two-fold in that we must first delve into whether the self-dealing rules of Chapter 42 of the Code apply to Taxpayer as income beneficiary. We must also determine if there are any self-dealing issues regarding whether Taxpayer, as a substantial contributor, is involved in any self-dealing transactions with regard to the Trust.

First, as a charitable remainder unitrust under § 664(d)(2) of the Code, the Trust is considered to be a split-interest trust as described in § 4947(a)(2). By virtue of being described in § 4947(a)(2), the Trust is subject to the provisions of § 4941, which impose an excise tax on acts of self-dealing. The involvement of disqualified persons in certain transactions with the Trust constitutes self-dealing under § 4941. Since Taxpayer is a substantial contributor to the Trust under § 4946, Taxpayer is considered to be a disqualified person with respect to the Trust. Therefore, because the proposed judicial reformation of the Trust based on a drafting error may have the effect of increasing the annual amount payable to Taxpayer, any such increase could be considered to be a transfer to, or use by, or for the benefit of, a disqualified person of income or assets of a private foundation and may be considered to be an act of self-dealing under § 4941.

However, under § 4947(a)(2) of the Code, the self-dealing rules of § 4941 do not apply to any amounts payable under the terms of a split-interest trust to income beneficiaries as long as no deduction was allowed under §§ 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B) with respect to the income interest of any such beneficiary. As a result, the self-dealing rules of § 4941 do not apply to Taxpayer as an income beneficiary to the extent that Taxpayer did not take a deduction as described above.

Regarding whether Taxpayer, as a substantial contributor, is subject to the self-dealing rules of § 4941 of the Code, the circumstances presented above indicate that there is no act of self-dealing. We are satisfied a mistake was made in the drafting of the Trust as set forth above.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(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 your authorized representative.

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 an 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.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes