INTERNAL REVENUE SERVICE
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November 5, 1998

Legend

Trust A =

Trust B =

Grantor =

X =

Foundation =

a =

State A =

b =

c =

d =

Dear Sir:

In a letter dated , and subsequent submissions, you requested rulings regarding the estate, gift, and generation-skipping transfer ("GST") tax consequences, and the income tax consequences related to the creation of a charitable lead unitrust ("Trust A") and a charitable lead annuity trust ("Trust B"). Specifically, you have requested the following rulings:

1. Trust A and Trust B will qualify as charitable lead trusts, the funding of which will result in completed gifts for federal gift tax purposes and will entitle Grantor to gift tax charitable deductions under § 2522 of the Internal Revenue Code based upon the present value, determined in accordance with §§ 25.2522(c)-3(d)(2)(v) and 25.2512-5 of the Gift Tax Regulations, respectively, of the unitrust and annuity payments payable from Trust A and Trust B.

2. Upon the Grantor's death, no portion of the principal of either Trust A or Trust B will be included in her gross estate under § 2033, 2035, 2036, or 2038.

3. If the Grantor allocates her GST exemption to Trust A, Trust A's applicable fraction for GST purposes shall be equal to the amount of GST exemption allocated to Trust A divided by the value of the property contributed to Trust A less the amount of the charitable deduction allowed for gift tax purposes with respect to the lead unitrust interest.

4. Grantor will be entitled to an income tax charitable deduction under § 170(f)(2)(B) based upon the present value of the unitrust and annuity payments payable from Trust A and Trust B.

5. If the charitable deduction allowed for the year in which Trust A and Trust B are created exceeds the limitations imposed by § 170(b), the unused portion of this deduction may be carried forward by the Grantor pursuant to § 170(b).

6. During the Grantor's lifetime, Trust A and Trust B will be treated as grantor trusts for income tax purposes.

7. Beginning after Grantor's death, Trust A and Trust B will be eligible to elect, under current law, to qualify as electing small business trusts under § 1361(e)(1) for tax years beginning after December 31, 1997.

The facts and representations submitted are as follows. Grantor proposes to create two irrevocable trusts: Trust A, a charitable lead unitrust, and Trust B, a charitable lead annuity trust. Under the terms of Trust A and Trust B, the Grantor is the sole grantor. Grantor proposes to transfer stock of X, a subchapter S corporation, to Trust A and Trust B. Both trusts will terminate six years from the date of inception of

each trust.

The beneficiary of the charitable lead interests of Trust A and Trust B is Foundation. Foundation is exempt from federal income tax under § 501(c)(3) and is classified as a private foundation defined in § 509. Grantor is a director and officer of Foundation. The by-laws of Foundation will be amended before Trust A and Trust B are executed to provide that any funds Foundation receives from Trust A and Trust B will be required to be segregated into a separate fund, with control over the disbursement of the segregated funds limited to directors and officers of Foundation other than Grantor.

During Grantor's life, Grantor's brother, a, has a power, exercisable in a non fiduciary capacity, to reacquire trust property by substituting property of an equivalent value. When the trusts terminate, the remaining principal and any accrued or undistributed trust income will be either distributed, or held in further trust for the benefit of Grantor's descendants.

Grantor represents that: (1) all beneficiaries of Trust A and Trust B are individuals or qualifying exempt organizations as defined in § 1361(e)(1)(A)(i); (2) Trust A and Trust B are not exempt from tax under subtitle A of the Code; and (3) a is a nonadverse party within the meaning of § 672.

Trust A

Under the terms of Trust A, during the last day of each year of the charitable lead interest, the trustee will pay a unitrust amount, equal to a rate selected to fix the charitable interest at slightly below sixty percent of the net fair market value of the assets to Foundation, or if Foundation shall not be a “qualified charitable organization” on such date, to such one or more charitable recipients and, if more than one, in such equal or unequal shares as the trustees, in their sole and absolute discretion, shall determine. The trustees shall prorate the unitrust amount on a daily basis for any short taxable year.

Article First, section A1 provides that the words “qualified charitable organization” shall mean and refer to an organization that shall be qualified as an organization to which contributions, gifts, and bequests are deductible for United States income tax, gift tax, and estate tax purposes under the provisions of § 170(c)(2), (3), (4) or (5) and §§ 2522(a) and 2055(a). Article First, section A2 provides that the words “charitable recipients” shall mean and refer to an organization or organizations which shall, on the date any distribution is paid to it or them pursuant to the provisions of this article, be a qualified charitable organization which the trustees, in their discretion, shall select and designate pursuant to the provisions hereof in a written instrument signed and acknowledged by the trustees and filed with the trust records; provided, however, that the charitable recipients selected on any occasion may, but need not be the same organization or organizations selected by the trustees on any previous occasions.

Article First, section B3 provides that the unitrust amount shall be paid by the

trustees first from items constituting gross income of such trust for purposes of § 642(c) for the taxable year for which such amount is payable, and shall be paid first from ordinary income (other than unrelated business income), then from short-term capital gains and then from long-term capital gains. To the extent that such items of gross income are insufficient to pay the unitrust amount in full for any year, the unpaid portion of the unitrust amount for such year shall be paid from other items of income and/or principal of such trust as the trustees shall determine. Article First, section C1 provides that upon termination of the charitable lead interest, the trustees shall pay the then principal of the trust, together with all net income thereof accrued but not yet collected, and collected but not yet disposed of, other than any amount then due to any qualified charitable organizations, as follows:

1. If any descendant of Grantor shall be living upon termination of the lead interest, the trustees shall continue to hold the principal and income in accordance with the provisions of Article Second.

2. If no descendant of Grantor shall be living on the termination of the lead interest, the trustees shall pay the principal and income to qualified charitable organizations that the trustees, in their discretion select. If the trustees fail to select a qualified charitable organization within six months of the termination of the lead interest, the principal and income will go to Foundation, provided that Foundation is then a qualified charitable organization. Pursuant to Article First, section B4, any income not paid out pursuant to any other provision of Section B shall be accumulated and, at least annually, added to the principal of Trust A.

Article First, section C, and Article Second provide that upon termination of the charitable lead interest, the remaining corpus and income will be held in further trust by the trustees for the Grantor's descendants. This further trust will terminate upon the date of death of the last surviving beneficiary of the trust. At that time, the trustees will pay the principal of the trust, together with all net income accrued but not yet collected, and collected but not yet disposed of, to one or more qualified charitable organizations as the trustees in their discretion shall select. If the trustees fail to select a qualified charitable organization within six months of the termination of the trust, the principal and income will go to Foundation.

Article First, section D3 provides that the trustees are prohibited: (i) from engaging in any act of self-dealing as defined in § 4941(d); (ii) except to the extent provided by § 4947(b)(3), from retaining any excess business holdings as defined in § 4943(c) which would subject the trust to tax under § 4943 or from making or retaining any investments which would subject the trust to tax under § 4944; and (iii) from making any taxable expenditure as defined in § 4945(d).

Article Third provides that no person may make any addition to the income or principal of Trust A.

Article Fourth provides that Trust A is irrevocable and not subject to amendment or change, except as directed in Article First, section D4. Article First, section D4 provides that it is the grantor's express intention that Trust A qualify as a charitable lead unitrust as described in the Internal Revenue Code and the regulations thereunder, and the trustees are empowered to amend the terms of Trust A relating to such trust or the administration or investment of it, for the sole purpose of complying with the Code and regulations so that Trust A will qualify and continue to qualify as a charitable lead unitrust.

Article Fifth provides that Trust A shall be governed by the laws of State A.

Article Sixth provides that there will be one initial corporate trustee and two individuals. Grantor may not be appointed a trustee.

Article Tenth, section G1, provides that at any time when Grantor is living, a shall be authorized to exercise the power, which he shall exercise in a non-fiduciary capacity, to reacquire or acquire any principal which is held in Trust A by substituting other property having an equivalent value on the date of substitution. Paragraph G2 provides that b shall have this power at any time when the Grantor is living but a is not living.

Trust B

Article First, section B2 provides that during each taxable year of the charitable lead interest, the trustees shall pay the annuity amount on the last day of each year to Foundation, provided it shall be a qualified charitable organization on such date, or, if it shall not be a qualified charitable organization on such date, to one or more charitable recipients and, if more than one, in such equal or unequal shares as the trustees, in their sole and absolute discretion, shall determine.

Article First, section A1 provides that the words "qualified charitable organization" shall mean and refer to an organization that shall be qualified as an organization to which contributions, gifts and bequests are deductible for United States income tax, gift tax, and estate tax purposes under the provisions of § 170(c)(2), (3), (4) or (5) and §§ 2522(a) and 2055(a). Article First, section A2 provides that the words "charitable recipients" shall mean and refer to an organization or organizations which shall, on the date any distribution is paid to it or them pursuant to the provisions of this Article, be a qualified charitable organization which the trustees, in their discretion, shall select and designate pursuant to the provisions hereof in a written instrument signed and acknowledged by the trustees and filed with the trust records; provided, however, that the charitable recipients selected on any occasion may, but need not be the same organization or organizations selected by the trustees on any previous occasion.

Article First, section B1 provides that the annuity amount will be equal to a percentage of the original net fair market value of the property held in the trust as of the date of the trust agreement. The rate selected will fix the charitable interest at slightly

below 60 percent. The trustees shall prorate the annuity amount on a daily basis for any short taxable of the net fair market value of the trust assets.

Article First, section B3 provides that the trustees shall pay the annuity amount first from items constituting gross income of the trust for purposes of § 642(c) for the taxable year that such amount is payable, and shall be paid from ordinary income (other than unrelated business income), then from short-term capital gains and then from long-term capital gains. To the extent that these items of gross income are insufficient to pay the annuity amount in full for any year, the unpaid portion of the annuity amount for such year shall be paid from other items of income and/or principal of the trust as the trustees determine.

Article First, section B4 provides that any income not paid out pursuant to the other provisions of section B shall be accumulated and, at least annually, added to the principal of Trust B.

Under Article First, section C1, upon termination of the charitable lead interest, the trustees shall pay the then principal of the trust, together with all net income thereof accrued but not yet collected, and collected but not yet disposed of, other than any amount then due to any qualified charitable organizations, as follows:

1. If any descendant of Grantor shall be living upon termination of the lead interest, the trustees shall pay the principal and income, per stirpes, to the living descendants of the grantor as shall then be living, subject, however, in the case of c and d, and each grandchild and more remote descendants of Grantor pursuant to a continuing trust established under Article Second.

2. If no descendant of the grantor shall be living on the termination of the lead interest, the trustees shall pay the principal and income to qualified charitable organizations that the trustees, in their discretion shall select. If the trustees fail to select a qualified charitable organization within six months of the termination of the lead interest, the principal and income will go to Foundation.

Article First, section D3 provides that the trustees are prohibited: (i) from engaging in any act of self-dealing as defined in § 4941(d); (ii) except to the extent provided by § 4947(b)(3), from retaining any excess business holdings as defined in § 4943(c) which would subject the trust to tax under § 4943 or from making or retaining any investments which would subject the trust to tax under § 4944; and (iii) from making any taxable expenditure as defined in § 4945(d).

Article Third provides that no person may make any addition to the income or principal of Trust B.

Article Fourth provides that the trust is irrevocable and not subject to amendment or change, except for that provided by Article First, section D4. Article First, section D4

provides that it is Grantor's express intention that the trust shall qualify as a charitable lead annuity trust as described in the Internal Revenue Code and the regulations thereunder, and the trustees are empowered to amend the terms of Trust B relating to such trust or the administration or investment of it, for the sole purpose of complying with the Code and regulations so that the trust will qualify and continue to qualify as a charitable lead annuity trust.

Article Sixth provides that the initial trustees of Trust B are two individuals. Each is authorized to appoint another individual to act in her place; however Grantor may not be appointed trustee.

Article Tenth, section G provides that at any time when the Grantor is living, a shall be authorized to exercise the power, which he shall exercise in a non-fiduciary capacity, to reacquire or acquire any principal which is held in the trust by substituting other property having an equivalent value on the date of substitution. Paragraph G2 provides that b shall have this power at any time when the Grantor is living but a is not living.

Gift, Estate and Generation-Skipping Transfer Tax Issues

Ruling Request 1 - Trust A and Trust B will qualify as charitable lead trusts, the funding of which will result in completed gifts for federal gift tax purposes and will entitle Grantor to gift tax charitable deductions under Internal Revenue Code § 2522 based upon the present value, determined in accordance with §§ 25.2522(c)-3(d)(2)(v) and 25.2512-5, respectively, of the unitrust and annuity payments payable from Trust A and Trust B.

Section 2501 provides that a tax, computed as provided in § 2502, is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident, or nonresident.

Section 2511(a) provides, in part, that subject to limitations contained in chapter 12, the tax imposed by § 2501 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 2522(a) provides that, in computing an individual's taxable gifts for the calendar year, a deduction shall be allowed for the amount of all gifts to or for the use of certain governmental entities, certain corporations organized and operated exclusively for religious, charitable, scientific, educational purposes, and certain other fraternal organizations.

Section 2522(c)(2)(B) provides that, where a transfer is made to both a charitable and a noncharitable person or entity, no deduction shall be allowed for the charitable portion of the gift unless, in the case of interests other than charitable remainder

interests, 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 25.2522(c)-3(c)(2)(vi) 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 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 which must be paid under the conditions specified in the instrument of transfer can be ascertained as of the date of 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.

Section 25.2522(c)-3(c)(2)(vii) states that the term "unitrust interest" means the right pursuant to the instrument of transfer to receive a 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. In computing the net fair market value of the property which funds the unitrust interest, all assets and liabilities shall be taken into account without regard to whether particular items are taken into account in determining the income from the property. The net fair market value of the property which funds the unitrust interest may be determined on any one date during the year or by taking the average of valuations made on more than one date during the year, provided that the same valuation date or dates and valuation methods are used each year. Payments under a unitrust interest may be paid 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 such date.

Section 25.2522(c)-3(d)(1) provides that the amount of the deduction in the case of a contribution of a partial interest in property to which § 2522 applies is the fair market value of the partial interest on the date of gift. The fair market value of an annuity, life estate, term for years, remainder, reversion, or unitrust interest is its present value.

Section 25.2522(c)-3(d)(2)(iv) provides, in part, that the present value of a guaranteed annuity interest is to be determined under § 25.2512-5 except that, if the annuity is issued by a company regularly engaged in the sale of annuities, the present value is to be determined under § 25.2512-6.

Section 25.2522(c)-3(d)(2)(v) provides that the present value of a unitrust interest is to be determined by subtracting the present value of all interests in the transferred property other than the unitrust interest from the fair market value of the transferred property.

Based upon the facts submitted and the representations made, under the terms of Trust A, a qualified charitable organization or organizations are given the irrevocable right to receive annually, for a specified term of six years, a fixed percentage of the net fair market value, determined annually, of the property that funds the unitrust interest. We conclude that the interest is a unitrust interest within the meaning of § 2522(c)(2)(B) and the regulations thereunder. Accordingly, we conclude that a gift tax charitable deduction under § 2522(a) will be allowed in an amount equal to the present value of the unitrust interest determined as of the date of the funding of Trust A. The amount of the charitable deduction will be determined under § 25.2522-3(d)(2)(v).

Based upon the information submitted and the representations made, under the terms of Trust B, a qualified charitable organization or organizations are given the irrevocable right to receive a determinable amount annually, for a specified term of six years. We conclude that the interest is a guaranteed annuity within the meaning of § 2522(c)(2)(B). Accordingly, we conclude that a gift tax charitable deduction is allowed under § 2522(a). Under § 25.2522(c)-3(d)(2)(iv), the amount of the deduction is the present value of the guaranteed annuity determined in accordance with § 25.2512-5.

We note that the terms of Trust A provide that the unitrust amount is to be paid first from items constituting gross income of Trust A for purposes of § 642(c) for the taxable year for which the amount is payable, and is to be paid first from ordinary income other than unrelated business income, then from short–term capital gains and then from long-term capital gains. To the extent that the items of gross income are insufficient to pay the unitrust amount in full for any year, the unpaid portion of the unitrust amount for the year is to be paid from other items of income and/or principal of the Trust A as the trustees shall determine.

We also note that terms of Trust B provide that the trustees are to pay the annuity amount first from items constituting gross income of Trust B for purposes of § 642(c) for the taxable year that the amount is payable, and the amount is to be paid from ordinary income other than unrelated business income, then from short-term capital gains and then from long-term capital gains. To the extent that these items of gross income are insufficient to pay the annuity amount in full for any year, the unpaid portion of the annuity amount for the year is to be paid from other items of income and/or principal of Trust B as the trustees shall determine.

The ordering of the income distributions from Trust A and Trust B will not be given effect for federal income tax purposes because the ordering provisions have no economic effect independent of the tax consequences. Trust A and Trust B are required to pay annually a stated unitrust amount and a stated annuity amount to organizations described in §§ 170(c) and 2055(a), regardless of the amount or character of income that Trust A and Trust B earn. Accordingly, income distributed to organizations described in §§ 170(c) and 2055(a) shall consist of the same proportion of each class of items of income of Trust A and Trust B as the total of each class bears to the total of all

classes. See § 1.642(c)-3(b)(2).

Ruling Request 2 - Upon Grantor's death, no portion of the principal of Trust A or Trust B will be includible in Grantor's gross estate

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2035(a) provides that if: (1) The decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death; and (2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under § 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall posses or enjoy the property or the income therefrom.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Based upon the information submitted and the representations made, Trust A and Trust B will be irrevocable. A fixed percentage of the value of the property transferred to Trust A will be distributed to Foundation during the six year charitable lead term and, thereafter, the corpus and remaining income will pass in further trust for the benefit of Grantor's descendants. A fixed amount will be distributed annually from Trust B to Foundation during the six year charitable lead term. Thereafter, the corpus and remaining income will pass either outright or in further trust for Grantor's descendants. Grantor retains no interest or reversion in Trust A or Trust B, and no right to alter,

amend, or revoke the trusts. Grantor cannot serve as trustee of either trust. Although Grantor is a director of Foundation, the funds the Trusts will distribute to Foundation will be segregated in a separate fund, the disbursement of which will be governed by a separate fund committee to which the Grantor will not belong and on which she will be ineligible to serve. Further, Grantor may not participate in any amendments of the by-laws of the Foundation that would alter these new provisions or otherwise have any bearing upon the separate fund or separate fund committee.

Accordingly, we conclude that upon Grantor's death, no portion of the principal of Trust A or Trust B will be includible in Grantor's gross estate for federal estate tax purposes under § 2033, 2035, 2036, or 2038.

Ruling Request 3 - If the Grantor allocates her GST exemption to Trust A, Trust A's applicable fraction for GST purposes shall be equal to the amount of GST exemption allocated to Trust A divided by the value of the property contributed to the trust less the amount of the charitable deduction allowed for gift tax purposes with respect to the lead unitrust interest.

Section 2601 imposes a tax on every generation-skipping transfer as defined in § 2611(a).

Section 2602 provides that the generation-skipping transfer tax is computed, in general, by multiplying the taxable amount by the "applicable rate." Under § 2641(a), the applicable rate is the maximum federal estate tax rate multiplied by the "inclusion ratio" with respect to the transfer.

Section 2611(a) defines the term "generation-skipping transfer" as (1) a taxable distribution, (2) a taxable termination, or (3) a direct skip.

Section 2631 provides that, for purposes of determining the inclusion ratio, every individual is allowed a generation-skipping transfer tax exemption of $1,000,000 which may be allocated by the individual or his executor to any property with respect to which the individual is the transferor.

Section 2642(a)(1)(A) provides that except for direct skip transfers, the inclusion ratio is the excess (if any) of 1 over the "applicable fraction" determined for the trust from which such transfer is made. Section 2642(a)(2) provides, in part, that the applicable fraction is a fraction the numerator of which is the amount of the GST exemption allocated to the trust and the denominator of which is the value of the property transferred to the trust reduced by the sum of (1) the federal estate tax or state death tax actually recovered from the trust attributable to such property and (ii) any charitable deduction allowed under § 2055 or § 2522 with respect to such property.

Based upon the facts submitted and the representations made, Grantor proposes to transfer stock in X to Trust A, a charitable lead unitrust. In ruling 1, we concluded

that Grantor would be entitled to a gift tax charitable deduction under § 2522(a) for the present value of the unitrust interest. At the termination of the charitable lead term, the assets of Trust A will be held in a continuing trust for Grantor's descendants.

We conclude that if Grantor allocates her GST exemption to Trust A, Trust A's "applicable fraction" will be equal to the amount of the GST exemption allocated to Trust A divided by the value of the property contributed to Trust A less the amount of the charitable gift tax deduction allowed under § 2522 with respect to such property.

Income Tax Issues

Ruling Request 4 - Grantor will be entitled to an income tax charitable deduction under § 170(f)(2)(B) based upon the present value of the unitrust and annuity payments payable from Trust A and Trust B.

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

Section 1.170A-1(c)(1) provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in § 170(e)(1) and § 1.170A-4.

Section 170(f)(2)(b) provides that no charitable contribution deduction is allowed for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of the interest for purposes of applying § 671.

Section 170(e)(1)(B) provides that, in the case of a charitable contribution to or for the use of a private foundation (other than a private foundation described in § 170(b)(1)(E)), the amount of any contribution otherwise taken into account for purposes of computing the charitable contribution deduction is reduced by the sum of the amount of any gain which would not have been long-term capital gain and the amount of gain which would have been long-term capital gain, if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of the contribution).

Because the charitable beneficiary of Trust A and Trust B, Foundation, or an alternative charitable donee, may be a private foundation (other than a private foundation described in § 170(b)(1)(E)), Grantor's contributions will be subject to the limitations of § 170(b)(1)(B), if the property that Grantor intends to put in Trust A and Trust B is not capital gain property (as described in § 170(b)(1)(C)(iv)). To the extent

that the property is capital gain property, Grantor's contribution will be subject to the limitations of § 170(b)(1)(D).

Because the charitable beneficiary of Trust A and Trust B, Foundation, or an alternative charitable donee, may be a private foundation (other than a private foundation described in § 170(b)(1)(E)), Grantor's contribution will be subject to the limitations of § 170(e)(1)(B).

A. Trust A

Section 1.170A-6(c)(2)(ii)(A) treats an income interest as a "unitrust interest" only if it is an irrevocable right pursuant to the governing instrument of the trust to receive payment, not less often than annually, of a fixed percentage of the net fair market value of trust assets, determined annually. This regulation provides that in computing the net fair market value of the trust assets, all assets and liabilities shall be taken into account without regard to whether particular items are taken into account in determining the income of the trust. The regulation further provides that the net fair market value of the trust assets may be determined on any one date during the year or by taking the average of valuations made on more than one date during the year, provided that the same valuation date or dates and valuation methods are use each year. Payments under a unitrust interest may be paid for a specified term or for the life or lives of an individual or individuals.

Section 1.170A-6(c)(3)(ii) provides that the deduction allowed by § 170(f)(2)(B) for a charitable contribution of a unitrust interest is limited to the fair market value of such interest on the date of contribution. This regulation further provides that the fair market value of the unitrust interest shall be determined by subtracting the present value of all interests in the transferred property other than the unitrust interest from the fair market value of the transferred property.

With exceptions not relevant here, § 1.170A-6(c)(2)(ii)(D) provides, in general, that an income interest will not be considered a unitrust interest if any amount other than an amount in payment of the unitrust interest may be paid by the trust for a private purpose before the expiration of all the income interests for a charitable purpose. Article First, section D1 of Trust A provides that the trustees shall not exercise any powers granted in the trust agreement in such a manner as to result in disallowance of the unitrust interest of the trust from qualifying for a charitable contribution deduction for United States income, gift, or estate tax purposes. Therefore, payments that do not comply with § 1.170A-6(c)(2)(ii)(D) are prohibited during the six-year unitrust term.

Under Trust A, the trustee is required to pay to Foundation, or if it is not a qualified § 170(c) organization, to a donee that is described in § 170(c)(2), (3), (4), or (5), a unitrust amount equal to a percentage of the net fair market value of the unitrust assets. The percentage will be fixed at the time that the trust is created. Such amount is determined as of the first day of each taxable year of the unitrust for a term of six

years. As shown in the previous paragraph, no other payments will be permitted during the six-year term of the lead unitrust interest. Therefore, a qualified charity will have an irrevocable right to receive the unitrust amount. If Grantor is considered the owner of Trust A for purposes of § 675(4) (see ruling request 4), Trust A will qualify as a charitable lead unitrust for purposes of the income tax charitable contribution deduction under § 170(f)(2)(B).

Article First, section B1 provides that the unitrust amount will be determined using the net fair market value of the assets held by Trust A valued as of the first day of each taxable year of Trust A. Section 1.170A-6(c)(2)(ii)(A) provides that the same valuation date or dates and valuation methods must be used each year. The first day of the initial short taxable year of Trust A may be a different date from the first day of subsequent taxable years. We conclude that the valuation of assets on the first day of the short taxable year and the first day of each subsequent taxable year is consistent with § 1.170A-6(c)(2)(ii)(A).

The governing instrument of a charitable lead unitrust must meet certain requirements. § 1.170A-6(c)(2)(ii)(E). We conclude that Trust A meets these requirements.

Trust A qualifies as a charitable lead unitrust within the meaning of § 1.170A-6(c) if Grantor is the owner of the income interest for purposes of § 675(4), and the income interest is a qualified unitrust interest for purposes of the income tax charitable contribution deduction under § 170(f)(2)(B). Pursuant to § 170(f)(2)(B), Grantor will be entitled to deduct as a charitable contribution for federal income tax purposes the value, as of the date of the contribution, of the unitrust interest in her taxable year in which Trust A is created and funded, determined in accordance with § 1.170A-6(c)(3)(ii) and subject to the applicable limitations of § 170 including § 170(b) and § 170(e)(1) and subject to any applicable limitations under other sections of the Code.

B. Trust B

Section 1.170A-6(c)(2)(i)(A) treats an income interest as a “guaranteed annuity interest” only if it is an irrevocable right pursuant to the governing instrument of the trust to receive a guarantee annuity. This regulation provides that 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. An amount is determinable if the exact amount which must be paid under the conditions specified in the governing instrument of the trust can be ascertained as of the date of transfer.

Section 1.170A-6(c)(3)(i) provides that the deduction allowed by § 170(f)(2)(B) for a charitable contribution of a guaranteed annuity interest is limited to the fair market value of such interest on the date of contribution, as computed under § 20.2031-7 or, for

certain prior periods, § 20.2031-7A.

With exceptions not relevant here, § 1.170-6(c)(2)(i)(E) provides, in general, that an income interest consisting of an annuity transferred in trust after May 21, 1972, will not be considered a guaranteed annuity interest if any amount other than an amount in payment of the guaranteed annuity interest may be paid by the trust for a private purpose before the expiration of all the income interests for a charitable purpose. Article First, section D1 of Trust B provides that the trustees shall not exercise any powers granted in the trust in such manner as to result in disallowance of the annuity interest of the trust as a charitable contribution deduction for United States income, gift, or estate tax purposes. Therefore, payments that do not comply with § 1.170A-6(c)(2)(i)(E) are prohibited during the six-year annuity trust term.

Under Trust B, the trustee is required to pay to Foundation, or if it is not a qualified § 170(c) organization, to a donee that is described in § 170(c)(2), (3), (4), or (5), an annuity amount, which will be determined on the date that Trust B is created. As shown in the previous paragraph, no other payments will be permitted during the six-year term of the lead annuity interest. Therefore, a qualified charity will have an irrevocable right to receive the annuity amount. If Grantor is considered the owner of Trust B for purposes of § 675(4) (see ruling request 4), Trust B qualifies as a charitable lead annuity trust for purposes of the income tax charitable contribution deduction under § 170(f)(2)(B).

The governing instrument of a charitable lead annuity trust must meet certain requirements. § 1.170A-6(c)(2)(i)(D) and (F). We conclude that Trust B meets these requirements.

Based upon the information submitted and representations made, if Trust B qualifies as a charitable lead annuity trust within the meaning of § 1.170A-6(c) and Grantor is the owner of the income interest for purposes of § 675, we conclude the income interest is a qualified annuity trust interest for purposes of the income tax charitable contribution deduction under § 170(f)(2)(B). Pursuant to § 170(f)(2)(B), Grantor will be entitled to deduct as a charitable contribution for federal income tax purposes the value, at the date of the contribution, of the annuity trust interest in her taxable year in which Trust B is created and funded, determined in accordance with § 1.170A-6(c)(3)(i) and subject to the applicable limitations of § 170 including § 170(b) and § 170(e)(1) and subject to any applicable limitations under other sections of the Code.

Ruling Request 5 - <u>If the charitable deduction for the year in which Trust A and Trust B are created exceeds the limitations imposed by Internal Revenue Code § 170(b), the unused portion of this deduction may be carried forward by the Grantor pursuant to § 170(b).</u>

Under § 170(b)(1)(B), if the aggregate of charitable contributions exceeds the percentage limitations of that section, such excess shall be treated (in a manner

consistent with the rules of § 170(d)(1)) as a charitable contribution (to which § 170(b)(1)(A) does not apply) in each of the five succeeding taxable years in order of time.

Section 170(b)(1)(D)(ii) provides that, if the aggregate amount of contributions described in § 170(b)(1)(D)(i) exceeds the limitation of § 170(b)(1)(D)(i), such excess shall be treated (in a manner consistent with the rules of § 170(d)(1)) as a charitable contribution of capital gain property to which § 170(b)(1)(D)(i) applies in each of the five succeeding years in order of time.

Grantor may carry over excess charitable contributions under § 170(b)(1)(B), to the extent that the contributed property is not capital gain property (as described in § 170(b)(1)(C)(iv)), or under § 170(b)(1)(D)(ii), to the extent that the contributed property is capital gain property.

Ruling Request 6 - <u>During the Grantor's lifetime, Trust A and Trust B will be treated as grantor trusts for income tax purposes</u>

Section 671 provides that if the grantor is treated as the owner of any portion of a trust, the grantor's taxable income and credits shall include those items of income, deduction, and credits against tax that are attributable to that portion of the trust to the extent that such items would be taken into account in computing the taxable income or credits against the tax of an individual.

Sections 673 through 677 specify the circumstances under which the grantor is treated as the owner of a portion of the trust.

Section 675(4) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of § 675(4), the term "power of administration" includes a power to reacquire the trust corpus by substituting other property of an equivalent value.

Section 1.675-1(a) of the Income Tax Regulations provides that the grantor is treated as the owner of any portion of a trust if, under the terms of the trust instrument or circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust.

Section 1.675-1(b) provides that the circumstances that cause administrative controls to be considered exercisable primarily for the benefit of the grantor are the existence of certain powers of administration exercisable in a nonfiduciary capacity by any nonadverse party without the approval or consent of any person in a fiduciary capacity. The term "powers of administration" means, among other powers, a power to reacquire the trust corpus by substituting other property of equivalent value. If a power

is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. This presumption may be rebutted only by clear and convincing proof that the power is not exercisable primarily in the interests of the beneficiaries. If a power is not exercisable by a person as trustee, the determination of whether the power is exercisable in a fiduciary or nonfiduciary capacity depends on all the terms of the trust and the circumstances surrounding its creation and administration.

In the present case, the circumstances surrounding the administration of Trust A and Trust B will determine whether the power of administration is exercisable in a fiduciary or nonfiduciary capacity. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office of the District Director where the returns are filed. Therefore, we cannot determine at this time whether Grantor will be treated as the owner of Trust A and Trust B under § 675(4). Provided that the circumstances indicate that the power of administration is exercisable in a nonfiduciary capacity, Grantor will be treated as the owner of Trust A and Trust B under § 675.

Ruling Request 7 - Beginning after Grantor's death, Trust A and Trust B will be eligible to elect, under current law, to qualify as electing small business trusts under § 1361(e)(1) for tax years beginning after December 31, 1997

Section 1361(b)(1) provides, in part, that the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Under § 1361(c)(2)(A)(v), an electing small business trust described in § 1361(e) is an eligible shareholder of an S corporation.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term 'electing small business trust' means any trust if–

(i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, or (III) and organization described in paragraph (2), (3), (4), or (5) of § 170(c), (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(1)(B) provides that the term "electing small business trust" does not include–

(i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

Based upon the current trust instruments, current law, and on the information submitted and the representations made, we conclude that, should Grantor die during the 6 year term, Trust A and Trust B would be eligible to elect to be trusts described in § 1361(e)(1).

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under the cited provisions or any other provisions of the Code.

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

Sincerely yours,

Christine Ellison

Christine Ellison
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