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Department of the Treasury

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Date: June 10, 1999

Re:

LEGEND:
Taxpayer =
Corporation A =

Family Charitable Trust =
State X =
Trust 1 =

Trustees =

This is in response to your letter dated August 11, 1998, and subsequent correspondence, in which you requested rulings concerning the federal income, gift, and estate tax consequences of the creation of a proposed guaranteed annuity trust.

Trust 1, a revocable inter vivos trust established by Taxpayer, owns shares of both voting and nonvoting stock in Corporation A, an S Corporation. Taxpayer proposes to direct the trustees of Trust 1 to transfer Corporation A voting and nonvoting stock from Trust 1 to Family Charitable Trust, an irrevocable trust that Taxpayer proposes to establish. Family Charitable Trust is intended to qualify as a guaranteed annuity trust as described in § 2522 of the Internal Revenue Code and the applicable regulations. The proposed trust agreement contains the following relevant provisions:

Article 1 of the trust agreement provides that the trust is irrevocable and not subject to any power of invasion, alteration, or amendment, except that the trustees may in writing amend the trust agreement at any time to enable the trust to continue to

qualify as a guaranteed annuity trust as described in §§ 2055(e)(2)(B) and 2522(c)(2)(B).

Article 2(a) provides that, for fifteen years from the date that the trust agreement is executed, the trustees will in each taxable year of the trust pay to such one or more organizations then described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) as the trustees shall select on an annual basis, in such proportions as the trustees shall determine, an amount equal to 9.9% of the net fair market value of the trust property as initially constituted, valued as of the date of execution of the trust. The annuity amount shall be paid annually at the end of each taxable year of the trust.

Article 2(h)(ii) provides that any net income in excess of the annuity amount may be paid to or for the use of such one or more organizations, then described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a), as the trustees shall select, in such proportions as the trustees shall determine. Any net income not so paid may be held for future payments or added to principal, in the discretion of the trustees.

Article 2(b) provides that at the end of the fifteen year charitable term, the trustees will divide the trust property into equal shares, one share for each of Taxpayer’s children who is then living and one share for each of Taxpayer’s children who has died leaving issue then living. The trustees shall hold each share of the trust property so set apart as a separate and independent trust named for the child for whom it was set apart, and shall administer each trust for the benefit of the child for whom it is named and such child’s issue of all generations, living from time to time. Each trust shall terminate, however, twenty-one years after the death of the last survivor of the Taxpayer and the Taxpayer’s children or if earlier, upon the death of the last survivor of the Taxpayer’s issue whenever born.

Article 2(b) further provides that the trustees have the power to add one or more organizations, then described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a), to the class of beneficiaries eligible to receive distributions from the trust property upon the termination date. Prior to administering the trust property according to the provisions of Article 2(b), the trustees may distribute any part or all of the trust property to and among such organizations and in such proportions, equally or unequally and to the exclusion of any one or more of them, as the trustees determine. The trustees’ determination regarding the distribution of the trust property shall be final and binding on all persons.

Article 2(h)(iv) prohibits the trustees from receiving any contributions or additions to the trust after the initial contribution.

Article 2(h)(v) prohibits the trustees from paying any amounts to or for the use of any person other than an organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) prior to the termination of the trust, unless the amount is transferred for full and adequate consideration.

Article 2(h)(vi) prohibits the trustees from engaging in any act of self-dealing (as defined in § 4941(d)) and from making any taxable expenditures (as defined in § 4945(a)). For any period during which §§ 4942, 4943, or 4944 are applicable to the trust, the trustees shall make such distributions from income or principal as are necessary to keep the trust from becoming subject to tax under § 4942, and shall not retain any excess business holdings or make any investments as defined in § 4943(c), and shall not acquire, make, or retain any investments in such a manner as to subject the trust to tax under § 4944.

Article 5 provides that there shall always be two trustees of each trust. Except as provided in Item 6, successor or additional trustees shall be designated by the trustee or trustees then serving. If there is no trustee then in office, successor trustees shall be designated by a majority of legally competent members of the oldest generation of Taxpayer's issue of which there are legally competent members.

Article 6 provides that the Taxpayer during his life and competency, and thereafter a majority of the legally competent members of the oldest generation of the Taxpayer's issue of which there are legally competent members, shall have the power to remove a trustee and appoint a successor; provided, however, that the Taxpayer's issue shall not have the power to remove an original trustee, and further provided that any successor trustee shall not be a person who is related or subordinate to the Taxpayer or to any person having the power to remove the trustee within the meaning of § 672(c). Neither the Taxpayer nor the Taxpayer's spouse can serve as trustee.

The trust is to be administered under the laws of State X.

Ruling Request #1

Taxpayer requests a ruling that the charitable annuity interest in Family Charitable Trust will qualify as a guaranteed annuity interest (as described in § 25.2522(c)-3(c)(2)(vi) of the Gift Tax Regulations) and the funding of the trust will result in a completed gift for federal gift tax purposes that will qualify for a gift tax charitable deduction under § 2522.

Section 2501 imposes a tax on the transfer of property by gift by any individual. Section 25.2511-1(a) provides that the gift tax applies to every kind of transfer by way of gift, whether direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(a) provides that the gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer. The tax is a primary and personal liability of the donor, is an excise upon the act of making the transfer, is measured by the value of the property passing from the donor, and attaches at the time the property passes, regardless of the fact that the identity of the donee may not then be known or ascertainable.

Under § 25.2511-2(b), a gift is complete and subject to the gift tax when the donor has so parted with dominion and control over the property transferred as to leave in the donor no power to change its disposition, whether for the donor's own benefit or for the benefit of another.

Section 25.2511-2(c) provides that a gift is incomplete to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries.

Under § 25.2511-2(e), a donor is considered to have a power if it is exercisable by the donor in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property, such as a trustee.

Section 2522(a) provides that, in computing the taxable gifts each 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)(B) provides that, where a transfer is made to both a charitable and noncharitable person or entity, no deduction shall be allowed for the charitable portion of the gift, unless, in the case of an interest other than a charitable remainder interest, the interest is in the form of a guaranteed annuity or is a fixed percentage distributed annually of the fair market value of the property determined on an annual basis.

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 such date. 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 the gift.

Section 25.2522(c)-3(c)(2)(vi)(b) provides that a charitable interest is a guaranteed annuity interest only if it is a guaranteed annuity interest in every respect.

Section 25.2522(c)-3(c)(2)(vi)(e) contains a further requirement for qualification as a guaranteed annuity interest in trust if the present value on the date of gift of all the income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all amounts in the trust. In this situation, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and the retention of assets which would give rise to a tax under § 4944 if the trustee had acquired the assets.

Under § 25.2522(c)-3(c)(2)(vi)(d), the amount of the deduction for a guaranteed annuity interest in trust is limited to the fair market value of the guaranteed annuity interest as determined under § 25.2522(c)-3(d)(2)(iv).

In the present case, for purposes of § 25.2511-2(b), the Taxpayer will not retain any power over the property he contributes to the trust. The Taxpayer will not retain any interest or reversion in the trust nor will he have the right to alter, amend, or revoke the trust. Neither the Taxpayer nor the Taxpayer's spouse can serve as trustee of the trust. In addition, the Taxpayer holds no general power of appointment over the trust property. Accordingly, we conclude that the funding of the trust will result in a completed gift for federal gift tax purposes under §§ 2501 and 2511.

The annuity payable under the proposed terms of the trust satisfies the requirements of § 25.2522(c)-3(c)(2)(vi) and therefore, will be a guaranteed annuity interest for purposes of § 2522(c)(2)(B). Accordingly, the transfer to Family Charitable Trust will qualify for a gift tax charitable deduction under § 2522 equal to the actuarial value of the guaranteed annuity payable to charity, as determined under § 25.2522(c)-3(d)(2)(iv).

Ruling Request #2

Taxpayer requests a ruling that he will be entitled to a federal income tax deduction under § 170(a) for the value, at the date of the contribution, of the charitable annuity interest held under the Family Charitable Trust.

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) of the Income Tax Regulations 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(a).

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.

Under § 1.170A-6(c)(2)(i)(A), a "guaranteed annuity interest" is an irrevocable right pursuant to the governing instrument of the trust 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 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.

Under § 1.170A-6(c)(3)(i), 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 § 20.2031-7T or, for certain prior periods, § 20.2031-7A.

With exceptions not relevant here, § 1.170A-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 a 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 2(h)(v) of the proposed trust document provides that the trustees are prohibited from paying any amounts to or for the use of any

person other than an organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) prior to the termination date of the trust. Therefore, payments that do not comply with § 1.170A-6(c)(2)(i)(E) are prohibited during the 15-year annuity trust term.

Section 1.170A-6(c)(2)(i)(C) provides that where a charitable interest is in the form of a guaranteed annuity interest, the governing instrument of the trust may provide that income of the trust which is in excess of the amount required to pay the guaranteed annuity interest shall be paid to or for the use of a charitable organization. Article 2(h)(ii) of the proposed trust document provides that any net income in excess of the annuity amount may be paid to or for the use of such one or more organizations, then described in §§ 170(b)(a)(A), 170(c), 2055(a), and 2522(a), as the trustees shall select, in such proportions as the trustees shall determine. Any net income not so paid may be held for future such payments or added to principal, in the discretion of the trustees.

Under §§ 1.170A-6(c)(2)(i)(D) and (F), in order to qualify as a guaranteed annuity interest, the governing instrument of a trust must meet certain requirements. Under §§ 4947(a)(2) and 508(e), with certain exceptions in § 4947(b)(3), the governing instrument of a charitable annuity trust must include provisions prohibiting the trust from engaging in any act of self-dealing (as defined in § 4941(d)), from retaining any excess business holdings (as defined in § 4943(c)), from making any investments in such manner as to subject the trust to tax under § 4944, and from making any taxable expenditures (as defined in § 4945(d)). Section 4947(b)(3)(A) and § 53.4947-2(b) provide, however, that §§ 4943 and 4944 do not apply to such interests if: (i) the entire income interest (and none of the remainder interest) of the trust is devoted solely to a charitable purpose; and (ii) all amounts in such trust for which a deduction was allowed have an aggregate value of not more than 60 percent of the aggregate fair market value of all amounts in such trust. Article 2(h)(vi) of the proposed trust document contains provisions that meet these requirements.

Section 1.170A-6(c)(2)(i)(D) provides that if the present value on the date of transfer of all the income interests for a charitable purpose exceeds 60 percent of the aggregate fair market value of all amounts in the trust (after the payment of liabilities), the income interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits both the acquisition and retention of assets which would give rise to a tax under § 4944 if the trustee had acquired such assets. In the present case, Article 2(h)(vi) of the proposed trust document provides that the trustees are

prohibited from acquiring, making, or retaining any investments in such a manner as to subject the trust to tax under § 4944.

During the 15-year charitable annuity term, the trustees will in each taxable year of the trust pay to such one or more organizations, then described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a), as the trustees shall select on an annual basis, an amount equal to 9.9% of the net fair market value of the trust property as initially constituted, valued as of the date of execution of the trust. As discussed above, no payments to any other recipient will be permitted during the 15-year term of the charitable annuity interest. Therefore, a qualified charity will have an irrevocable right to receive the annuity amount. The charitable annuity payable under the Family Charitable Trust agreement qualifies as a guaranteed annuity interest for purposes of the income tax charitable contribution deduction under § 170(f)(2)(B).

Because the trust satisfies the requirements of § 1.170A-6(c)(2)(i) and as discussed below, Taxpayer is the owner of the income interest for purposes of § 671, the guaranteed annuity interest qualifies for an income tax charitable contribution deduction under § 170(f)(2)(B). Pursuant to § 170(f)(2)(B), Taxpayer will be entitled to an income tax charitable contribution deduction for the present value, on the date of the contribution, of the guaranteed annuity interest, subject to any 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 #3

Taxpayer requests a ruling that Family Charitable Trust will be an eligible shareholder in Corporation A, a subchapter S corporation, by virtue of its status as a grantor trust.

Section 1361(b)(1) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 671 provides that where it is specified in subpart E that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then 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 which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 1.671-3(b)(3) of the Income Tax Regulations provides that both ordinary income and other income allocable to corpus are included by reason of an interest in or a power over both ordinary income and corpus, or an interest in or a power over corpus alone which does not come within the provisions of § 1.671-3(b)(2). Section 1.671-3(b)(3) further provides that a grantor includes both ordinary income and other income allocable to corpus in the portion he is treated as owning, if he is treated under §§ 674 or 676 as an owner because of a power over corpus which can affect income received within a period such that he would be treated as an owner under § 673 if the power were a reversionary interest.

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

Section 673 provides that the grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds five percent of the value of such portion.

Section 674(a) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(c) provides that § 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor --(1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, or (2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries). A power does not fall within the

powers described in § 674(c), if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

It is represented that Taxpayer is treated as the owner of all the stock held in Trust 1 for federal income tax purposes. It is also represented that the trustees of Family Charitable Trust are non-adverse parties under § 672(b).

Based on the information submitted and representations made, we conclude that Taxpayer will be treated as the owner of Family Charitable Trust under § 674(a). Accordingly, during Taxpayer's life, Family Charitable Trust will be a permitted shareholder of an S corporation under § 1361(c)(2)(A)(i).

Ruling Request # 4

Taxpayer requests a ruling that the value of the property held in the Family Charitable Trust will not be includible in Taxpayer's gross estate for federal estate tax purposes.

Section 2033 provides for the inclusion in the gross estate of any property in which the decedent had an interest at the time of his death.

Section 2035(a) provides that if a 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 the value of such property (or 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.

Sections 2036, 2037, and 2038 provide 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 but either retained an interest in or a power over the property.

Section 2042 provides that the value of the gross estate shall include the value of all proceeds of life insurance payable to the decedent's estate or the value of all proceeds receivable by all other beneficiaries with respect to which the decedent retained any incidents of ownership.

In the present case, the Taxpayer will not retain any interest or reversion in the trust nor will he have the power to

alter, amend, or revoke the trust. Neither the Taxpayer nor his spouse can serve as trustee of the trust. Taxpayer has retained the power to remove and replace the trustees. However, any successor trustee selected by Taxpayer cannot be related or subordinate to the Taxpayer within the meaning of § 672(c). See Rev. Rul. 95-58, 1995-2 C.B. 191. In addition, the Taxpayer will not hold a general power of appointment over the property in the trust.

Accordingly, based on the facts submitted and the representations made, no portion of trust will be included in the Taxpayer's gross estate for federal estate tax purposes at the Taxpayer's death.

Ruling Request # 5

Taxpayer requests a ruling that the Family Charitable Trust will not be treated as having excess business holdings in Corporation A so long as: (a) the trust owns only 2 percent of the corporation's voting stock and 2 percent in value of all outstanding shares of all classes of the corporation's stock; and (b) no other private foundation or split-interest trust owns any Corporation A stock.

Section 501(c)(3) exempts from Federal income tax organizations organized and operated exclusively for charitable or educational purposes.

Section 509(a) provides that, unless specifically excepted, a domestic or foreign organization described in § 501(c)(3) is a private foundation and subject to the excise taxes of Chapter 42.

Section 4947(a) provides that certain trusts which are not exempt under § 501(a) are treated as private foundations and subject to the excise taxes imposed by Chapter 42.

Section 4943(a) imposes an excise tax on the excess business holdings of any private foundation in a business enterprise during any taxable year.

Section 4943(c)(2)(C) provides that a private foundation shall not be treated as having excess business holdings in any corporations in which it (together with all other private foundations which are described in § 4946(a)(1)(H)) owns not more than 2 percent of the voting stock and not more than 2 percent in value of all outstanding shares of all classes of stock.

Section 4946(a)(1)(H) provides that for purposes of § 4943 only, the term "disqualified person" includes a private foundation:

(i) which is effectively controlled, directly or indirectly by the same person or persons who control the private foundation in question, or

(ii) substantially all the contributions to which were made (directly or indirectly), by the same person or persons described in §§ 4946(a)(1)(A), (B), or (C), or members of their families (within the meaning of § 4946(d)) who made (directly or indirectly) substantially all of the contributions to the private foundation in question.

Based on the Taxpayer's representation that, when established, Family Charitable Trust will hold no more than 2 percent of Corporation A's outstanding voting stock and no more than 2 percent in value of all outstanding shares of all classes of Corporation A stock and that no other controlled private foundation or disqualified person or split-interest trust holds or will hold any stock in Corporation A, Family Charitable Trust will not have an excess business holdings, as the term is defined in § 4943, in Corporation A.

Except as ruled above, we express or imply no opinion concerning the federal tax consequences of this transaction under the cited provisions of the Code or any other provision 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,

Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

_____
George Masnik
Chief, Branch 4

Enclosure
Copy for section 6110 purposes