

Part III - Administrative, Procedural, and Miscellaneous

Post-1997 Distributions of Capital Gains from Charitable Remainder Trusts

Notice 99-17

This notice modifies Notice 98-20, 1998-13 I.R.B. 25, to reflect changes made to § 1(h) of the Internal Revenue Code by §§ 4002(i)(3) and 4003(b) of the Tax and Trade Relief Extension Act of 1998 (Division J of H.R. 4328, Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999), Pub. L. No. 105-277, 112 Stat. 2681 (1998) (TTREA of 1998). The changes affect the treatment of post-1997 distributions of certain capital gains properly taken into account in 1997 by a charitable remainder trust (CRT) described in § 664.

BACKGROUND

Notice 98-20 provides guidance on the ordering and taxation of distributions under § 664(b)(2) from a CRT to reflect changes made to § 1(h) by the Taxpayer Relief Act of 1997 (TRA 1997), Pub. L. No. 105-34, § 311, 111 Stat. 788, 831. TRA 1997 amended § 1(h) to provide for new capital gain tax rates for noncorporate taxpayers. Under Notice 98-20, a CRT's long-term capital gains (LTCGs) and losses fall into three separate tax rate groups: (1) the 28-percent group, (2) the 25-percent group, and

(3) the 20-percent group. Grouping of LTCGs properly taken into account by a CRT is necessary in order to determine the treatment of distributions by the CRT. Notice 98-20 provides that LTCGs properly taken into account by a CRT from January 1, 1997, through May 6, 1997, are treated as LTCGs in the 28-percent group.

Section 4002(i)(3) of the TTREA of 1998 added § 1(h)(13)(D). New § 1(h)(13)(D) provides that § 1(h)(13)(A) and § 1(h)(13)(B)(ii) (providing 28-percent rate treatment for certain LTCGs properly taken into account in 1997) do not apply to any capital gain distribution made by a CRT, effective for taxable years ending after December 31, 1997. Because § 1(h)(13)(A) and § 1(h)(13)(B)(ii) do not apply to a CRT distribution for taxable years ending after December 31, 1997, LTCGs (other than collectibles gain) properly taken into account by a CRT during 1997 and distributed in taxable years ending after December 31, 1997, that would have been in the 28-percent group now fall within either the 25-percent group or the 20-percent group.

To reflect the changes made to § 1(h) by § 4002(i)(3) of the TTREA of 1998, this present notice modifies two sections of Notice 98-20: (1) 1997 PRE-EFFECTIVE DATE LONG-TERM CAPITAL GAINS and (2) EXAMPLE ILLUSTRATING ORDERING AND CHARACTER RULES. The 1997 PRE-EFFECTIVE DATE LONG-TERM CAPITAL GAINS section of Notice 98-20 should be disregarded for taxable years ending after December 31, 1997. In the EXAMPLE ILLUSTRATING ORDERING AND CHARACTER RULES section of Notice 98-20, the 28-percent group gain is changed to collectibles gain.

DISCUSSION

The character of a CRT's income is determined at the time the income is realized by the trust. Under § 1(h)(13)(D), a CRT's LTCG in the 28-percent group (other than collectibles gain) that was properly taken into account during 1997 and distributed in taxable years ending after December 31, 1997, falls within either the 25-percent group or the 20-percent group. Thus, a CRT's LTCG described in the previous sentence now falls within the 25-percent group if the gain (1) was from property held more than 12 months but not more than 18 months, (2) was properly taken into account for the portion of the taxable year after July 28, 1997, and before January 1, 1998, and (3) otherwise satisfies the requirements for unrecaptured § 1250 gain under § 1(h)(7); any remaining LTCG falls within the 20-percent group.

To reflect this change in law, some CRTs will need to remove from the 28-percent group any LTCGs (other than collectibles gain) properly taken into account during 1997 that were not distributed in taxable year 1997 and place those LTCGs in either the 25-percent group or the 20-percent group, as appropriate.

Tables 1 and 2 illustrate the recent changes made to § 1(h) and their effect on CRTs.

| Table 1 Rules Applicable to LTCGs Distributed in Tax Year 1997 | | | |
|---------------------------------------------------------------------------------|------------------------------------------|-----------------------------------------------------------------------|---------------------------------------------------------------------------|
| Pre-1997 LTCGs | LTCGs realized from 1/1/97-5/6/97 | LTCGs realized from 5/7/97-7/28/97 | LTCGs realized from 7/29/97-12/31/97 |
| 20% | 28% if property held > 12 months | 28% for collectibles gain | 28% if property held > 12 months and ≤ 18 months or for collectibles gain |
| | | 25% if property held > 12 months and LTCG is unrecaptured § 1250 gain | 25% if property held > 18 months and LTCG is unrecaptured § 1250 gain |
| | | 20% for all other property held > 12 months | 20% for all other property held > 18 months |

| Table 2 Rules Applicable to LTCGs Distributed in Post-1997 Tax Years | | | |
|---------------------------------------------------------------------------------------|-------------------------------------------------|---------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| Pre-1997 LTCGs | LTCGs realized from 1/1/97-5/6/97 | LTCGs realized from 5/7/97-7/28/97 | LTCGs realized from 7/29/97-12/31/97 |
| No change—20% | Change— 20% if property held > 12 months | No change—28% for collectibles gain | Change—28% only for collectibles gain |
| | | No change—25% if property held > 12 months and LTCG is unrecaptured § 1250 gain | Change—25% if property held > 12 months and LTCG is unrecaptured § 1250 gain |
| | | No change—20% for all other property held > 12 months | Change—20% for all other property held > 12 months |

EFFECTIVE DATE

The statutory changes described in this notice apply to CRT distributions made in taxable years ending after December 31, 1997.

EFFECT ON OTHER DOCUMENTS

Notice 98-20 is modified.

DRAFTING INFORMATION

The principal author of this notice is Mary Beth Collins of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Collins on (202) 622-3080 (not a toll-free call).