

Internal Revenue Service

Department of the Treasury

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Refer Reply To:
CC:PSI:2-PLR-159270-02
Date:
June 10, 2003

Trust =

A =

B =

Trustee =

Attorney =

Financial Advisor =

Firm =

D1 =

D2 =

D3 =

Court =

State =

x% =

Dear :

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This letter responds to a letter dated September 25, 2002, submitted by Trust's authorized representatives on behalf of Trustee and Trust, requesting rulings under §§ 664 and 4941 of the Internal Revenue Code concerning the effect of a judicial reformation of Trust on the qualification of Trust as a charitable remainder unitrust under § 664.

The information submitted states that on D1, A created Trust with the intention that Trust qualify as a charitable remainder unitrust under § 664(d)(2). Trustee is the trustee of Trust.

A established Trust with the assistance of Financial Advisor. Following discussions with Financial Advisor, it was determined that Trust should provide for payment of a unitrust amount of x% of the net fair market value of the Trust's assets, payable from income and to the extent income was insufficient, then from principal. For purposes of this ruling, this type of unitrust payment method will be referred to as a fixed percentage method.

Financial Advisor contacted Firm to draft Trust. Article 2 of the original trust provides that in each taxable year of Trust, the trustee shall pay to A and B in equal shares during their lifetimes, a unitrust amount equal to the lesser of: (a) Trust income for the taxable year as defined in § 643(b) of the Code and the regulations thereunder, and (b) x percent (x%) of the net fair market value of the assets of Trust valued as of the first day of each taxable year of Trust (the "valuation date"). The unitrust amount for any year shall also include any amount of trust income for such year that is in excess of the amount required to be distributed under (b) to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as x percent (x%) of the net fair market value of Trust assets on the valuation dates. For purposes of this ruling, this type of unitrust payment method will be referred to as a NIMCRUT payment method.

A represents that the NIMCRUT payment method provided in the original trust instrument was not what he intended. A told financial advisor to prepare a fixed percentage method trust. Notwithstanding A's clear intentions to include a fixed percentage method in Trust, the NIMCRUT payment method was inadvertently included in Trust due to an undetected scrivener error. The error in the payment method was discovered in D2.

A represents that A and B did not take, nor were they allowed a deduction under any provision of the Code for amounts payable to them pursuant to the terms of Trust.

Since the creation of Trust, Financial Advisor and Trustee have administered Trust as a charitable remainder unitrust with a fixed percentage payment method and not as a charitable remainder unitrust with a NIMCRUT payment method.

Because of this error, and because Trust is irrevocable, Trustee sought an order from Court, with notice to all beneficiaries and the State attorney general, authorizing an

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amendment ab initio of Trust, by removing the NIMCRUT payment method provision and inserting a fixed percentage payment method provision. State law permits reformation of trusts, upon the approval of the court, to correct mistakes and accord with the creator's intent. No parties objected to the proposed reformation.

On D3, Court issued an order that Trust be reformed, ab initio, contingent upon Trust receiving from the Internal Revenue Service a private letter ruling with regard to the reformation of Trust.

Court ordered that Article 2 of Trust be reformed, ab initio, to provide that in each taxable year of the Trust, the Trustee shall pay to B and A (hereinafter referred to as "the Recipients") in equal shares during their lifetimes, a unitrust amount equal to x percent (x%) of the net fair market value of the assets of Trust valued as of the first day of each taxable year of Trust (the "valuation date"). Upon the death of the first of the Recipients to die, the survivor Recipient shall be entitled to receive the entire unitrust amount. The unitrust shall be paid in quarterly installments. Any income of Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount property payable and the unitrust amount actually paid.

Section 664(d)(2) provides that for purposes of § 664, a charitable remainder unitrust is a trust (A) for which a fixed percentage (which is not less than 5 percent) of the net fair market value of its assets, valued annually, is to be paid not less often 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 the 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 subparagraph (A) may be paid to or for the use of any person other than an organization described in § 170(c), and (C) following termination of the payments described in subparagraph (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.

Section 1.664-3(a)(4) of the Income Tax Regulations provides that the 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).

Section 4941(a)(1) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(a) generally imposes a tax on the participation of a foundation manager in an act of self-dealing knowing that it is such act, payable by the foundation manager.

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

Section 4946(a) 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), a family member of a substantial contributor (including children), and a foundation manager (including a trustee).

Section 4947(a)(2) provides generally that split-interest trusts are subject to the provisions of § 4941 in the same manner as if such trusts were private foundations, but, under § 4947(a)(2)(A), not with respect to any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under §§ 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

Section 53.4947-1(c)(2)(i) of the Foundation and Similar Excise Taxes Regulations provides that under § 4947(a)(2)(A), § 4941 does not apply to any amounts payable under the terms of a split-interest trust to income beneficiaries unless a 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.

Although Trust remains a split-interest trust described in § 4947(a)(2) and therefore, generally subject to the self-dealing provisions of § 4941, under § 4947(a)(2)(A), the self-dealing rules of § 4941 do not apply to amounts payable under the terms of the split interest trust to income beneficiaries as long as no deduction was allowed for such income interest under §§ 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

As A and B, the income beneficiaries of Trust, are both disqualified persons with respect to Trust, no deduction was allowed under § 170(f)(2)(B). As no deduction was allowed under § 170(f)(2)(B), § 4947(a)(2)(A) excepts amounts payable to the income beneficiaries from the self-dealing provisions of § 4941. Accordingly, the judicial reformation of Trust from a NIMCRUT to a fixed percentage CRUT does not result in an act of self-dealing since the self-dealing provisions of § 4941 are not applicable.

Based solely on the representations submitted, we conclude that the judicial reformation of Trust, ab initio, does not violate § 664. Accordingly, we conclude that the judicial reformation, ab initio, of Trust does not adversely affect Trust’s qualification as a charitable remainder unitrust under § 664.

Additionally, as the reformation of Trust from a NIMCRUT to a fixed percentage CRUT only affects amounts payable to the income beneficiaries for which no deduction was allowed under § 170(f)(2), the self-dealing provisions of § 4941 are not applicable. Therefore, the reformation of Trust will not result in an act of self-dealing.

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Except as specifically set forth above, no opinion is expressed as to the federal tax consequences of the above described facts under any other provision of the Code. Specifically, no opinion is expressed concerning whether Trust is or was a charitable remainder unitrust within the meaning of § 664(d)(2).

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Trust's authorized representative.

Sincerely yours,

J. THOMAS HINES
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes