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Department of the Treasury

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Person to Contact:

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Date:

January 19, 1999

LEGEND:

A =

B =

C =

Trust =

Bank =

State =

Dear:

This responds to a letter dated March 3, 1998, and subsequent correspondence submitted by your authorized representatives requesting the following rulings concerning the effect of a proposed transfer of an insurance policy to a charitable remainder trust:

(1) The existence or exercise of a trustee's power to pay annual premiums on an insurance policy on B's life will not cause A or B to be treated as the owner of all or any portion of the Trust under § 677(a)(3) of the Internal Revenue Code;

(2) The existence or exercise of the trustee's power to pay annual insurance premiums will not disqualify the Trust as a charitable remainder unitrust under § 664;

(3) A will be entitled to an income tax charitable contribution deduction for the present fair market value of the remainder interest in the insurance policy contributed to the Trust;

(4) A will be entitled to a gift tax charitable deduction upon the contribution of an insurance policy to the Trust based upon the present value of the remainder interest in the Trust; and

(5) After a gift to the Trust is completed, the gifted asset and the asset of the Trust will at no time be includible in A's gross estate or in the gross estate of B.

FACTS

A, the grantor, proposes to create the Trust, which is intended to qualify as a charitable remainder unitrust under § 664(d)(2) and (3). The trustee of the Trust will be Bank and will not be A or grantor's spouse, B. The Trust will be governed by the laws of State.

The governing instrument of the Trust provides that the trustee will pay the unitrust amount in quarterly installments to C for her life. C, the step-daughter of A, is the sole income beneficiary of the Trust. The unitrust amount will be the lesser of the Trust's income, as defined in § 643(b), or six percent of the net fair market value of the Trust's assets valued annually. The unitrust amount for any year will include any amount of the Trust's income in excess of the amount required to be distributed under the general rule above to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as six percent of the net fair market value of the Trust's assets on the valuation dates.

Upon the death of C, the trustee will distribute all of the then principal and income of the Trust to charities that qualify as organizations described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a).

A will fund a policy of insurance on B's life with enough cash so that no additional premiums are expected to be due. A will then transfer the insurance policy to the Trust and assign ownership of the policy to the trustee. The trustee will designate the Trust as the beneficiary of the policy.

Article V, Paragraph R of the Trust's governing instrument provides that the trustee will have the power:

To sell appreciated assets contributed to or owned by the Trust and may use the proceeds therefrom, or use other assets of the Trust, to acquire and hold insurance on the life of B and to pay the premiums on such insurance and to exercise all rights of an owner of such insurance, including the right to surrender the insurance or allow it to lapse, provided that the

premiums paid on the insurance, whether payable from net income or taxable income of the Trust, shall be charged to the Trust's principal account and any proceeds paid on the insurance upon the death of the insured, any dividends paid on the insurance during the life of the insured, any withdrawals made from the insurance during the life of the insured and any amount paid on the surrender of the insurance during the life of the insured shall be credited to the Trust's principal account, and no part of any such receipt shall be credited to the Trust's net income account notwithstanding any statute, rule, or convention to the contrary.

One of the statutory provisions of State's law provides that a trust is administered with due regard to the respective interests of income beneficiaries and remaindermen if receipts are credited and expenditures are charged to income or principal in accordance with the terms of the trust instrument, notwithstanding contrary statutory provisions. State's law has no statutory provision concerning whether the Trust's payment of premiums on life insurance policies should be charged to principal or income, or concerning whether any amounts received by a trust on account of life insurance policies should be allocated to principal or income. In addition, any State law that would allocate to income a portion of the proceeds received from the sale or other disposition of underproductive assets is subject to the provisions of the Trust's governing instrument.

LAW AND ANALYSIS

Ruling Requests 1 and 2

Under § 664(d)(2), a charitable remainder unitrust is a trust that provides for the distribution of the unitrust amount, at least annually for life or a term of years, to one or more persons (at least one of which is not a charitable organization) with an irrevocable remainder interest to be held for the benefit of, or paid over to, a qualified charitable organization.

Under § 664(d)(2)(A), the unitrust amount is generally a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of the trust's assets valued annually. However, under § 664(d)(3), the governing instrument may instead provide that the trustee is to pay the unitrust recipient (A) the amount of the trust income, if such amount is less than the amount determined by the fixed percentage of the value of the trust's assets; and (B) any amount of trust income which is in excess of the amount required to be distributed based on the fixed percentage, to the extent that the

aggregate of the amounts paid in prior years was less than the aggregate of the required amounts based on the fixed percentage of the value of the trust's assets.

Section 1.664-3(a)(1)(i)(b) of the Income Tax Regulations refers to the payout provisions of § 664(d)(3) as the "income exception." This section of the regulations states that trust income under the income exception means income as defined in § 643(b) and the applicable regulations.

Section 643(b) provides that the term "income" when standing alone means the amount of income of the trust for the taxable year determined under the terms of the governing instrument and applicable local law.

Section 1.664-1(a)(4) provides that for a trust to be a charitable remainder trust, it must satisfy the definition of, and function exclusively as, a charitable remainder trust from the creation of the trust. Solely for purposes of § 664 and the regulations thereunder, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code (subpart E), but in no event prior to the time property is first transferred to the trust. For the preceding sentence, neither the grantor nor the grantor's spouse is treated as the owner of the trust merely because the grantor or the grantor's spouse is named as a recipient of the annuity or unitrust amount.

Section 677(a)(3) provides that the grantor is treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or in the discretion of the grantor or a nonadverse party, or both, may be applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse (except policies of insurance irrevocably payable for a purpose specified in § 170(c)(relating to the definition of charitable contributions)).

In this case, A will transfer an insurance policy on the life of B, A's spouse, to the Trust. If necessary, the trustee may pay the premiums on the policy. The terms of governing instrument provide that any amount received by the Trust from the insurance policy on B's life, whether received during B's life or upon his death, will be allocated to the Trust's principal, and not income. Because the Trust is an "income exception" unitrust within the meaning of § 664(d)(3) and § 1.664-3(a)(1)(i)(b), the unitrust amount payable to the noncharitable beneficiary is limited to the Trust's income as described in § 1.664-3(a)(1)(i)(b) if such income is less than the fixed percentage of the net value of the Trust's assets. Because amounts received from the insurance policy on B's life will not

be allocated to income under the terms of the governing instrument, these amounts will not be used in computing the amount of the Trust's income and, thus, will not be used in determining the income limitation on the unitrust amount payable to the noncharitable beneficiary. Rather, amounts received from an insurance policy on the life of B will be allocated to the Trust's principal and will become part of the remainder that is payable to qualified charitable organizations.

Therefore, after applying the applicable law to the facts presented and the representations made, we conclude that under these circumstances the insurance policy on B's life is irrevocably payable for a charitable purpose under § 677(a)(3). Because the policy is so payable, we conclude that the existence or exercise, if necessary, of the trustee's power to pay annual premiums on the insurance policy on B's life does not cause A or B to be treated as the owner of all or any portion of the Trust under § 677(a)(3).

If there are no other provisions in the governing instrument that cause A, B, or any other person to be treated as the owner of the Trust under subpart E and if the Trust otherwise qualifies as a charitable remainder unitrust under § 664, we conclude that the existence or exercise, if necessary, of the trustee's power to pay the annual premiums on the insurance policy on B's life will not cause the Trust to be deemed to be created any later than when property is first transferred to the Trust under § 1.664-1(a)(4). Thus, the existence or exercise, if necessary, of the trustee's power to pay the annual premiums on the insurance policy on B's life will not disqualify the Trust as a charitable remainder trust, assuming the Trust otherwise qualifies as a charitable remainder trust under § 664.

Ruling Request 3

Section 170 permits a deduction for any charitable contribution payment of which is made within the taxable year.

Section 170(f)(2)(A) generally provides that, in the case of property transferred in trust, no charitable contribution deduction is allowed for the value of the charitable remainder interest unless the trust is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664), or a pooled income fund (described in § 642(c)(5)). See § 1.170A-6(b)(1).

Therefore, assuming the Trust qualifies as a charitable remainder unitrust, we conclude that A will be entitled to a charitable contribution deduction for the present fair market value of the remainder interest in the insurance policy contributed to the Trust.

Ruling Request 4

Section 2522(a)(2) provides in part that, in computing taxable gifts, there shall be allowed as a deduction the amount of all gifts made during the year to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Section 2522(c)(2) provides in part that where a donor transfers an interest in property (other than an interest described in § 170(f)(3)(B)) to a person, or for a use, described in § 2522(a) or § 2522(b) and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in § 2522(a) or § 2522(b), no deduction shall be allowed under this section for the interest which is, or has been transferred to the person, or for the use, described in § 2522(a) or § 2522(b) unless in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust, a charitable remainder unitrust (described in § 664), or a pooled income fund (described in § 642(c)(5)). In the case of any other interest, the interest must be in the form of a guaranteed annuity or a fixed percentage distributed yearly of the fair market value of the property to be determined yearly.

Provided the Trust otherwise qualifies as a charitable remainder trust under § 664, we conclude that A will be allowed a gift tax charitable deduction under § 2522(a) for the present value of the remainder interest in the Trust as determined under § 25.2522(c)-3(d)(2)(ii).

Ruling Request 5

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

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 the decedent's death.

Section 2035(a) provides that if 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 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 decedent's gross estate includes the value of all property to the extent of any interest transferred by the decedent in which the decedent has retained for life either an income interest in the property or the right to designate the persons who will possess or enjoy the property or have an interest in the income of the property.

Section 2038(a)(1) provides that, in the case of transfers after June 22, 1936, 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, where the enjoyment thereof was subject at the date of 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 when any such power is relinquished during the 3-year period ending on the date of the decedent's death.

Section 2041(a)(2) provides in part, that the gross estate includes the value of all property to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1)(A) defines the term "general power of appointment" to include a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed to be a general power of appointment.

Section 2042(2) provides that the value of the gross estate shall include the value of all property to the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any

other person.

In the present case, A and B will not retain any interest in or power over any of the property transferred to the Trust and under the terms of the Trust will not possess any interest or power with respect to the Trust corpus. Accordingly, we conclude that the Trust will not be included in the gross estate of either A or B. Furthermore, assuming B never possessed any incidents of ownership in the policy, we conclude that § 2035(a) will not apply with respect to the insurance policy.

No opinion is expressed as to any other provisions of the Trust or any other amendments to the provisions of the Trust. No opinion is expressed on the federal tax consequences of the formation or operation of the Trust under the provisions of any other section of the Code. Specifically, no opinion is expressed on whether the Trust is a qualified charitable remainder unitrust under § 664.

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.

Under a power of attorney on file in this office, we are sending a copy of this letter to your authorized representative.

Sincerely yours,

Jeff Erickson
Assistant to the Branch Chief,
Branch 3
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

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