

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2-PLR-114828-01
Date:
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Legend

Trust =

A =

B =

C =

D =

E =

Company =

Charity =

Church =

School =

State =

g =

h =

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D1 =D2 =D3 =D4 =D5 =

Dear :

This letter responds to a letter dated March 5, 2001, and subsequent correspondence, submitted by Trust's authorized representative, requesting rulings under § 664 of the Internal Revenue Code concerning the effect of a proposed judicial reformation of Trust on the qualification of Trust as a charitable remainder unitrust under § 664.

The information submitted states that on D1, A and B, husband and wife, hired C, a financial planner, to advise them on retirement planning. A and B followed C's advice and decided to research the idea of establishing a charitable trust funded with shares of Company, a publicly traded stock that had greatly appreciated. C contacted D, the head of planned giving at Charity, and requested illustrations for both a charitable remainder trust with a fixed percentage payout under § 664(d)(2) (CRUT) and a charitable remainder trust with net income with make-up payout under § 664(d)(3) (NIMCRUT). C informed A and B about CRUTs and used the requested illustrations to explain NIMCRUTs. C explained that while a CRUT would pay A and B with a fixed percentage of the trust's net fair market value each year, a NIMCRUT would pay A and B the lesser of the income from the trust or the fixed percentage (with an income make-up provision). A and B selected a NIMCRUT because they already had sufficient income for their needs and informed C of their decision.

On D2, C informed D that A and B had decided to establish a charitable remainder trust. D assumed that A and B wanted a CRUT to provide additional income and he sent a copy of the Charity sample CRUT document to C and E, A and B's lawyer. C did not review the sample CRUT, instead relying on the expertise of E. While E requested several minor changes, nobody had informed E that A and B wanted a NIMCRUT rather than a CRUT. Throughout this entire process communications were limited to emails between C, D and E. As a result of the limited communications, A and B mistakenly signed a CRUT on D3, and contributed the Company stock to the CRUT.

The governing instrument of Trust provides that the unitrust amount payable to A and B, is g percent of the net fair market value of the trust assets, valued as of the first

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day of each taxable year of Trust. The charitable remaindermen named in Trust are h percent to Charity, g percent to Church and g percent to School.

The error in signing a CRUT instead of the intended NIMCRUT was discovered on D4, when A and B turned over their income tax information to their accountant. In subsequent meetings between A, B, C, D and an attorney for Charity, all of the parties agreed that the error was caused by a breakdown in communications that resulted in A and B executing a CRUT instead of the NIMCRUT they had requested. It was agreed by all parties that a reformation of the Trust should be pursued so that A and B would have the NIMCRUT that they had selected.

A and B further represent that the proposed reformation of Trust is necessary due to a scrivener's error that is contrary to A and B's original intent to establish a NIMCRUT. To establish their original intent, A and B have provided affidavits from C and D that establish the breakdown in communications.

Since all the interested parties are in agreement that a scrivener's error occurred in the drafting of the trust instrument, it is proposed that a judicial modification of the trust agreement be done with notice to the Attorney General of State in accordance with State law. The sole modification will be to redraft the trust instrument to provide for the net income method of payment intended rather than the current fixed percentage. A and B also represent that A, B and Trust's returns for the taxable years ending D4 and D5 were filed as if Trust were a NIMCRUT and that no adjustments will be necessary for those returns if the rulings they requested are granted.

Specifically, you request the following rulings:

1. The proposed judicial modification of the Trust changing the fixed percentage method of payment of the unitrust amount to the net income with make-up provision method of payment of the unitrust amount will not violate § 664 or any of the regulations thereunder.

2. The proposed judicial modification of the Trust will not adversely affect the Trust's qualification as a charitable remainder unitrust under § 664 and the regulations thereunder.

Section 664(d)(2) provides that for purposes of § 664, a charitable remainder unitrust is a trust—(A) from which a fixed percentage (which is not less than 5 percent nor more than 50 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 § 664(d)(2)(A) and other than

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qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c), (C) following the termination of the payments described in § 664(d)(2)(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 or, to the extent the remainder interest is in qualified employer securities (as defined in § 664(g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined § 664(g)), and (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Section 664(d)(3) provides that notwithstanding the provisions of § 664(d)(2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year—(A) the amount of the trust income, if such amount is less than the amount required to be distributed under § 664(d)(2)(A), and (B) any amount of the trust income which is in excess of the amount required to be distributed under § 664(d)(2)(A), to the extent that (by reason of § 664(d)(3)(A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

Section 1.664-3(a)(3)(ii) of the Income Tax Regulations provides that a trust is not a charitable remainder unitrust if any person has the power to alter the amount to be paid to any named person other than an organization described in § 170(c) if such power would cause any person to be treated as the owner of the trust, or any portion thereof, if subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code were applicable to such trust.

Section § 1.664-3(a)(4) provides, in part, 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). Notwithstanding the preceding sentence, the grantor may retain the power exercisable only by will to revoke or terminate the interest of any recipient other than an organization described in § 170(c).

In *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

Provided that a State court determines that a scrivener's error was made in

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drafting Trust and that Trust is modified by amending the trust agreement as discussed above, and provided that the court's modification of Trust is in accordance with State law properly applied, we conclude that the proposed judicial reformation changing the fixed percentage method of payment of the unitrust amount to the net income with make-up provision method of payment of the unitrust amount will not violate § 664 or any of the regulations thereunder. Accordingly, we also conclude that the proposed judicial modification of the Trust under State law will not adversely affect the Trust's qualification as a charitable remainder unitrust under § 664 and the regulations thereunder.

The rulings above are expressly contingent on the issuance of a court order and modification of Trust, as described above.

Except as we have specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code. Specifically, no opinion is expressed as to whether Trust otherwise qualifies as a charitable remainder trust under § 664.

This letter 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.

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

Sincerely yours,
James A. Quinn
Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures:

Copy of a letter
Copy for § 6110 purposes