

INTERNAL REVENUE SERVICE

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-126222-01

Date:
April 11, 2002

Re:

Legend:

Decedent =

RLT =

RLT Charity =

CRUT =

Charity 1 =

Charity 2 =

Charity 3 =

Charity 4 =

Charity 5 =

Charity 6 =

\$X =

Y =

Z =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

State =

Dear _____ :

This is in response to your letter dated January 11, 2002, and prior correspondence submitted in which you requested rulings on behalf of Decedent's estate concerning the proposed division of Trust.

The facts are represented to be as follows: On Date 1, Decedent executed CRUT, a trust intended to qualify as a charitable remainder trust described in § 664(d)(3) of the Internal Revenue Code. Decedent also executed RLT, a revocable trust on that same date. Decedent executed a will on Date 2, and amended and restated RLT on Date 3. Decedent died testate on Date 4 and was not survived by a spouse or children.

In general, under the terms of CRUT a Unitrust Interest is to be paid annually by the trustee. The Unitrust Interest is the lesser of a "Unitrust Amount" equal to five percent (5%) of the net fair market value of CRUT valued as of the valuation date of each taxable year, or the net income of CRUT for the year. If in any subsequent year CRUT net income exceeds the Unitrust Amount payable during such year, then to the extent that the aggregate of the amounts paid to the unitrust beneficiaries in prior years is less than the total of all Unitrust Amounts payable for such years, the trustee is to make additional payments to the unitrust beneficiaries in an amount calculated to cure the prior deficit.

The Unitrust Interest is to be paid to Decedent during his lifetime. On Decedent's death, the Unitrust Interest is to be paid to Y individuals referred to as the "Successor Income Beneficiaries" for each Successor Income Beneficiary's life and the lifetime of the survivor of them. On the death of the last to die of the Successor Income Beneficiaries, CRUT is to terminate, and the trustee is to distribute the remaining assets of CRUT, including principal and accumulated income, outright, in equal shares, to Charities 1-6. Paragraph 4.2, provides that if any charitable remaindermen is not an organization described in §§ 170(c), 170(b)(1)(A), 2055 and 2522 of the Code at the time a distribution is required to be made to it, then the trustee is to distribute such respective amount of CRUT in equal shares to the other organizations described in paragraph 4.1. If none of the charitable remaindermen qualify as an organization described in those sections of the Code, then the trustee is to distribute such respective amount of CRUT to one or more other organizations described in those sections of the Code as the trustee, in its sole discretion, deems appropriate.

Paragraph 3.7 of CRUT provides that Decedent expressly reserves the power, exercisable only by Decedent's will, to revoke and terminate the survivorship payments for any one (1) or more of the Successor Income Beneficiaries. If Decedent effectively exercises such testamentary power, it is to have the same effect as though the Successor Income Beneficiary or Beneficiaries whose interest or interests have been revoked had predeceased Decedent.

Paragraph 7.4 of CRUT provides that no estate, inheritance or any other death taxes with respect to CRUT is to be allocated to or recoverable from CRUT, and Decedent agrees not to make any inconsistent direction in Decedent's will. Nevertheless, if for any reason, CRUT becomes liable for or subject to a lien for death taxes on the death of Decedent, the income interests of the Successor Income Beneficiaries will take effect only if such Successor Income Beneficiary or Beneficiaries furnish any funds which are necessary for payment of such death taxes for which CRUT may be liable. If any one or more of the Successor Income Beneficiaries fail to furnish those funds, then said Successor Income Beneficiaries are to be deemed to have predeceased Decedent. This provision may be enforced by the trustee or any one or more of the charitable remaindermen, acting alone or together.

Paragraph SECOND of Decedent's will provides that all of Decedent's property is to be distributed to RLT. Decedent's will did not contain any directions regarding the payment of estate or inheritance taxes.

Paragraph 5 of the amended and restated RLT provides that upon the death of Decedent, the residue of RLT, after payment of all expenses and taxes and certain specific bequests, is to be distributed to RLT Charity, an organization described in §§ 170(c) and 2055. Paragraph 7.6 of RLT provides that the trustee is to pay any state or federal estate or inheritance tax imposed because of the death of Decedent from the principal of RLT and charge such payment proportionately against the interests of the residual beneficiaries of RLT. However, should any such tax be imposed partly because of the assets of RLT and partly because of other property, the trustee is to pay from the principal of RLT only the proportion of the tax as the total value of the assets of RLT giving rise to the tax bears to the total value of all property giving rise to the tax.

As noted above, Decedent died on Date 4. The executor of Decedent's estate determined that the value of assets held in CRUT on the date of death was includible in Decedent's gross estate under § 2036. See, Rev. Rul. 76-273, 1976-2 C.B. 268. Further, at the time of Decedent's death, of the Y Successor Income Beneficiaries designated in CRUT, only Z were then living.

Subsequent to Decedent's death, a dispute arose regarding whether all estate taxes generated by the inclusion of property (including CRUT) in the Decedent's gross estate would be payable from RLT or from other sources. RLT Charity, as the residual beneficiary of RLT, asserted that payment of the estate taxes generated by the inclusion of CRUT in the gross estate should be paid, under the terms of CRUT, by the Successor Income Beneficiaries of CRUT. On Date 5, the trustee of CRUT and RLT filed a petition in the Superior Court of State requesting instructions on proration of the estate tax liability. On Date 6, State Superior Court entered a decision finding that any estate taxes attributed to property passing outside of RLT, including CRUT, were not to be paid from the assets of RLT. The court ordered that the estate taxes imposed as a result of the inclusion of CRUT in the gross estate are to be paid by the Successor Income Beneficiaries of CRUT, in proportion to the value of their respective interests in CRUT. If any of the Successor Income Beneficiaries do not pay his or her share of such taxes, he or she would be deemed to have predeceased Decedent under the terms of CRUT. As a result, if none of Successor Income Beneficiaries of CRUT pay the taxes attributable to their respective interests, CRUT corpus will pass directly to Charities 1- 6, as remaindermen. On Date 7, the Successor Income Beneficiaries of CRUT filed an appeal to the State Court of Appeals. During pendency of the appeal, the Successor Income Beneficiaries of CRUT, Charities 1-6, and RLT Charity entered into negotiations. All the parties, other than Charity 1 and Charity 2 have entered into an agreement.

Under the agreement, CRUT will be divided into three charitable remainder unitrusts intended to qualify under § 664(d)(3), designated as Trust A-1, Trust A-2 and Trust B as follows:

Trust A-1 will consist of one-sixth (1/6) of CRUT. The initial non-charitable beneficiaries of Trust A-1 will be those Successor Income Beneficiaries living on Decedent's date of death. All of the terms and conditions of CRUT will be applicable to Trust A-1 except that the remainder beneficiary of Trust A-1 will be solely Charity 1.

Trust A-2 will consist of one-sixth (1/6) of CRUT. The initial non-charitable beneficiaries of Trust A-2 will be those Successor Income Beneficiaries living on Decedent's date of death. All of the terms and conditions of CRUT will be applicable to Trust A-2 except that the remainder beneficiary of Trust A-2 will be solely Charity 2.

Trust B will consist of two-thirds (2/3) of CRUT. The initial non-charitable beneficiaries of Trust B will be those Successor Income Beneficiaries living on Decedent's date of death. All of the terms and conditions of CRUT will be applicable to Trust B except that the remainder beneficiaries of Trust B will be solely Charities 3-6. The remainder beneficiaries of Trust B will be Charities 3-6. Trust B will then be terminated and the Successor Income Beneficiaries and the Charities 3-6 will immediately be paid outright an amount equal to the present value of their respective interests as determined under § 7520 and § 1.664-4(e)¹. The Successor Income Beneficiaries will be responsible for the payment of death taxes attributable to their respective interests in Trust B as well as the death taxes attributable to their respective unitrust interests in Trusts A-1 and A-2.

CRUT will be divided into three separate trusts, Trust A-1, Trust A-2, and Trust B, on a pro rata basis.

RLT Charity will pay \$X to Successor Income Beneficiaries of CRUT on account of attorneys' fees. The entire residue of RLT, after payment of all applicable estate and inheritance taxes on the specific bequests under RLT and undiminished by the payment of the taxes on the income interest of CRUT, will pass to RLT Charity.

On Date 8, the Superior Court of State approved the division of CRUT and the termination and distribution as described in the agreement, contingent on the issuance of a favorable ruling by the Internal Revenue Service.

Decedent's estate has requested the following rulings:

1. The proposed division of CRUT into three separate and distinct unitrusts will not cause Trust A-1, Trust A-2, or Trust B to fail to qualify as charitable remainder trusts under § 664 of the Internal Revenue Code.
2. Decedent's estate is entitled to an estate tax deduction under § 2055 of the Code for the date of death value of the residuary bequest (augmented by the net probate estate passing to RLT under Decedent's will) provided in RLT to RLT Charity (as determined under the terms of RLT), less the \$X payment to be made by RLT Charity to the Successor Income Beneficiaries of CRUT and less any federal and state estate and inheritance taxes attributable to the \$X payment.
3. The estate tax charitable deduction for RLT is not to be reduced by any federal and state estate and inheritance taxes caused by the taxation of the interests of Successor Income Beneficiaries of CRUT.
4. Decedent's estate is entitled to an estate tax charitable deduction for the lesser of: (i) the date of death actuarial value of the remainder interest in CRUT, unreduced by any, federal and state estate and inheritance taxes, or (ii) the sum of (a) the actual amount passing to the remainder beneficiaries of Trust B and (b) the date of death actuarial value of the remainder of Trust A-1 and Trust A-2, unreduced by any federal and state estate and inheritance taxes.
5. The proposed division will not cause CRUT, Trust A-1, Trust A-2 or Trust B to realize gain for federal income tax purposes under § 61 and § 1001 of the Code.

¹ The actuarial values will be determined as of the date of death of Decedent. A pro rata share of interest, dividends, and other income which has accrued to Trust B since the date of death of Decedent, will be added to each respective interest.

Ruling Request 1

Under § 664(d)(2) of the Code a charitable remainder unitrust is a trust pursuant to which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of the assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of whom 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. No amount other than the above-described payments may be paid to or for the use of any person other than an organization described in § 170(c). Following the termination of the payments described above, the remainder interest in the trust generally is to be transferred to, or for the use of, an organization described in § 170(c). Under § 664(d)(3), the trust instrument may provide, in lieu of the provisions of § 664(d)(2), that the trustee shall pay to the income beneficiary for each year the lesser of the trust income for the year or a fixed percentage of the trust corpus determined annually as prescribed in § 664(d)(2).

In the present case, CRUT will be divided on a pro rata basis and Trust A-1, Trust A-2, and Trust B will contain the same provisions as CRUT. The Successor Income Beneficiaries remain the same in each of the three separate trusts. While each charity named in CRUT is now named as a remainderman in only one of Trust A-1, Trust A-2, and Trust B, each charity will have the correct percentage interest in CRUT preserved after the division.

Based on the facts and representations submitted, we conclude that the division of CRUT into three separate trusts, Trust A-1, Trust A-2, and Trust B will not cause CRUT or the three separate trusts to fail to qualify as charitable remainder trusts under § 664.

Ruling Requests 2, 3, and 4

Section 2055(a) of the Code provides that for estate tax purposes, the value of the taxable estate is determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises or transfers to or for the use of any corporation, organized and operated exclusively for religious, charitable, scientific, literary or educational purposes.

Section 2055(e)(2)(A) of the Code provides that where an interest in property passes or has passed from the decedent to a person, or for a use, described in § 2055(a), and an interest in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in § 2055(a), a deduction shall be allowed under this section for the interest which passes or has passed to the person, or for the use, described in § 2055(a) if, in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)).

In Rev. Rul. 82-128, 1982-2 C.B. 71, A creates a charitable remainder unitrust pursuant to which a six percent unitrust interest is to be paid to A until his death, and then to B, until B's death. Upon the death of the survivor of A and B, the remaining trust assets are payable to a charitable organization described in §§ 170(c), 2055(a) and 2522(a). Under applicable state law, federal estate and state death taxes, in the absence of a clear direction to the contrary in the decedent's will, must be equitably apportioned against and payable from the separate interests in the estate that will give rise to these taxes. The ruling concludes that since the possibility exists that on A's death, trust corpus will be used to pay estate taxes (since the trust is subject to inclusion in A's gross estate under § 2036) the trust does not qualify under § 664. See § 664(d)(2)(B) providing that no amount other than the unitrust amount may be paid to or for the use of any person other than an organization described in § 170(c). See also, § 1.664-

1(a)(6), Example (3). On the other hand, if the trust provides that B's successor interest will take effect only if B furnishes the funds for payment of any estate tax for which the trustee may be liable, then the trust will qualify under § 664. Under this provision, there could be no invasion of trust corpus to pay the estate tax.

In the instant case, consistent with the terms of the State Superior Court order interpreting the terms of RLT and CRUT, the residue of RLT (determined without reduction for any federal and state estate or inheritance taxes attributable to the inclusion of CRUT in the gross estate) will pass to RLT Charity. Accordingly, we conclude that an estate tax charitable deduction under § 2055(a) will be allowable for the date of death value of the residuary bequest (augmented by the net probate estate passing to RLT under Decedent's will) provided in RLT to RLT Charity (as determined under the terms of RLT), less the \$X payment to be made by RLT Charity to the Successor Income Beneficiaries and less any federal and state estate and inheritance taxes attributable to the \$X payment. In determining the date of death value of the RLT residuary bequest, the RLT residue is not to be reduced by any federal or state estate or inheritance tax attributable to the inclusion of the CRUT in the gross estate or attributable to the interests of the Successor Income Beneficiaries of CRUT.

In addition, as discussed above, the division of CRUT into Trusts A-1, Trust A-2, and Trust B will not affect the qualification of CRUT, or the successor trusts under § 664. Further, pursuant to the proposed division of CRUT into Trust A-1, Trust A-2, and Trust B, and the termination of Trust B, the actuarial value of the interests of the Successor Income Beneficiaries and Charities 1-6 will be identical to the actuarial value of the interests as determined for estate tax deduction purposes under the original terms of CRUT. Accordingly, assuming CRUT otherwise qualifies as a charitable remainder trust described in § 664(d)(3), Decedent's estate is entitled to an estate tax charitable deduction under § 2055(a) for the lesser of: (i) the date of death actuarial value (determined under § 7520 and § 1.664-4(e)) of the remainder interest in CRUT, determined without reduction for any state or federal estate or inheritance taxes attributable to the inclusion of CRUT in the gross estate; or (ii) the sum of (a) the actual amount passing to the remainder beneficiaries of Trust B on termination and (b) the date of death actuarial value (determined under § 7520 and § 1.664-4(e)) of the remainder interests in Trust A-1 and Trust A-2, determined without reduction for any state or federal estate or inheritance taxes attributable to the inclusion of CRUT in the gross estate.

Ruling Request 5

Section 61(a)(3) of the Code provides that gross income includes gains derived from dealings in property.

Section 1001(a) of the Code provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

A partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests, but do not acquire a new or additional interest as a result thereof. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

In Rev. Rul. 69-486, 1969-2 C.B. 159, distinguished by, Rev. Rul. 83-61, 1983-1 C.B. 78, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries and was subject to the provisions of § 1001 and § 1002 of the Code.

The present case is distinguishable from Rev. Rul. 69-486 because it has been represented that the assets of CRUT will be allocated among Trust A-1, Trust A-2, and Trust B in a pro rata manner and each trust will receive its proportionate part of each of the assets of CRUT. Accordingly, the proposed transaction will not be treated as a pro rata distribution to Trusts A-1, A-2, and B, followed by an exchange of assets among those trusts.

Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991) concerns the issue of when a sale or exchange has taken place that results in realization of gain or loss under § 1001 of the Code. In Cottage Savings, a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Supreme Court in Cottage Savings, 499 U.S. at 560-61, concluded that § 1.1001-1 of the regulations reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different."

In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Code so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Cottage Savings, 499 U.S. at 564-65. In Cottage Savings, 499 U.S. at 566, the Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans.

It is consistent with the Supreme Court's opinion in Cottage Savings to find that solely as the result of the pro rata division of CRUT into Trust A-1, Trust A-2, and Trust B, the interests of the non-charitable income beneficiaries of Trust A-1, Trust A-2, and Trust B will not differ materially from their interests in CRUT. Immediately after the pro rata division, the non-charitable beneficiaries will be entitled to a distribution from each trust that bears the same ratio to the distribution they would have received from the CRUT as the value of that trust's assets bears to the value of the CRUT's assets. One of the six charitable remainder beneficiaries of CRUT will be the sole remainder beneficiary of Trust A-1. A second of the six charitable beneficiaries of CRUT will be the sole remainder beneficiary of Trust A-2. Although the respective remainder beneficiary of Trust A-1 and Trust A-2 will be the sole beneficiary of a trust funded with assets representing one-sixth of the value of the assets of CRUT, their respective interests will not differ materially from their interest as a beneficiary of one-sixth of the remainder interest of CRUT. Similarly, the interest of each of the four charitable remainder beneficiaries of Trust B, which will be funded with assets representing two-thirds of the value of the assets of CRUT, will not differ materially from their respective interests as one of the six charitable remainder beneficiaries of CRUT.

The proposed division of CRUT into Trust A-1, Trust A-2, and Trust B and the proposed

pro rata allocation of the assets of CRUT among Trust A-1, Trust A-2, and Trust B will not result in the realization of gain by any of such trusts.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for the rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. We express no opinion on whether CRUT qualifies as a charitable remainder trust under § 664 or whether the separate trusts, Trust A-1, Trust A-2, Trust B, each will qualify as charitable remainder trusts under § 664. Further, the conclusion under ruling request 5 is limited solely to the income tax consequences of the division of CRUT into Trust A-1, Trust A-2, and Trust B under §§ 61 and 1001 and no opinion is expressed or implied concerning the application of any provision of the Code or regulations to CRUT, Trust A-1, Trust A-2, Trust B, or any beneficiaries thereof with respect to any events or transactions.

In accordance with the powers of attorney on file with this office, we are sending a copy of this letter to the executor of Decedent's estate, the trustee of RLT and CRUT, Successor Income Beneficiaries of CRUT, and RLT Charity.

The ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,
George L. Masnik
Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes