

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04-PLR-121616-02

Date:

APRIL 04, 2003

Re:

LEGEND:

Settlor =  
Spouse =  
Trust =  
Foundation =  
City =  
a =  
Distribution Trust =  
  
Date 1 =  
Son 1 =  
Son 2 =  
Daughter =

Dear :

This is in response to your April 3, 2002 letter requesting a ruling concerning the federal income, gift, and estate tax consequences of the creation of a proposed charitable lead unitrust.

You have requested the following rulings:

1. Trust will qualify as a charitable lead unitrust, the funding of which will result in a completed gift for gift tax purposes under sections 2501 and 2511 of the Internal Revenue Code and will entitle Settlor to a gift tax charitable deduction under section 2522 based on the present value of the annual unitrust payment payable from Trust.

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2. No portion of the principal of Trust will be included in Settlor's gross estate for federal estate tax purposes under section 2035, 2036, or 2038 upon the death of Settlor.
3. Trust will not be treated as a grantor trust for income tax purposes under sections 671 through 677 and no portion of the income of Trust will be taxable to Settlor.
4. Trust will be allowed a deduction under section 642(c) for amounts of gross income paid to Foundation or such other charitable beneficiaries described in section 170(c) during the taxable year.

The facts submitted are as follows:

Settlor proposes to establish Trust, an irrevocable trust, intended to qualify as a charitable lead unitrust. Settlor proposes to transfer \$a in cash and other assets to Trust. Under the Trust Agreement, Son 1, Son 2, and Daughter will serve as Trustees of Trust.

Article II, paragraph 2.1 of the Trust Agreement provides, in part, that in each taxable year of Trust, the Trustee shall pay Foundation for a period of 20 years beginning with the first date the Trustee accepts property hereunder as indicated on Schedule A, a Unitrust amount equal to 5% of the net fair market value of the trust assets valued as of the first day of each taxable year of the trust (the "Valuation Date").

Article II, paragraph 2.3 provides that the Unitrust Amount shall be paid in equal installments at the end of each six months from income, and to the extent that income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the Unitrust Amount shall be added to principal.

Article II, paragraph 2.5 provides that in the event that a charity named in or pursuant to Article II is not an organization of the type described in sections 170(b)(1)(A), 170(c), 2055(a) and 2522(a), the amount which would have been transferred to such charity shall instead be transferred to one or more organizations described in sections 170(b)(1)(A), 170(c), 2055(a) and 2522(a), in the sole discretion of the Trustee, or any successor Trustee then acting.

Article III, paragraph 3.1 provides that upon the termination of Trust, the Trustee shall distribute Trust assets, if any remain, into a designated inter vivos trust known as Distribution Trust and said funds will be distributed in accordance with the guidelines outlined in that trust for final distribution. In the alternative, should Distribution Trust not be in existence at the time of the termination of the charitable interest, the Trustee shall distribute all of the remaining principal and income of Trust, free of trust, to Settlor's children in equal shares and if any child has predeceased the Settlor leaving issue then that child's share to his or her issue in equal shares, and if no living issue then that child's share to the remaining surviving children of Settlor.

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Article V, paragraph 5.1 provides that in any taxable year in which an additional contribution or contributions are made to the trust, the valuation to be made and the amount to be paid as described in Article II shall be computed in accordance with section 1.170A-6(c)(2) of the Income Tax Regulations.

Article VI, paragraph 6.4 provides that in the case of the resignation, refusal, removal, or inability to act of a Trustee, the remaining Trustee(s) shall act as Trustee. If no remaining Trustee is acting, Foundation shall appoint a successor Trustee. If at any time no Trustee is acting and Foundation has failed to select a Trustee, a successor Trustee shall be appointed by a court of competent jurisdiction.

Article XI, paragraph 11.1 provides that the provisions of the Trust Agreement may be amended by the Trustee solely for the purpose of obtaining and maintaining qualification as a qualified charitable lead trust as defined in sections 2522(c)(2)(B) and 2055(e)(2)(B) and only in such manner and to such extent as it deems necessary to comply with the requirements of such Code sections and Regulations thereunder.

Article XI, paragraph 11.2 provides that the charities designated in Article II may be amended or revoked by a specific written instrument delivered by the Settlor to the Trustee, adding or substituting other charities and/or changing the shares of any one or more charities.

Article XI, paragraph 11.3 provides that except as provided in Article XI, the Trust Agreement may not be altered, amended, or revoked by anyone.

On Date 1, Settlor and his wife, Spouse, (the Grantors) established the Distribution Trust. Article II of Distribution Trust provides that upon the receipt of funds from Trust, the trustees of Distribution Trust shall take such receipts and distribute an equal share of such receipts to Son 1, Son 2, and Daughter. In the event any of the Grantors' children has predeceased the Grantors, the Trustees shall divide the principal of Distribution Trust into such number of equal shares and in such manner as may be practicable, so that there shall be one share for such child of the Grantors who has previously died, but who shall have left surviving issue, to be held and administered as follows:

Until the Termination Date, defined below, the Trustees shall distribute to or for the benefit of the issue of Son 1, Son 2, and Daughter as much of the net income and principal as the Trustees may consider appropriate for his or her health, education, support, or maintenance, annually adding to principal any undistributed income. Upon each of the youngest surviving child of the Grantors' child reaching the age of 35, the Trustees shall distribute one-half of the principal and accumulated income of the trust outright to said beneficiaries. The Termination Date is the earlier of (1) the date on which the youngest grandchild dies or (2) the date on which said grandchild reaches the age of 40 years. Upon the Termination Date, the Trustees shall distribute the remaining trust outright equally among the children of a deceased child, if he or she is age 40, or, if he or she has not reached age 40, as said beneficiary may direct by specific reference to this general power of appointment in his or her will.

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Article XV of Distribution Trust provides that Distribution Trust is irrevocable.

It is represented that Foundation is a charitable organization under section 501(c)(3) and is a private foundation under section 509.

## LAW AND ANALYSIS

### Ruling 1

Section 2501 imposes a tax for each calendar year on the transfer of property by gift by any individual. Section 2511(a) provides, in part, that subject to limitations contained in chapter 12, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(a) of the Gift Tax Regulations provides that the gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer. The tax is a primary and personal liability of the donor, is measured by the value of the property passing from the donor, and attaches at the time the property passes, regardless of the fact that the identity of the donee may not then be known or ascertainable.

Section 25.2511-2(b) provides that a gift is complete and subject to the gift tax when the donor has so parted with dominion and control over the property transferred as to leave in the donor no power to change its disposition, whether for the donor's own benefit or for the benefit of another.

Section 25.2511-2(c) provides that a gift is incomplete to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves.

Section 25.2511-2(d) provides that a gift is not considered incomplete merely because the donor reserves the power to change the manner or time of enjoyment.

Section 25.2511-2(e) provides that a donor is considered to have a power if it is exercisable by the donor in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property, such as a trustee.

Section 2522(a) provides, in part, that, in computing taxable gifts for the calendar year, there is allowed a deduction for the amount of: all gifts to or for the use of a corporation or trust organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Section 2522(c)(2)(B) provides that, where a donor transfers an interest in property to both a charitable and a noncharitable person or entity, no deduction shall be allowed for the charitable portion of the gift, unless the interest is in the form of a guaranteed annuity or is a fixed percentage distributed annually of the fair market value of the property determined on an annual basis.

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Section 25.2522(c)-3(c)(2)(vii) defines the term "unitrust interest" to mean an irrevocable right pursuant to an instrument of transfer to receive payment, not less often than annually, of a fixed percentage of the net fair market value, determined annually, of the property which funds the unitrust interest.

Section 25.2522(c)-3(d)(1) provides that the amount of the deduction for an unitrust interest is limited to the fair market value of the unitrust interest on the date of the gift. The fair market value of an unitrust interest is its present value.

Section 25.2522(c)-3(d)(2)(v) provides that the present value of a unitrust interest is determined by subtracting the present value of all interests in the transferred property other than the unitrust interest from the fair market value of the transferred property.

In this case, Settlor retains the power to change the charitable beneficiaries of Trust. Thus, Settlor's transfer is incomplete for gift tax purposes under section 25.2511-2(c). cf. Rev. Rul. 77-275, 1977-2 C.B. 346, illustrating that a retained power to designate charitable beneficiaries of a trust renders the transfer to charity incomplete for gift tax purposes. Accordingly, based on the facts submitted and the representations made, we conclude that Settlor is not entitled to a gift tax charitable deduction under section 2522 for the present value of the annual unitrust payment payable from Trust.

### Ruling 2

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent the decedent had an interest therein at the time of his death.

Section 2035(a) provides that if the decedent transferred an interest in 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 the property (or interest therein) would have been included in the gross estate under section 2036, 2037, 2038, or 2042 if the interest or relinquished power had been retained by the decedent on the date of death, then 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 gross estate includes 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 the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death: (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

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Section 2038(a)(1) provides that 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 the 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 his 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 where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In this case, Settlor retains the right to designate the charity that shall enjoy the income from the Trust and the right to amend or revoke the charities designated in Article II by adding or substituting other charities and/or changing the shares of any one or more charities. Accordingly, based on the facts submitted and the representations made, we conclude that Trust is includible in Settlor's gross estate.

### Ruling 3

Section 671 provides that where it is specified in subpart E that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Sections 673 through 677 specify the circumstances under which the grantor is treated as the owner of a portion of a trust.

Under section 675 and applicable regulations, the grantor is treated as the owner of any portion of a trust if under the terms of the trust agreement or circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiary of the trust.

Section 677 provides that the grantor shall be treated as the owner of any portion of a trust, whether or not the grantor is treated as the owner under section 674, 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 distributed to the grantor or the grantor's spouse, held or accumulated for future distribution to the grantor or the grantor's spouse, or applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Under section 1.677(a)-1(d) of the Income Tax Regulations, the grantor shall be treated as the owner of the portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in the discharge of a legal obligation of the grantor.

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The Trust Agreement does not contain any of the provisions or powers that would cause Settlor or any other person to be treated as the owner of any portion of Trust under section 673, 674, 676, or 677.

In addition, the Trust Agreement does not contain powers that cause administrative control to be exercisable primarily for the benefit of Settlor under section 675. However, whether Settlor will be treated as the owner of Trust under section 675 will depend on the actual operation of Trust. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the relevant parties have been examined by the office of the appropriate Area Director.

#### Ruling 4

Section 642(c)(1) provides that in the case of an estate or trust (other than a trust meeting the specifications of sections 651 and 652), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)).

Section 642(c)(4) provides that in the case of a trust, the deduction allowed by section 642(c) is subject to section 681.

Section 681(a) provides that in computing the deduction allowable under section 642(c) to a trust, no amount otherwise allowable under section 642(c) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to its unrelated business income for such year.

Section 1.642(c)-3(b)(2) provides that, in determining whether the amounts of income paid, permanently set aside, or used for a purpose specified in section 642(c)(1), (2), or (3) include particular items of income of an estate or trust not included in gross income, the specific provision controls if the governing instrument specifically provides as to the source out of which amounts are to be paid, permanently set aside, or used for such purpose. In the absence of specific provisions in the governing instrument, an amount to which section 642(c)(1), (2), or (3) applies is deemed to consist of the same proportion of each class of the items of income of the estate or trust as the total of each class bears to the total of all classes.

Except to the extent that Trust has unrelated business income under section 681(a), and except to the extent that contributions are nondeductible under section 508(d) or 4948(c)(4), Trust will be allowed deductions in accordance with section 642(c)(1) for amounts of gross income paid to charitable beneficiaries described in section 170(c) during the taxable year, or by close of the following taxable year if the trustee makes an election under section 1.642(c)-1(b). Because the deduction under section 642(c)(1) is limited to amounts of gross income, no deduction will be allowed for a distribution of an amount of principal except to the extent that the amount distributed

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has been included in the gross income of Trust and provided no deduction was allowed for any previous taxable year for the amount distributed.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,

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Lorraine E. Gardner  
Senior Counsel, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes