

when this stuff matters

- high stated unitrust payout
- principal balances down
- fixed annuity decimating principal
- NIMCRUT with no "flip" provision
 - or with triggering event unlikely to

occur

- reduced life expectancy of contingent or defensible successor income beneficiary
- immediate needs of charitable remainderman
- ditto income bene
- anticipated changes in marginal tax rates

Figure H

Charitable Remainder Unitrusts: Reported Unitrust Percentage, Filing Year 2009

[All figures are estimates based on samples]

Unitrust percentage	Number of returns	Percent of total
All returns [1]	95,922	100.0
5 percent, under 10 percent	82,870	86.4
5 percent under 6 percent	21,316	22.2
6 percent under 7 percent	18,390	19.2
7 percent under 8 percent	19,464	20.3
8 percent under 9 percent	18,749	19.5
9 percent under 10 percent	4,951	5.2
10 percent under 20 percent	12,416	12.9
20 percent under 35 percent	502	0.5
35 percent to 50 percent	133	0.1

[1] Includes 1,742 returns for which an invalid unitrust percentage was reported and efforts made to correct the unitrust percentage were not successful.

NOTES: Detail may not add to totals due to rounding.

from 11insitrusts09winbu11.pdf

Figure 1**Charitable Remainder Unitrust (CRUT) Types, by Filing Year 2009**

[All figures are estimates based on samples—money amounts are in thousands.]

CRUT type	All		Number of returns	Percent of total	Net income of r
	Number of returns	Percent of total			
All CRUTs	95,922	100.0	(1)	(2)	
Standard CRUT	74,689	77.9			
Net income CRUT	4,617	4.8			
Net income with makeup CRUT	16,616	17.3			

[1] Includes returns that did not report end-of-year book value of total assets (Form 5200). Often, these zero amounts are explained by trusts filing a final return.

NOTE: Detail may not add to totals due to rounding.

from 11insitrusts09winbu11.pdf

End-of-Year Book Value of Total Assets,

Size of end-of-year book value of total assets				
(1)	\$500,000 under \$3 million		\$3 million or more	
Percent of total	Number of returns	Percent of total	Number of returns	Percent of total
(4)	(5)	(6)	(7)	(8)
100.0	25,671	100.0	3,702	100.0
78.3	20,011	78.0	2,570	69.4
5.2	1,041	4.1	133	3.6
16.5	4,619	18.0	999	27.0

(1), column (b)) from the balance sheet, or that reported the amount as zero.

from 11insitrusts09winbu11.pdf



commutation :

- each party receives its actuarial share outright
- treated as sale of lead interest to remainderman
- holder of lead interest treated as having zero basis



surrender :

- holder of lead interest surrenders to remainderman
- charitable deduction for actuarial value
 - subject to contribution limits for appreciated property



exchange :

- **surrender in exchange for gift annuity**
- **treated as bargain sale**
- **present value of annuity treated as long term gain, recognized ratably over expected return multiple**

Rev. Rul. 86-60

Situation 1: surrender by CRAT
settlor to remainder charity

- qualifies for both income and gift tax charitable deductions
- method of calculating deductions not mentioned

Rev. Rul. 86-60, cont'd

Situation 2: surrender by both
settlor and successor annuitant

- surrender by successor annuitant
qualifies because it is the only
interest he ever had in the property

however,

Rev. Rul. 86-60, cont'd

- surrender by settlor qualifies for gift tax deduction only because it is in the form of a fixed annuity citing section 2522 (c) (2)

- no deduction for partial interest where another interest is retained, transferred, "or has been transferred"

re valuation of annuity interest

Reg. 25.7520-3(b) (2) (v) , example 5

- where annuity payout as percentage of initial value is higher than 7520 rate,

"the annuity must be valued as an annuity payable for a term of years or until the prior death of the annuitant, with the term of years determined by when the fund will be exhausted by the annuity payments. "

threshold condition 1:

- trust not initially created for purpose of evading partial interest rule of section 170 (f) (3) (A)

threshold condition 2:

- life expectancy of income beneficiary not less than would be indicated by tables under Reg. 1.72-9

[not an express condition of Rev. Rul. 86-60]

threshold condition 2, cont'd

- life expectancy condition first mentioned in
PLR 200252092

- commutation of a 20 pct. unitrust
- term of five years or earlier death of both
settlers

threshold condition 2, cont'd

but compare Reg. 25.7520-3(b) (3)

- mortality component may not be used if individual used as measuring life "dies or is terminally ill at the time the gift is completed"

Reg. 25.7520-3(b)(3), cont'd

defn. "terminally ill"

- at least 50 pct. probability individual will die within one year

- but if individual survives eighteen months, "presumed to have not been terminally ill"

- unless contrary established by "clear and convincing evidence"

keeping in mind:

- structuring the transaction to get a favorable advance ruling

versus

- surviving a challenge if the transaction were structured differently or if the tax consequences were reported differently

but what about Circular 230

- sec. 10.34, w/ respect to returns and other filings, ref. 6694(a)(2)
 - "substantial authority" if undisclosed
 - "reasonable" if disclosed
 - "more likely than not" if shelter or "reportable" transaction

[cf. Notice 2008-99, 2008-47 I.R.B. 1194, *infra*]

but what about Circular 230, cont'd

- sec. 10.35 (covered opinions)
withdrawn under regs. proposed 09/14/12,
finalized 06/12/14

- revisions to sec. 10.37 (written
opinions) set "reasonableness" standard

- not to take into account
likelihood of issue being raised on
audit

but what is "substantial authority"

Reg. 1.6662-4(d)(3) defn.

- weight of authorities in support
"substantial in relation to" weight of
authorities against

- IRS pronouncements, court
decisions, legislative history, etc.

- not what some guy says at a
breakfast meeting

what is "substantial authority," cont'd

from Reg. 1.6662-4 (d) (3) (iii)

"a private letter ruling is not authority if revoked or if inconsistent with a subsequent proposed regulation, revenue ruling or other administrative pronouncement published in the Internal Revenue Bulletin"

key issues from the letter rulings

1. calculating the deduction for an outright surrender (income tax, gift tax)
2. calculating the amounts to be distributed to each party in a commutation
 - a. disqualification under 664 (d)
 - b. self-dealing per 53.4947-1 (c) (2) (i)
3. calculating the amount to be recognized as gain in a commutation or exchange

the net income limitation

PLR 200205008 (10/23/01)

- partial surrender of survivor's interest in NIMCRUT to one of two remaindermen

- deduction limited to lesser of present value of stated percentage payout or straight income interest

- references to Reg. 20.2031-7(d) and Reg. 25.2522(c)-3(d)(2)(v), but no direct authority

the net income limitation, cont'd

PLR 200208039 (11/29/01)

- judicial commutation of eight pct. NICRUT, w/ consent of state attorney general
- taxpayer last survivor of several successive income benes
- trust invested for total return, yielding less than three pct. currently

Whether section 4941 of the Code applies depends on whether the proposed allocation of trust assets to the income beneficiary may properly be considered as "payable under the terms of such trust" and "directed by the terms of the governing instrument of the trust and not discretionary with the trustee" under section 53.4947-1(e) of the regulations. The critical question, in our view, is whether early termination may be expected to result in a greater allocation of the trust assets to the income beneficiary, to the detriment of the charitable beneficiary, than a non-early termination. The possibility of gamesmanship by the income beneficiary and whipsawing of the Service exists here.

From P.L.R. 200208039

X's proposed allocation method is reasonable if the income beneficiary has no knowledge of a medical condition or other circumstance likely to result in a shorter life expectancy than that predicted by the actuarial tables. Otherwise, an early termination would tend to deprive the charity of its benefit and would be inconsistent with the charitable deduction allowed to the donor of the trust. In the latter case, a charitable remainder trust could not terminate early without paying the termination tax under section 507(c).

From P.L.R. 200208039

the net income limitation, cont'd

PLRS 200524014 and 200525008 (03/15/05)

- judicial commutation of portion of ten pct. NIMCRUT, w/ consent of state attorney general
- remainder designated to private operating foundation w/ respect to which settlor was disqualified person
- nothing said about life expectancies

the net income limitation, cont'd

"we express no opinion as to the method of determining the present value of the unitrust interest [] for purposes of calculating the amount of the income and gift tax charitable deductions [.]"

but no self-dealing, ref. Reg. 53.4941(d)-2(f)(2),
"incidental or tenuous benefit"

the net income limitation, cont'd

similarly, PIR 200808018 (11/07/07)

- nonjudicial commutation of portion of seven pct. FLIPCRUT**
- term of years w/ contingent, defeasible payout to "family trust"**
- again, "no opinion" on method of determining present value**
- no mention of self-dealing**

the net income limitation, cont'd

PLR 200525014 (03/30/05)

- judicial commutation of fifteen pct. NICRUT, w/ consent of state attorney general
- remainder designated to private nonoperating foundation w/ respect to which settlors were disqualified persons
- taxpayers conceded capital gain, zero basis issues

the net income limitation, cont'd

- nothing said about trust not having been created for purpose of evading partial interest rule
- closely held stock sold, thus "purpose to provide management no longer exists"

the net income limitation, cont'd

- revoked by PLR 200614032 (01/09/06) , no explanation given
- replaced by PLR 200616035 (01/25/06)
- altered facts
- most notably, reserved power to redesignate exercised in favor of public charities

the net income limitation, cont'd

PLR 200725044 (03/27/07)

- nonjudicial commutation of ten pct. NIMCRUT
- remainder to private nonoperating foundation redesignated to public charities
- no mention of capital gain, zero basis issues

After discussions with our office, A individually and as trustee, submitted a letter dated April 27, 2006, in which the charitable beneficiaries were changed to E through Q. A agreed to a different payout in calculating the respective interests in the trust. Specifically, the letter stated in part that:

The Taxpayer understands and agrees that, contrary to the formula assumed in his letter dated August 17, 2004, the payout rate to be used in calculating the respective interests will be the lesser of the Code Section 7520 rate in effect at the time of termination of the trust and the stated interest rate of 10% contained in the trust agreement.

From P.L.R. 200725004

the "special factor"

- Reg. 1.7520-3(b) (1) (ii) defn. "restricted interest"

- "subject to a contingency, power, or other restriction," whether provided by terms of governing instrument or caused by circumstances

note: PLR 200725004 does not say the net income limitation is in fact a restriction

the "special factor," cont'd

- section 4947(a) (2) treats a split interest trust as a private foundation for purposes of self-dealing rules

- Reg. 53.4947-1(c) (2) (i) makes an exception for amounts paid to the income bene of a split interest trust unless a deduction was allowed "with respect to the income interest"

query: was a deduction allowed w/ respect to the difference betw. the stated unitrust payout and a straight income interest at the current 7520 rate

again, keeping in mind:

- structuring the transaction to get a favorable advance ruling

versus

- surviving a challenge if the transaction were structured differently or if the tax consequences were reported differently

commutation as capital transaction

- the letter rulings fairly consistently cite Rev. Rul. 72-243, 1972-1 C.B. 233

- in effect, a belated acquiescence in *McAllister v. Comm'r*, 157 F.2d 235 (2d Cir. 1946), cert. den., 330 U.S. 826 (1946)

[IRS had argued assignment of income]

- ruling issued in 1972 to address transitional issues on 1969 enactment of section 1001(e)

Commutation as capital transaction

what Rev. Rul. 72-243 literally says is

"the life tenant's sale of her entire interest in a testamentary trust to the remainderman is a sale of a capital asset"

no more

commutation as capital transaction, cont'd

what section 1001(e) (1) says:

"In determining gain or loss from the sale or other disposition of a term interest in property, that portion of the adjusted basis of such interest which is determined pursuant to section 1014, 1015, or 1041 (to the extent that such adjusted basis is a portion of the entire adjusted basis of the property) shall be disregarded. "

[emphasis supplied]

commutation as capital transaction, cont'd

but let's look at the cross references

- specifically, section 1015 (b)
- carryover basis for property "acquired by a transfer in trust . . . other than by gift"

[emphasis supplied]

- ordinarily understood to refer to a sale

commutation as capital transaction, cont'd

- Reg. 1.1015-1(b) allocates basis betw. income and remainder interests per actuarial factors

[cross reference Regs. 1.1014-5(a) and 20.2031-7]

- adjusting to reflect "change in relative values on account of the lapse of time"

so far, so good . . .

commutation as capital transaction, cont'd

but then, in determining gain or loss on disposition,

"that part of the adjusted uniform basis assignable . . . to the interest sold or otherwise disposed of shall be disregarded to the extent and in the manner provided by section 1001(e) and [Reg.] 1.1001-1(f) "

okay, so, what did the legislature intend