

Part III - Administrative, Procedural, and Miscellaneous

Guidance on Making Payments for Charitable Remainder Trusts

Notice 97-68

This notice informs taxpayers that the rules in §§ 1.664-2(a)(1)(i) and 1.664-3(a)(1)(i)(e) of the proposed Income Tax Regulations, published in a Notice of Proposed Rulemaking on April 18, 1997 (62 Fed. Reg. 19072), will not be effective for certain charitable remainder trusts (CRTs) for the 1997 taxable year.

BACKGROUND

Generally, a CRT is a trust that provides for a specified distribution at least annually over a specified period to one or more noncharitable beneficiaries and holds an irrevocable remainder interest in the trust for a charitable organization. Section 664 of the Internal Revenue Code provides for two types of CRTs: a charitable remainder annuity trust (CRAT) and a charitable remainder unitrust (CRUT). A CRAT pays a fixed annuity amount at least annually to the noncharitable beneficiary or beneficiaries. A CRUT pays a fixed percentage of the fair market value of the assets held by the trust as of the annual valuation date (the unitrust amount) at least annually to the noncharitable beneficiary or beneficiaries.

Section 664(d) provides that to qualify as a CRT, the trust must pay the annuity or unitrust amount at least annually to the noncharitable beneficiaries. As an administrative convenience, §§ 1.664-2(a)(1) and 1.664-3(a)(1) of the Income Tax Regulations have allowed CRTs to pay the annuity or unitrust amount within a reasonable time after the close of the tax year in which it is due without the timing of the payment causing the trust to fail to function exclusively as a CRT.

PROPOSED REGULATIONS REGARDING PAYING ANNUITY OR UNITRUST AMOUNT

The proposed amendments to §§ 1.664-2(a)(1)(i) and 1.664-3(a)(1)(i)(e) of the proposed regulations (the proposed timing amendments) would require a CRT to pay the annuity amount or the unitrust amount under the fixed percentage method of § 664(d)(2) by the close of the tax year in which the payment is due in order to function exclusively as a CRT. Under the effective date in the proposed regulations, once final, the proposed timing amendments would apply to taxable years ending after April 18, 1997, the date the proposed regulations were published in the Federal Register.

The Service and Treasury issued the proposed timing amendments in response to abuses associated with the use of accelerated CRTs described in Notice 94-78, 1994-2 C.B. 555. Taxpayers using accelerated CRTs characterize the payment of the annuity or unitrust amount as a distribution of trust corpus that is not subject to tax by delaying the required payment until

after the end of the tax year in which it is due.

Since publishing the proposed regulations, the Service and Treasury have received a significant number of comments expressing concern that the proposed timing amendments will place a significant burden on many trusts that are not engaging in abuses. Some commentators observed that for many CRTs the character of the annuity or unitrust amount is not affected by the time at which the payment is made. Because these trusts have accumulated sufficient income in the ordinary, capital gains, and other income categories of § 664(b)(1), (2), and (3), no portion of the annuity or unitrust amount distributed will be characterized as trust corpus under § 664(b)(4) irrespective of whether the amount is paid before or after the close of the tax year for which it is due. The commentators add that being required to pay the annuity or unitrust amount by the close of the calendar year would create a hardship if the trustee is relying on end-of-the-year dividends and similar income, which may not arrive until January of the following year, to make the annuity or unitrust payment. The commentators also argue that the proposed timing amendments would create a hardship for trustees of CRUTs that have a December 31 valuation date because such a trustee would be forced to value the assets in the trust and make a payment of the unitrust amount after the close of business and before midnight on that date.

In light of the enactment of the Taxpayer Relief Act of 1997

(the Act) on August 5, 1997, other commentators have argued that the proposed timing amendments are no longer necessary to stop the abuses created by accelerated CRTs. The Act amended the definition of a CRT to include a maximum allowable percentage of 50 percent for calculating the annuity amount or unitrust amount and a minimum 10 percent present value for the charitable remainder interest. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1089, 111 Stat. 960, 961. We note that the Senate Finance Committee explicitly stated that it did not intend for the Act to "limit or alter the validity of the regulations proposed by the Treasury Department on April 18, 1997, or the Treasury Department's authority to address this or other abuses of the rules governing the taxation of charitable remainder trusts or their beneficiaries." S. Rep. No. 33, 105th Cong., 1st Sess. 201 (1997).

Several commentators have asked for relief from the effective date for the proposed timing amendments while their comments are considered and before the regulations are finalized.

APPLICATION OF PROPOSED TIMING AMENDMENTS

The Service and Treasury recognize that complying with the proposed timing amendments in 1997 may create an unnecessary burden on those trusts for which the potential for abuse is minimal. Therefore, when the proposed regulations are adopted as final regulations under a Treasury Decision, the Service and Treasury intend to provide that for the taxable year 1997 a CRT

created before January 1, 1998, will not be made subject to the rules stated in §§ 1.664-2(a)(1)(i) and 1.664-3(a)(1)(i)(e) of the proposed regulations if in 1997 the trust is:

(1) A CRAT under which the sum certain to be paid each year to one or more persons is 15 percent or less of the initial net fair market value of all property placed in the trust, or

(2) A CRUT under which the fixed percentage of the net fair market value of the unitrust's assets to be paid each year to one or more persons is 15 percent or less, or

(3) A CRAT or CRUT from which all of the annuity amounts or unitrust amounts paid for 1997 are characterized in the hands of the beneficiary as income from the categories described in § 664(b)(1), (2), and (3), and not as trust corpus.

Thus, a CRT created before January 1, 1998, that meets any one of these three exceptions may pay its annuity amount or unitrust amount for the taxable year 1997 within a reasonable period of time after the close of the tax year under §§ 1.664-2(a)(1)(i) and 1.664-3(a)(1)(i) of the Income Tax Regulations.

The Service and Treasury will continue to consider the comments submitted on the proposed regulations before deciding whether to adopt an amended version of the proposed regulations as final regulations.

For further information regarding this notice, please call Mary Beth Collins or Jeff Erickson of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries) on (202) 622-

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