

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also: Part I, §§ 642(c), 2055; §20.2055-2)

Rev. Proc. 2007-46

SECTION 1. PURPOSE

This revenue procedure contains an annotated sample declaration of trust and alternate provisions that meet the requirements for a testamentary charitable lead annuity trust (CLAT) providing for annuity payments payable to one or more charitable beneficiaries for the annuity period followed by the distribution of trust assets to one or more noncharitable remaindermen.

SECTION 2. BACKGROUND

The Internal Revenue Service (Service) is issuing sample forms for CLATs; annotations and alternate sample provisions are included as further guidance. In addition to the sample trust instrument for a testamentary CLAT that is included in this revenue procedure, samples are provided in a separate revenue procedure for grantor

discretion of the trustee; (.03) the annuity amount as a specific dollar amount; and (.04) designation of an alternate charitable beneficiary in the trust instrument. If a trust is substantially similar to the sample trust in section 4 of this revenue procedure or properly integrates one or more alternate provisions from section 6 into a document substantially similar to the sample trust in section 4, is a valid trust under applicable local law, and operates in a manner consistent with the terms of the instrument, and if all other deductibility requirements are satisfied, the value of the charitable lead interest will be deductible by the decedent's estate under § 2055(e)(2)(B) and payments of the annuity amount to the charitable lead beneficiary will be deductible from the gross income of the trust to the extent provided by § 642(c)(1). In addition, a testamentary CLAT will qualify for the safe harbor created under this revenue procedure if the trust satisfies all of the requirements set forth in the preceding sentence, except that it defines the annuity amount as an increasing amount for which the value is ascertainable at the creation of the trust and/or provides for a different disposition of trust assets upon the termination of the annuity period.

Except as provided above, a trust that contains substantive provisions in addition to those provided in section 4 of this revenue procedure (other than properly integrated alternate provisions from section 6 of this revenue procedure or provisions necessary to establish a valid trust under applicable local law that are not inconsistent with the applicable federal tax requirements), or that omits any of the provisions of section 4 of this revenue procedure (unless an alternate provision from section 6 of this revenue procedure is properly integrated), will not necessarily be ineligible for the relevant

charitable deduction(s), but neither will that trust (or contributions to it) be assured of qualification for the appropriate charitable deductions. The Service generally will not issue a letter ruling on whether a testamentary CLAT qualifies for income and estate tax charitable deductions. The Service, however, generally will issue letter rulings relating to the tax consequences of the inclusion in a CLAT of substantive trust provisions other than those contained in sections 4 and 6 of this revenue procedure.

SECTION 4. SAMPLE TESTAMENTARY CHARITABLE LEAD ANNUITY TRUST

I give, devise, and bequeath [property bequeathed] to my Trustee in trust to be administered under this provision. I intend this bequest to establish a charitable lead annuity trust, within the meaning of Rev. Proc. 2007-46. This trust shall be known as the _____ Charitable Lead Annuity Trust, and I hereby designate _____ as the initial trustee (hereinafter “the Trustee”). All references to “section” or “§” in this instrument shall refer to the Internal Revenue Code of 1986, 26 U.S.C. § 1, et seq.

1. Payment of Annuity Amount. In each taxable year of the trust during the annuity period, the Trustee shall pay to [designated charitable recipient] an annuity amount equal to [number representing the annual annuity percentage to be paid to the designated charitable recipient] percent of the initial net fair market value of all property passing to this trust, as finally determined for federal estate tax purposes. If [designated charitable recipient] is not an organization described in §§ 170(c) and 2055(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c) and 2055(a) as the Trustee shall

select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion. The term "the Charitable Organization" shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient. During the trust term, no payment shall be made to any person other than the Charitable Organization. The annuity period is a term of [number of years of annuity period] years. The first day of the annuity period shall be the date of my death, and the last day of the annuity period shall be the day preceding the [ordinal number corresponding to the length of the annuity period] anniversary of that date. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal estate tax purposes, the Trustee shall pay to the Charitable Organization (in the case of an undervaluation) or receive from the Charitable Organization (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

2. Deferral Provision. The obligation to pay the annuity amount shall commence with the date of my death, but payment of the annuity amount may be deferred from this date until the end of the taxable year in which the trust is completely funded. Within a reasonable time after the end of the taxable year in which the trust is

acquired by the Trustee, would subject the Trustee to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3).

7. Taxable Year. The taxable year of the trust shall be the calendar year.

- (1) Income taxation of testamentary charitable lead trusts. A testamentary CLAT is a complex trust that is taxable as a separate entity under the provisions of subchapter J of the Code. The trustee of the trust must apply for a tax identification number for the trust.

- (2) Deduction under § 642(c)(1) available for amounts paid for a charitable purpose. Under § 642(c)(1), a testamentary CLAT is allowed a deduction in computing its taxable income for any amount of gross income, without limitation, that under the terms of the trust instrument is paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)) during the taxable year. Section 642(c)(1) and § 1.642(c)-1(a). An amount paid to a corporation, trust, or community chest, fund, or foundation otherwise described in § 170(c)(2) shall be considered paid for a purpose described in § 170(c) even though the corporation, trust, or community chest, fund, or foundation is not created or organized in the United States, any state, the District of Columbia, or any possession of the United States. Section 1.642(c)-1(a)(2). With regard to amounts of income paid to the charitable beneficiary after the close of the taxable year in which the income was received (but on or before the last day of the next succeeding taxable year), the trustee of a testamentary CLAT may elect to take the charitable deduction for that payment for the year in which the income was received, rather than for the year in which the payment was made. Section 642(c)(1). The election is made by filing a statement with the income tax

return for the taxable year in which the charitable contribution is treated as paid. See § 1.642(c)-1(b).

- (3) Charitable lead beneficiary requirements. A deduction is allowed under § 642(c)(1) for any amount of the gross income of a testamentary CLAT that is paid for a purpose specified in § 170(c). Note that the class of permissible charitable recipients for obtaining a deduction under § 642(c)(1) differs from the class of permissible charitable recipients for obtaining a deduction under § 170(a). Compare § 170(c) and § 1.642(c)-1(a)(2).
- (4) Unrelated business taxable income. Under § 681, a testamentary charitable lead trust's deduction under § 642(c)(1) is disallowed in any year to the extent that the deduction is allocable to the trust's unrelated business taxable income, as defined in § 512, for that taxable year. See § 1.681(a)-2. However, a partial deduction is allowed under § 512(b)(11) for amounts allocable to unrelated business taxable income. Section 512(b)(11). See § 512(b)(12) and § 1.681(a)-2(a).
- (5) Computation of estate tax charitable deduction. In general, the estate tax charitable deduction available under § 2055(e)(2)(B) with respect to contributions to a CLAT is equal to the present value of the annuity interest. Section 7520 requires that an annuity interest must be valued using tables published by the Service. The method for valuing a charitable lead annuity interest is set forth in the regulations. See

§ 20.7520-2. If estate or other death taxes are paid from the assets used to fund a testamentary CLAT, the amount deductible under § 2055 is the amount that passes to charity, reduced by the amount of estate or death taxes paid. Section 2055(c).

- (6) Trustee provisions. The trust instrument may name alternate or successor trustees and/or may include a process for the appointment of unnamed alternate or successor trustees. In addition, the trust instrument may contain certain administrative provisions relating to the trustee's duties and powers.

.02 Annotations for Paragraph 1, Payment of Annuity Amount, of the Sample Trust.

- (1) Guaranteed annuity. To qualify for an estate tax charitable deduction, a CLAT must provide for the payment of a guaranteed annuity amount at least annually to a qualified charitable organization for each year during the annuity period. See § 2055(e)(2)(B). A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for one or more measuring lives. See section 5.02(4) for a discussion of the permissible term of a testamentary CLAT. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer may be ascertained as of the appropriate valuation date. Section 20.2055-2(e)(2)(vi)(a). A charitable interest expressed as the right to receive an annual payment from a trust equal to the lesser of a

sum certain or a fixed percentage of the trust assets (determined annually) is not a guaranteed annuity interest. See § 20.2055-2(e)(2)(vi)(b). In addition, a charitable lead annuity interest is not a guaranteed annuity interest if the trustee has the discretion to commute and prepay the charitable interest prior to the termination of the annuity period. Rev. Rul. 88-27, 1988-1 C.B. 331. If a charitable interest in the form of a guaranteed annuity interest is in trust and the present value of the charitable interest on the appropriate valuation date exceeds 60 percent of the aggregate value of all amounts in the trust, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits the acquisition and retention of assets that would give rise to a tax under § 4943 or 4944, as modified by §§ 4947(a)(2) and 4947(b)(3). Section 20.2055-2(e)(2)(vi)(e). These prohibitions are contained in the sample trust in section 4. See section 5.07 for a further discussion of the 60 percent test. See section 6.03 for an alternate provision that provides for an annuity amount stated as a specific dollar amount.

- (2) Payment requirements. CLATs are not subject to any minimum or maximum payout requirements. The governing instrument of a CLAT must provide for the payment to a charitable organization of a fixed dollar amount or a fixed percentage of the initial net fair market value of the assets transferred to the trust. Alternatively, the governing instrument of a

CLAT may provide for an annuity amount that is initially stated as a fixed dollar or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time of the decedent's death. The annuity payments may be made in cash or in kind. If the trustee distributes appreciated property in satisfaction of the required annuity payment, the trust will realize capital gain on the assets distributed to satisfy part or all of the annuity payment and the trust will be allowed a § 642(c)(1) deduction for the realized capital gains. Rev. Rul. 83-75, 1983-1 C.B. 114. See section 5.03 for a discussion of the deferral of the requirement to pay the annuity amount until the end of the taxable year in which the trust is completely funded.

- (3) Rule against perpetuities. An interest payable for a specified term of years may qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. However, any such savings clause must utilize a period of vesting of not more than 21 years after the deaths of the measuring lives who are selected to maximize, rather than limit, the term of the trust. Section 20.2055-2(e)(2)(vi)(a).
- (4) Permissible term. Paragraph 1, Payment of Annuity Amount, of the sample trust provides for payment of the annuity amount for a specified term of years. Alternatively, the trust instrument may provide for payment of the annuity amount for the life or lives of one or more measuring lives or

for the life or lives of one or more measuring lives plus a term of years. Rev. Rul. 85-49, 1985-1 C.B. 330. Only one or more of the following individuals may be used as measuring lives: the decedent's spouse and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170 or 2055), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. Each person used as a measuring life for the annuity period must be living on the decedent's date of death. Section 20.2055-2(e)(2)(vi)(a). See section 6.01 for an alternate provision that provides for an annuity period based on the life of an individual.

- (5) Permissible recipients. A CLAT must have one or more charitable lead beneficiaries. The failure to designate a specific charitable beneficiary will not preclude the decedent's estate from receiving a charitable deduction if the trust instrument provides for the selection by the trustee of a charitable beneficiary described in §§ 170(c) and 2055(a). Rev. Rul. 78-101, 1978-1 C.B. 301. See section 6.02 for an alternate provision that provides the trustee with the power to apportion the annuity amount among charitable

to be paid in annual or other equal or unequal installments throughout the

amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. The second exception arises when, under the trust's governing instrument, the amount that may be paid for a private purpose is payable only from a group of assets that is devoted exclusively to private purposes and to which § 4947(a)(2) is inapplicable by reason of § 4947(a)(2)(B). Note that an amount is not deemed to have been paid for a private purpose if it was paid for full and adequate consideration in money or money's worth. Section 20.2055-2(e)(2)(vi)(f). See section 5.07 for the private foundation rules applicable to charitable lead trusts.

.03 Annotations for Paragraph 2, Deferral Provision, of the Sample Trust.

- (1) Deferral of requirement to pay annuity amount. The deferral provision in paragraph 2 of the sample trust authorizes the trustee to defer the payment of the annuity amount until the end of the taxable year of the trust in which the trust is completely funded.
- (2) Interest on annuity payments. The deferral provision in paragraph 2 of the sample trust provides for the payment of interest, compounded annually, with respect to any underpayment of the annuity amount during the period of estate administration. The sample trust requires that interest be computed at the § 7520 rate in effect on the date of the decedent's death. To the extent that interest payable under state law exceeds the applicable

§ 7520 rate, the payment of interest at the rate prescribed by state law will be deemed to satisfy the interest payment requirement set forth in the trust instrument.

.04 Annotation for Paragraph 3, Proration of Annuity Amount, of the Sample Trust.

- (1) Prorating the annuity amount. Paragraph 3, Proration of Annuity Amount, of the sample trust provides for the proration of the annuity amount in any short taxable year, including the last year of the annuity period.

.05 Annotation for Paragraph 4, Distribution Upon Termination of Annuity Period, of the Sample Trust.

- (1) Generation-skipping transfer tax. If a CLAT has or may have a skip person, as defined in § 2613(a), as a remainder beneficiary, the transfer to the trust will be subject to the generation-skipping transfer (GST) tax. Under § 2651(f)(3), a charitable organization is deemed to be in the same generation as the decedent/donor of a charitable lead trust. Therefore, the GST potential of a charitable lead trust is dependent upon whether any noncharitable beneficiary is a skip person. GST tax liability is determined by multiplying the taxable amount by the applicable rate. The applicable

.06 Annotation for Paragraph 5, Additional Contributions, of the Sample Trust.

- (1) Additions to the trust. For purposes of qualification under this revenue procedure, the trust instrument must contain a provision that prohibits additional contributions. A CLAT that permits additional contributions will not qualify for safe harbor treatment under this revenue procedure.

.07 Annotation for Paragraph 6, Prohibited Transactions, of the Sample Trust.

- (1) Prohibitions against certain investments and excess business holdings. Prohibitions against retaining any excess business holdings within the meaning of § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3), and against investments that jeopardize the exempt purpose of the trust within the meaning of § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3), are generally required. The sample trust in section 4 contains prohibitions against §§ 4943 and 4944 transactions. If the present value of the charitable interest does not exceed 60 percent of the aggregate value of all amounts in the trust, the trust instrument does not provide for the payment of any of the income interest to a noncharitable beneficiary, and the trust instrument does not provide for the payment of excess income to

private purpose.

.08 Annotation for paragraph 7, Taxable Year, of the Sample Trust.

- (1) Calendar year. The taxable year of a charitable lead trust must be a calendar year. Section 644(a).

.09 Annotation for paragraph 10, Investment of Trust Assets, of the Sample Trust.

- (1) Capital gains. Gains from the sale or exchange of capital assets may be allocated to the income or the principal of the trust. If the governing instrument is silent, capital gains are allocated in accordance with local law. Even if gains are allocated to principal, they will be deductible under § 642(c)(1) if they are paid to the charitable beneficiary as part of a charitable annuity payment. Rev. Rul. 83-75, 1983-1 C.B. 114.

SECTION 6. ALTERNATE PROVISIONS FOR SAMPLE TESTAMENTARY

CHARITABLE LEAD ANNUITY TRUST

.01 Annuity Period for the Life of One Individual.

- (1) Explanation. As an alternative to establishing a CLAT for a term of years, the trust instrument of a testamentary CLAT may provide for payment of the annuity amount for the life or lives of an individual or individuals. However, only one or more of the following individuals may be used as measuring lives: the decedent's spouse and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170 or 2055), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement

that each measuring life is a lineal ancestor (or the spouse of a lineal ancestor) of all noncharitable remainder beneficiaries, if on decedent's date of death there is a less than 15 percent probability that individuals who are not lineal descendants of an individual who is a measuring life will receive any trust principal. The probability must be computed under the applicable tables in § 20.2031-7. Section 20.2055-2(e)(2)(vi)(a).

- (2) Instruction for use. Replace the fifth and sixth sentences of paragraph 1, Payment of Annuity Amount, of the sample trust with the following sentences:

The annuity period is the lifetime of [designated measuring life]. The first day of the annuity period shall be the date of my death, and the last day of the annuity period shall be the date of death of [designated measuring life].

.02 Apportionment of the Annuity Amount in the Discretion of the Trustee.

- (1) Explanation. The trustee of a testamentary charitable lead trust may be granted the power to apportion the annuity payment from time to time among a class of qualifying charitable beneficiaries.
- (2) Instruction for use. Replace the first three sentences of paragraph 1, Payment of Annuity Amount, of the sample trust with the following two sentences:

In each taxable year of the trust during the annuity period, the Trustee shall pay to one or more members of a class

comprised of organizations described in §§ 170(c) and 2055(a) (hereinafter, collectively “the Charitable Organization”) an annuity amount equal to [number representing the annual annuity percentage to be paid to the Charitable Organization] percent of the initial net fair market value of all property passing to this trust, as finally determined for federal tax purposes. The Trustee may pay the annuity amount to one or more members of the class, in equal or unequal shares, as the Trustee, in the Trustee’s sole discretion, from time to time may deem advisable.

.03 Annuity Amount as a Specific Dollar Amount.

- (1) Explanation. As an alternative to stating the annuity amount as a percentage of the initial net fair market value of the assets transferred to the trust, the annuity amount may instead be stated as a specific dollar amount.
- (2) Instructions for use.
 - (a) Replace the first sentence in paragraph 1, Payment of Annuity Amount, of the sample trust with the following sentence:

In each taxable year of the trust during the annuity period, the Trustee shall pay to [designated charitable recipient] an annuity amount equal to [the stated dollar amount].
 - (b) Delete the last sentence in paragraph 1, Payment of Annuity

Amount, of the sample trust concerning the incorrect valuation of trust assets.

.04 Designation of an Alternate Charitable Beneficiary in the Trust Instrument.

and 2055(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Stephanie N. Bland of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure contact Stephanie N. Bland at (202) 622-3090 or (202) 622-7830 (not a toll free call).