

Section 664.—Charitable Remainder Trusts

26 CFR 1.664-3: Charitable remainder unitrust.

Charitable remainder trusts; qualified charitable remainder unitrusts; recipient trusts. This ruling provides that, in three situations, a charitable remainder unitrust may pay the unitrust amounts to a second trust for the life of an individual, who is financially disabled

as defined in section 6511(h)(2)(A) of the Code. In each situation, the use of the unitrust amounts by the second trust is consistent with the manner in which the individual's own assets would be used, and the individual is, therefore, considered to have received the unitrust amounts directly from the charitable remainder unitrust for purposes of section 664(d)(2)(A).

Rev. Rul. 2002-20

ISSUE

May a trust qualify as a charitable remainder unitrust under § 664 of the Internal Revenue Code, if the unitrust amounts are paid to a separate trust for the life of an individual who is “financially disabled,” as defined in § 6511(h)(2)(A)?

FACTS

An individual concurrently creates Trust A, a trust that otherwise qualifies as a charitable remainder unitrust, and a separate trust, Trust B. Under the governing instrument of Trust A, annual unitrust amounts will be paid to Trust B for the life of C. C is an individual who is financially disabled, that is, C is unable to manage C's own financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months.

Situation 1. Under the governing instrument of Trust B, a designated portion of the amount it receives from Trust A will be paid to C each month. If, at any time in the sole judgment of the trustee, the monthly payment to C is insufficient to provide adequately for the care, support, and maintenance of C, or is insufficient for the needs of C for any reason, additional amounts will be paid as needed to or on behalf of C from Trust B. Upon C's death, the balance remaining in Trust B will be distributed to C's estate.

Situation 2. Under the governing instrument of Trust B, the trustee may make distributions of income and principal, as determined in the trustee's sole and absolute discretion, for the financial aid and best interests of C in a manner

that supplements but does not supplant any governmental benefits otherwise available to *C*. Upon *C*'s death, the balance remaining in Trust *B* will be distributed to *C*'s estate.

Situation 3. Under the governing instrument of Trust *B*, the trustee may make distributions of income and principal, as determined in the trustee's sole and absolute discretion, for the financial aid and best interests of *C* in a manner that supplements but does not supplant any governmental benefits otherwise available to *C*. Upon *C*'s death, the governing instrument requires the trustee to reimburse the state for the total costs of medical assistance provided to *C* under the state's Medicaid plan. *C* is given a testamentary general power of appointment over the balance remaining in Trust *B*. If *C* fails to exercise the power, the balance will be distributed, in equal shares, to *C*'s sister and to *X*, a charitable organization.

LAW AND ANALYSIS

A charitable remainder unitrust is a trust from which a unitrust amount is payable at least annually during its term with an irrevocable remainder interest held for the benefit of charity. Under § 664 (d)(2)(A), the unitrust amount is a fixed percentage (not less than 5 percent and not more than 50 percent) of the net fair market value of the trust assets, valued annually. The unitrust amount is to be paid to one or more persons (at least one of which 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 the individual or individuals.

Section 1.664-3(a)(5)(i) of the Income Tax Regulations provides that the period for which the unitrust amount is payable begins with the first year of the charitable remainder trust and continues either for the life or lives of a named individual or individuals or for a term of years not to exceed 20 years. Only an individual or an organization described in § 170(c) may receive an amount for the life of an individual.

In general, a charitable remainder unitrust may pay unitrust amounts to a second trust only for a term of 20 years or less. In *Situations 1, 2, and 3*, the unitrust amounts are payable to Trust *B* for the life of *C*, not for a term of years. However, in each of these situations, the sole function of Trust *B* is to receive and administer the unitrust amounts for the benefit of *C*, who is unable to manage *C*'s own financial affairs by reason of a medically determinable mental or physical impairment. Upon *C*'s death, the assets remaining in Trust *B* will be distributed either to *C*'s estate or, after reimbursing the state for any Medicaid benefits provided to *C*, will be subject to *C*'s general power of appointment. In these situations, the use of the assets in Trust *B* during *C*'s life and at *C*'s death is consistent with the manner in which *C*'s own assets would be used. *C*, therefore, is considered to have received the unitrust amounts directly from Trust *A* for purposes of § 664 (d)(2)(A). Accordingly, the term of Trust *A* may be for the life of *C* and is not limited to a term of years.

The same result would apply if Trust *A* were a charitable remainder annuity trust.

HOLDING

A trust may qualify as a charitable remainder unitrust under § 664 if the unitrust amounts will be paid for the life of a financially disabled individual to a separate trust that will administer these payments on behalf of that individual and, upon the individual's death, will distribute the remaining assets either to the individual's estate or, after reimbursing the state for any Medicaid benefits provided to the individual, subject to the individual's general power of appointment.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-270 (1976-2 C.B. 194) which addresses facts covered by *Situation 1*, is amplified and superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is Jan Bennett Geier of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Ms. Geier at (202) 622-7830 (not a toll-free call).