March 2, 2010

Via electronic submission:
Notice.Comments@IRSCounsel.Treas.gov

Internal Revenue Service
Room 5203
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

RE: Internal Revenue Service Notice 2010-19; Internal Revenue Code Section 2511(c)

The following comments are submitted on behalf of the American Bar Association Section of Real Property, Trust and Estate Law in response to the notice referenced above. These comments have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

These comments were prepared by members of the Charitable Planning and Organizations Group of the Trust and Estate Division of the Section of Real Property, Trust and Estate Law of the American Bar Association. Mary Lee Turk, Chair of the Charitable Planning and Organizations Group, supervised the preparation of these comments and participated in their preparation. The principal drafting responsibility was exercised by Erik Dryburgh and Julie K. Kwon and substantive contributions were made by Carol G. Kroch. These comments were reviewed by Jerry J. McCoy on behalf of the Section’s Committee on Governmental Submissions.

If you have any questions, please do not hesitate to contact Mary Lee Turk at 312.332.6300, marylee@levinschreder.com

Very truly yours,

Roger D. Winston
Section Chair

cc: Alan F. Rothschild, Jr., Section Vice-Chair, Trust & Estate Division, ABA-RPTE
Bernice B. Donald, Secretary, American Bar Association
Thomas M. Susman, Governmental Affairs, American Bar Association
AMERICAN BAR ASSOCIATION
SECTION OF REAL PROPERTY, TRUST AND ESTATE LAW
CHARITABLE PLANNING AND ORGANIZATIONS GROUP
CHARITABLE PLANNING COMMITTEE

COMMENTS CONCERNING INTERNAL REVENUE CODE SECTION 2511(c) AND
INTERNAL REVENUE SERVICE NOTICE 2010-19

I. INFORMATION ON THESE COMMENTS

The following comments are submitted on behalf of the American Bar Association Section of Real Property, Trust and Estate Law. These comments have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

These comments were prepared by members of the Charitable Planning and Organizations Group of the Trust and Estate Division of the Section of Real Property, Trust and Estate Law (the “Section”) of the American Bar Association. Mary Lee Turk, Chair of the Charitable Planning and Organizations Group, supervised the preparation of these comments and participated in their preparation. The principal drafting responsibility was exercised by Erik Dryburgh and Julie K. Kwon and substantive contributions were made by Carol G. Kroch. These comments were reviewed by Jerry J. McCoy on behalf of the Section’s Committee on Governmental Submissions.

Contact person: Phone Number:
Mary Lee Turk 312-332-6300

Although the members of the Section who participated in preparing these comments have clients who would be affected by the federal tax principles addressed, or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these comments.

II. BACKGROUND

Section 2511(c) of the Internal Revenue Code (the “Code”) ¹ was enacted as a part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”)² to prevent taxpayers from “shifting” income to trusts without making a completed gift. Section 2511(c) as enacted by EGTRRA provided that a transfer in trust made after December 31, 2009, was to be treated as a “taxable gift” unless the trust was treated as wholly owned by the donor or the donor’s spouse under the grantor trust rules of subpart E of part I of subchapter J of chapter 1 of

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¹ All references herein to the “Code” refer to the Internal Revenue Code of 1986, as amended. Unless otherwise specified, all references to “Sections” herein refer to Sections of the Code.
Subtitle A of the Code. Technical corrections made to EGTRRA in the Job Creation and Worker Assistance Act of 2002 (the “2002 Act”){3} amended Section 2511(c) to replace the words “taxable gift under section 2503” with the words “transfer of property by gift.” The Joint Committee on Taxation’s report on the 2002 Act (the “Report”){4} provides that the amendment to Section 2511(c) made by the 2002 Act clarified that the gift tax annual exclusion and the marital and charitable deductions apply to transfers to trusts treated as gifts under Section 2511(c). The Report goes on to provide that, under Section 2511(c) as amended, “certain amounts transferred in trust will be treated as transfers of property by gift, despite the fact that such transfers would be regarded as incomplete gifts or would not be treated as transferred under the law applicable to gifts made prior to 2010.”{5} The Report provides the following two examples to illustrate the application of Section 2511(c):

[I]f in 2010 an individual transfers property in trust to pay the income to one person for life, remainder to such persons and in such portions as the settlor may decide, then the entire value of the property will be treated as being transferred by gift under the provision, even though the transfer of the remainder interest in the trust would not be treated as a completed gift under current Treas. Reg. § 25.2511-2(c). Similarly, if in 2010 an individual transfers property in trust to pay the income to one person for life, and makes no transfer of a remainder interest, the entire value of the property will be treated as being transferred by gift under the provision.{6}

Thus, the Report’s explanation confirms that Section 2511(c) may have two distinct consequences: (1) that all transfers to non-grantor trusts will be treated as completed gifts, and (2) that the entire value of the property will be treated as transferred by gift for gift tax purposes even if an individual “makes no transfer of [an interest]” in that property at all.

Section 2511(c) specifically contemplates the issuance of regulations to remove some transfers from the operation of its rule. And, like other provisions of EGTRRA, Section 2511(c) is set to sunset on December 31, 2011.

On February 2, 2010, the Internal Revenue Service (the “IRS”) issued Notice 2010-19 to clarify the effect of Section 2511(c) (the “Notice”).{7} The Notice provides that transfers to trusts that are treated as wholly owned by the donor or the donor’s spouse under subpart E of part I of subchapter J of chapter 1 of the Code (“grantor trusts”) are taxable under Chapter 12 of the Code to the same extent they were under prior law. The Notice confirms the Report’s conclusion that Section 2511(c) “provides that certain transfers in trust are treated as transfers of property by gift even though such transfers would have been regarded as incomplete gifts, or would not have been treated as transfers under the gift tax provisions in effect prior to 2010.”{8} (Emphasis added.) The Notice reiterates that Section 2511(c) subjects certain types of transfers to the federal gift tax under Chapter 12 of the Code that, before 2010, would have been considered incomplete and,

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4 Staff of the Joint Committee on Taxation, Technical Explanation of the “Job Creation and Worker Assistance Act of 2002” (JCX-12-02), March 6, 2002.
5 Id. at 39.
6 Id. at 39.
7 Notice 2010-19, 2010-7 IRB 404, 02/02/2010.
8 Id.
thus, not subject to the gift tax. The Notice concludes that, “[a]ccordingly, each transfer made in 2010 to a trust that is not treated as wholly owned by the donor or the donor’s spouse under subpart E of part I of subchapter J of chapter 1 is considered to be a transfer by gift of the entire interest in the property under section 2511(c).”\(^9\) (Emphasis added.)

III. COMMENTS ON EFFECT OF 2511(c) ON CHARITABLE REMAINDER TRUSTS

We are writing because of concerns about the possible application of Section 2511(c) to charitable remainder trusts qualifying under Section 664 and the Treasury regulations thereunder (“CRTs”). As further explained below, CRTs do not provide taxpayers with opportunities to shift income in the manner that Section 2511(c) was intended to preclude. Accordingly, we request that the IRS clarify as soon as possible that Section 2511(c) does not apply to CRTs, or alternatively, that Section 2511(c) does not apply to deem the settlor to have made a completed taxable gift of the value of any interests retained by the settlor.

The Code has provided for CRTs to encourage taxpayers to make charitable transfers since the Tax Reform Act of 1969. In fact, the IRS has fostered the creation of CRTs as permissible means of income, gift and estate tax planning with charitable gifts by issuing sample CRT forms for use by taxpayers. See Rev. Procs. 2005-53 through 2005-59; Rev. Procs. 2003-53 through 2003-60. Taxpayers regularly have relied on Section 664 and IRS guidance thereunder to implement legitimate charitable gifts by creating CRTs. Moreover, charities rely extensively on the creation of CRTs to obtain funds to support and effectuate their charitable functions.

A CRT is not a grantor trust. See Treas. Reg. § 1.664-1(a)(4). However, CRTs do not allow taxpayers to escape income taxation because the annuity or unitrust recipient remains subject to income tax on the distributions received from the CRT. See Code § 664; Treas. Reg. §§ 1.664-1 et seq. The recipient’s taxation of such distributions is based on the four-tier accounting characterization under Section 664(b), which generally deems the CRT income subject to the highest rate of federal income taxation to be distributed first to the recipient. Id. Thus, Section 664 already addresses the allocation of taxable income of a CRT and CRTs do not allow the potential to shift income among taxpayers in the abusive manner contemplated by Section 2511(c).

Because a CRT is not a grantor trust, the plain terms of Section 2511(c) suggest that it might apply to a CRT. As explained above, Section 2511(c) essentially provides that any transfer to a non-grantor trust is a completed transfer of all interests in the property by gift for federal gift tax purposes. The Notice expressly specifies that each transfer in 2010 to a non-grantor trust is a transfer by gift of the entire interest in the property under Section 2511(c). In addition, the examples in the Report quoted above indicate that any gifts to non-grantor trusts will be treated as complete and that an individual may be treated as making a completed taxable gift of the value of an interest that he or she retains. Thus, although CRTs are not vehicles for the abusive shifts of income that Section 2511(c) was intended to forestall, many have considerable concern that Section 2511(c) may extinguish CRTs as a viable alternative for

\(^9\) Id.
charitable giving. As a result, creation of CRTs has been delayed or eliminated due to this confusion.

Consider a typical one-life CRT in which the unitrust or annuity amount is paid to the settlor for life and, at death, the CRT terminates and distributes to a qualified charity. The value of the remainder interest transferred to charity qualifies for the gift tax charitable deduction under Section 2522. Prior to 2010, in the absence of Section 2511(c), the settlor’s retained annuity or unitrust interest was not subject to gift tax because the settlor had not transferred that interest, and no gift was deemed to occur. However, with the advent of Section 2511(c), one could argue that the entire value of the property transferred to the CRT constitutes a “transfer of property,” including the value of the interest that the settlor actually retained. Given that there is no offsetting gift tax deduction for a deemed “gift” to oneself (as none was required prior to the adoption of Section 2511(c)), the settlor arguably made a taxable gift of the value of the settlor’s retained annuity or unitrust interest.

Similarly, Section 2511(c) is problematic if it applies to a two-life CRT. Consider a CRT in which the annuity or unitrust is paid to the settlor for life, then to the settlor’s child for life, and upon the death of the survivor, the CRT terminates and distributes to a qualified charity. Typically, the settlor would retain a testamentary right to revoke the child’s successive annuity or unitrust interest to prevent a current gift for gift tax purposes, as expressly permitted by the applicable regulations. Treas. Regs. §§1.664-2(a)(4), 1.664-3(a)(4). Section 2511(c) would appear to preclude the effective use of this revocation power to prevent a current gift as described in the CRT regulations.

These unexpected gift tax consequences of the potential application of Section 2511(c) to CRTs do not promote the purpose of Section 2511(c) to prevent abusive shifts of income among taxpayers, because annuity or unitrust recipients are taxed on CRT distributions as described above. Instead, the application of Section 2511(c) to CRTs will reduce or eliminate the viability of CRTs in 2010 as a method of making charitable gifts. This result is contrary to the existing authority under the Code and related Treasury regulations permitting the use of CRTs, and the public policy reflected in those rules to encourage taxpayers to support charities in the execution of their exempt, charitable functions by the creation of CRTs. Congress could not have intended to deter taxpayers’ charitable giving and legitimate tax planning or to impede the ability of charities to raise funds necessary to fulfill their charitable missions.

IV. CONCLUSION

For the reasons described above, we urge the IRS to exercise the regulatory authority granted it in Section 2511(c) as soon as possible to clarify that Section 2511(c) does not apply to CRTs, or alternatively, that Section 2511(c) does not apply to deem the settlor to create a completed taxable gift of the value of any interests retained by the settlor.