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# *Estate & Succession Planning Corner*

## *Important Rulings on the Interface Between Marital and Charitable Planning*

By Lawrence I. Richman*

Portability has created an estate planning world in which there has been relatively little downside to single fund marital QTIP planning. When planners seek to integrate marital deduction planning with charitable planning there generally are two choices: (1) a marital deduction under Code Sec. 2056 coupled with a separate charitable deduction under Code Sec. 2055 or (2) a charitable remainder annuity or unitrust (a "CRT") for the benefit of the spouse with the remainder passing to charity upon the spouse's death.

Notwithstanding the exhaustive estate, income and excise tax regulations that apply to CRTs, planners often prefer the flexibility of a separate marital deduction trust coupled with a segregated, separated charitable deduction plan at the second spouse's death primarily on account of the significant planning flexibility available to respond to changes in circumstances and the needs of the surviving spouse under a plan that views the marital and charitable plan as distinct. While the estate and income tax rules governing such planning are relatively available, the fact is that when the charitable beneficiary is a private foundation there historically has been little guidance with respect to the interface between the marital and charitable deductions, particularly with respect to the application of the excise tax rules to marital trusts that ultimately pass to charity.

For planners, the issue is whether for excise tax purposes the marital and charitable planning trigger the split-interest trust rules. Were the marital and charitable trusts created under the trust agreement considered on a holistic basis, planners would need to deal with the application of the excise tax rules, most prominently the self-dealing rules, both during the administration of the marital trust while the surviving spouse is alive and upon the surviving spouse's death when the trust estate passes to a charity. Specifically, when the charitable transferee is a private foundation, the issue for planners is whether the excise tax on self-dealing could apply to transactions involving the marital trust during the lifetime and at the death of the surviving spouse prior to the ultimate distribution of property to the private foundation. The self-dealing rules are of particular concern because self-dealing penalties apply to BOTH direct and indirect acts of self-dealing and the definition of exactly what constitutes indirect self-dealing has been particularly unclear.

  

Two recent private letter rulings provide important guidance.

In LTR 201831009 dated May 2, 2018 and released August 3, 2018, the IRS was asked to consider these issues in the context of an executor who made a QTIP election for all the assets of a revocable trust upon the death of the grantor/settlor. The surviving spouse was entitled to all the net income of the trust along with such amounts of principal as the trustee determined necessary for her health, maintenance and support. Under the terms of the trust agreement, upon the death of the surviving spouse the then remaining trust estate will pass outright to a private foundation. The ruling posits that the QTIP qualifies for a marital deduction under Code Sec. 2056 and that upon the death of the surviving spouse the remaining trust property (all of which will be includable in the survivor's estate) will qualify for a charitable deduction under Code Sec. 2055.

Accordingly, the executor requested the following rulings:

1. That during the surviving spouse's lifetime the trust will not be treated as a split-interest trust under Code Sec. 4947(a)(2) such that the prohibited transaction rules' excess business holdings penalties, minimum charitable distribution requirements or jeopardy investment rules would not apply to the trust.
2. That during the lifetime of the surviving spouse the direct and indirect self-dealing rules of Code Sec. 4941 do not apply to the trust.
3. That after the death of the surviving spouse and prior to the distribution of the remaining trust estate to the private foundation that the trust will neither be treated as a non-exempt charitable trust under Code Sec. 4947 nor will it be subject to the self-dealing, excess business holding or jeopardy investment excise tax provisions of the Code.

In ruling that the private foundation rules and, in particular the self-dealing rules, do not apply to the marital trust the IRS's determination turned on its analysis that no charitable deduction was allowed for federal tax purposes upon the death of the first spouse (the settlor/grantor). Thus, the IRS held that Code Sec. 4947 did not apply to the trust agreement at the first spouse's death and, accordingly, the excise tax rules do not apply to the marital trust. Significantly, however, the IRS noted that this determination did not mean that direct transactions between the marital trust and the private foundation would not be subject to the private foundation rules. Thus, the IRS indicated that the Code Sec. 4941 prohibition on direct acts of self-dealing DO apply to the marital trust (assuming it is a disqualified person with respect to the foundation), BUT that the indirect self-dealing rules would not apply. In other words, if, for example, the marital trust were to sell an asset to a child of the grantor/settlor (who, for purposes of this example, would be considered a disqualified person with respect to the private foundation), the fact that the marital trust will ultimately pass to the family's private foundation and that the proceeds of such a sale may be part of the property passing to the private foundation, would NOT cause that intra-family sale to be considered an indirect act of self-dealing.

With respect to the issue of how the marital trust is treated upon the death of the surviving spouse when the entire trust estate passes to the foundation, the IRS ruled that the rules under Reg. §53.4947-1(b)(2)(v) allowing a reasonable period of administration/settlement would apply as long as the trust followed the estate administration exception rules under Reg. §53.4941(d)-1(b)(3). That regulation generally provides that the indirect self-dealing rules do not apply to a private foundation's expectancy when the executor/trustee has a power of sale, the transaction is approved by a court having jurisdiction over the trust, the trust receives not less than fair market value in a transaction that occurs prior to the termination of the trust during the settlement period and the trust receives assets no less liquid than those sold. The IRS noted that its position is intended to provide "for a reasonable period of settlement, so that the Trustees of Trust may perform the ordinary duties of administration necessary for the settlement of Trust."[1]

In LTR 201849009[2] dated August 24, 2018 and released December 7, 2018, the underlying facts were similar to those in LTR 201831009 in that a marital QTIP under Code Sec. 2056(b)(7) was created for the benefit of the surviving spouse upon the death of the Settlor/Grantor with the remaining trust estate upon the surviving spouse's death to pass to a private foundation. However, in LTR 201849009, certain property owned by the marital trust was subject to options held by family-controlled related party entities with some of those options exercisable during the surviving spouse's lifetime and others exercisable at her death.

In LTR 201849009, the private foundation asked that the IRS rule as follows on certain matters relating to the excise taxes that apply to private foundations:

1. That after the death of the surviving spouse, the estate administration exception to indirect self-dealing would apply during a reasonable period of settlement of the marital trust (the "Settlement Period"); and
2. That the five-year period for the disposition of any excess business holdings received by the foundation

will commence upon the actual receipt by the private foundation of such business interests after the conclusion of the Settlement Period.

Consistent with its reasoning in LTR 201831009, the IRS in the instant LTR also concluded that the estate administration exception should apply reasoning that "Although Trust is already irrevocable [upon the Grantor's/Settlor's death], upon Spouse's death Trust will be similarly situated to an estate or revocable trust that has become irrevocable on a grantor's death. It is reasonable to construe the reference in the exception of an estate or irrevocable trust to include other trusts the assets of which are includable in the beneficiary's gross estate for tax purposes (as Foundation represents is the situation here)."[3] Thus, since the Settlement Period rules apply to the Trust, the five-year period to dispose of excess business holdings will commence upon the actual distribution of such holdings to the private foundation.

Both these LTRs are important for planners in that they provide a roadmap on how to proceed with marital/charitable planning. The practical, reasonable approach taken by the IRS in these LTRs is to be applauded.

## ENDNOTES

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[1] LTR 201831009.

[2] LTR 201849009.

[3] LTR 201849009.



  