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Counsel

Buchanan Ingersoll & Rooney PC *PricewaterhouseCoopers*
Gerald H. Sherman William Archer
Stuart M. Lewis Donald Carlson
Deborah M. Beers

Keith A. Mong *Ricchetti, Inc.*
Steve Ricchetti
Jeff Ricchetti

Federal Policy Group *Arnold & Porter LLP*
Ken Kies Martha L. Cochran
Matthew Dolan David F. Freeman, Jr.

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Anthony Raglani, *Asst. Dir. of Policy & Public Affairs*

101 Constitution Avenue NW, Suite 703 East
Washington, DC 20001
Toll Free: 1-888-275-0092 Fax: 202-742-4479
www.aalu.org

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Subject: **General Estate and Gift Tax Developments: July 2010**

1. **Display of Art Work is Not Act of Self-Dealing**

Major References: [PLR 201029039](#)

2. **Court-Ordered Reformation of CRUT Is Not Act of Self-Dealing**

Major References: [PLR 201026005](#)

Prior AALU Washington Reports: 10-91; 09-111; 06-91; 05-09; 03-20

MDRT Information Retrieval Index Nos.: 2500.00; 7400.021; 7400.022; 7400.024

This Washington Report summarizes a few of the more important cases and rulings in the estate and gift tax areas which were decided or reported by the courts and the Internal Revenue Service in July of 2010, and on which we have not previously reported in Bulletins on insurance-related estate and gift tax matters.

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THE CONCLUSION OF THIS WASHINGTON REPORT.**

Private Letter Rulings

1. **PLR 201029039**

In PLR 201029039, the IRS ruled that the display of a small portion of a private foundation owned art collection at a shopping center, which was a disqualified person with respect to the foundation, did not constitute an act of self-dealing under section 4941 of the Internal Revenue Code. According to the Service, any benefit conferred on the disqualified person was incidental to the charitable purpose of displaying the art collection to the general public.

“Founder” established a private charitable foundation (“Foundation”) for the purpose of promoting public awareness and appreciation of leading twentieth century artists and their artwork. Founder was a “substantial contributor” to Foundation (and thus a disqualified person with respect to Foundation). Founder’s daughter and her husband served as directors of Foundation after his death. As foundation managers and family members of a substantial contributor to Foundation, daughter and her husband were also disqualified persons with respect to Foundation. Pursuant to the Founder’s Will, most of his modern art collection was bequeathed to the Foundation.

During his lifetime, Founder also contributed funds to establish an art museum (the “Art Center”), which was classified as a public charity - *i.e.*, not a private foundation. He also loaned pieces from his substantial personal art collection to the Art Center for display from time to time. However, due to the size of Founder’s collection, only about one-third of it could be exhibited at the Art Center at any given time. Additional pieces were displayed during Founder’s lifetime at a nearby airport terminal, and at a major retail shopping mall in which Founder had an ownership interest. After Founder’s death, Foundation continued to provide substantial financial support to the Art Center.

After Founder’s death, Foundation wanted to continue his practice of displaying five to ten pieces from the collection at the shopping mall, in which Founder’s daughter and her husband owned more than a 35% interest (thus making the shopping mall a disqualified person with respect to Foundation). The Foundation represented that the proposed displays would acknowledge that the Foundation owned the pieces, and encourage visitation to the Art Center to view additional works in the collection. The Foundation further represented that the shopping center would not attempt to capitalize commercially upon the display of the art, either through advertising or otherwise.

Under section 4941, a tax is imposed on each act of self-dealing between a disqualified person and a private foundation. Acts of self-dealing for this purpose include both the furnishing of goods and services by a private foundation to disqualified persons, and the use of the assets of a private foundation by and for the benefit of disqualified persons. The issue in the ruling was whether the display of the Foundation’s artworks in the shopping mall was an act of self-dealing. The Revenue Service determined that it was not.

The Service has issued a published revenue ruling (Rev. Rul. 74-600, 1974-2 CB 385) indicating that the placing of paintings owned by a private foundation in the residence of a substantial contributor (disqualified person) constitutes a prohibited act of self-dealing. In that ruling, the paintings, which had been on exhibit in various museums for a number of years, were displayed in the home of the substantial contributor together with his large private art collection in a part of the residence devoted to paintings and other works of art. On organized semi-annual tours of the residence, an estimated 2,000 visitors were admitted to view the private collection and the Foundation’s paintings. In addition, special tours were arranged on occasion for small groups of persons associated with the arts. The Service found self-dealing because

"[a]lthough the Foundation's paintings are sometimes made available for public viewing, this placement in the residence of the disqualified person results in a direct use of the Foundation's assets by or for the benefit of the disqualified person."

Revenue Ruling 74-600 was distinguished in PLR 201029039 on the basis of an exception to the self-dealing rules that arises when the use of the assets of a private foundation provides only an “incidental or tenuous” benefit to the disqualified person. The IRS found that the primary purpose of displaying the art in the shopping center was to promote public awareness and appreciation of the leading twentieth century artists and their creations and that the primary beneficiary of the artwork was the general public who would view it and not the shopping center or other disqualified persons. Accordingly, the IRS ruled that any benefits to the disqualified persons were incidental or tenuous. *See also* PLR 9221002, in which the Revenue Service reached a similar conclusion concerning the display of a private foundation’s works of art in commercial properties owned by disqualified persons.

2. PLR 201026005

In PLR 201026005, the Service determined that a reformed Charitable Remainder Unitrust (“CRUT”) was still a valid CRUT under section 664 of the Code, despite a scrivener’s error. The Service further ruled that the unitrust beneficiary’s repayment of income to the CRUT after its reformation did not trigger the self-dealing rules of section 4941.

In this ruling, on Date 1, “Attorney” drafted a CRUT for “Client” but, due to his error, the CRUT was drafted with a higher percentage payout than Client intended. To address the error, Client petitioned the local court with the consent of all of the parties, and with notice to the charitable remaindermen and the Attorney General of “State,” to reform the trust to correct the error. On Date 2, a State court entered an order correcting the scrivener's error and amending retroactively the unitrust amount, conditioned upon a ruling by the Service that Trust will be treated as a valid CRUT since the date of its inception (Date 1).

Client represented that he had returned the excess amounts and all accrued interest to the CRUT consistent with the treatment of the CRUT as a qualified charitable remainder trust with a stated a percent unitrust amount since Date 1. Client also represented that he had not, and will not, claim any additional charitable deduction as a result of the retroactive amendment of the CRUT. [We note that, had the CRUT been established initially with a lower unitrust percentage payout, the Client’s charitable deduction for the value of the remainder interest payable to charity undoubtedly would have been higher.]

On these facts, the IRS determined that the CRUT was a valid section 664 charitable remainder unitrust since its inception.

However, because the Client intended to return the excess unitrust amounts received by him prior to the reformation (and all accrued interest) to the CRUT, Client requested that the IRS rule that such repayment [and, presumably, the earlier receipt of the excess unitrust payments] was not “self-dealing” under section 4941. A charitable remainder trust is treated as a private foundation for certain purposes, including section 4941’s self-dealing provisions. Under that section, as noted above, self-dealing includes any direct or indirect transfer to, or the use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

On this issue, the Service ruled no self-dealing was involved because, although a split-interest trust, including a CRUT, is treated as a private foundation for purposes of the self-dealing rules, those rules, by statute, do not apply to the amounts payable under the terms of the split-interest trust to its income (or unitrust) beneficiaries, so long as no charitable deduction is allowed for such income interest.. In the case of a charitable remainder trust, the only charitable deduction that is allowable is for the value of the remainder interest. Accordingly, the Service ruled that the repayment will not constitute self-dealing.

We note that the Revenue Service has been reasonably generous in allowing the reformation of charitable remainder trusts containing “scriveners’ errors” in recent years. *See, e.g.*, PLRs 200932020, 200616035, 200441019 and 200251010, discussed in our Bulletins Nos. 09-111, 06-91, 05-09, and 03-20. This treatment may be compared to the Service’s recent refusal to respect the retroactive reformation of a testamentary trust named as the beneficiary of a decedent’s IRA in order to make it into a “see-through” trust for purposes of the section 401 designated beneficiary regulations. (*See* PLR 201021038, discussed in our Bulletin No. 10-91.)

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