

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B09 / PLR-112976-00

Date:

March 7, 2002

Legend

Taxpayer =

Company =

Current Trust =

Proposed Trust =

State =

Foundation =

Dear

This letter responds to your letter, dated January 3, 2002, and prior correspondence, submitted on behalf of Taxpayer, requesting rulings under §§ 2036 and 4947 of the Internal Revenue Code. You have withdrawn your ruling requests under § 2036. A response under § 4947 is included in this letter.

The facts submitted and representations made are summarized as follows: Taxpayer currently owns 100% of the voting common stock of Company through Current Trust. Current Trust is a revocable trust and Taxpayer is the settlor and sole beneficiary. The only outstanding Company stock is the voting common stock owned by Taxpayer through Current Trust. Company runs a family office that provides investment advice, and management, financial planning, estate planning, tax planning, and philanthropic and other family services to Taxpayer and members of Taxpayer's extended family. Taxpayer is currently the President and Chief Executive Officer of Company.

Taxpayer wishes to transition the ownership and operation of Company to others. Taxpayer also wishes for Company to be held and operated for the benefit of the members of Taxpayer's extended family. Taxpayer contemplates that Company will provide services to non-family member clients in the future.

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Taxpayer proposes to sell the voting common stock of Company to a generation-skipping trust ("Proposed Trust"). You have requested that we rule that Proposed Trust will not be subject to the private foundation excise tax rules pursuant to § 4947.

Article 2, section 2.1 of Proposed Trust provides that the trustees: (i) shall hold, manage, invest, and reinvest the trust property; (ii) shall collect the income earned on the trust property; and (iii) may distribute the net income and principal, as set forth below. Notwithstanding the broad powers granted to the trustees, it is the grantor's intention in setting up Proposed Trust that it be used primarily as the vehicle to own stock of Company, a State corporation, or any successor organization and to act in the manner required under State law for a shareholder of Company.

Article 2, section 2.2 of Proposed Trust provides that subject to Taxpayer's general statement of intent set forth in Article 2, and provided that Proposed Trust is not then indebted to Taxpayer, the trustees may pay to Foundation so much of the net income and principal of Proposed Trust property, if any, in any amounts as the trustees in their sole discretion determine. If Foundation is not in existence, or the trustees in their sole discretion, by unanimous consent, determine that Foundation is not suitable, then the trustees may pay such net income or principal to any one or more charities qualified under §§ 501(c)(3), 170(c)(2), 2055 or 2522(a) ("Qualified Charities") or any successor provision of the Code. Notwithstanding any provision of this Proposed Trust Agreement to the contrary, the trustees, in their sole and absolute discretion, may distribute income and/or principal of Proposed Trust to Taxpayer's spouse and/or any lineal descendants of Taxpayer or Taxpayer's spouse in the event any such persons are experiencing severe financial hardship. The trustees shall accumulate and add to the principal of Proposed Trust, each year, all net income not so distributed.

Article 2, section 2.3 provides that the "Termination Date" of Proposed Trust shall be whichever of the following events occurs first: (i) the termination date determined by the unanimous vote of the trustees, or (ii) the day before the term of Proposed Trust must cease under applicable law. On the Termination Date, the trustees shall distribute the remaining principal of Proposed Trust to Foundation if it is in existence at the Termination Date. If Foundation is not in existence at the Termination Date, or the trustees in their sole discretion and judgment, by unanimous consent, determine that Foundation is not suitable as a recipient of the distribution, then the trustees shall distribute the principal of Proposed Trust to one or more Qualified Charities.

1. Section 4947(a)(1)

In order for Proposed Trust to be subject to all or some of the private foundation provisions it must be described in § 4947(a)(1) or § 4947(a)(2).

Section 4947(a)(1) provides, in substance, that for purposes of the private foundation provisions, a trust that is not exempt from taxation under § 501(a), all of the

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unexpired interests in which are devoted to one or more exempt purposes described in § 170(c)(2)(B), and for which a deduction was allowed under § 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, (a non-exempt charitable trust) shall be treated as an organization described in § 501(c)(3) and shall be subject to the private foundation rules.

The purpose of § 4947(a)(1) is to subject completely charitable trusts that have not obtained tax exemption under § 501(c)(3) to the private foundation rules. The key language is that “all the unexpired interests in which are devoted” to exempt charitable organizations.

The Regulations under § 4947 do not define the term “unexpired interests” in a trust. Scott on Trusts, Section 85, addresses contingent interests in trusts as follows:

The fact that an interest is contingent on the happening of some future event does not prevent its being the subject of a trust. If the interest is transferable, the owner of the interest can transfer it to another as trustee, or he can declare himself trustee of it. Such an interest is more than a mere expectancy, which is not a property interest and which cannot be the subject of a trust.

Article 2, section 2.2 of Proposed Trust grants the trustees sole and absolute discretion to pay income or principal to Taxpayer’s spouse, Taxpayer’s lineal descendants, or Taxpayer’s spouse’s lineal descendants in the event any such persons are experiencing severe financial hardship. Thus, Proposed Trust contains a contingent interest that, for purposes of § 4947(a)(1) is an unexpired interest in the trust that is devoted to a non-charitable purpose. Therefore, based on the facts submitted and the representations made, we conclude that Proposed Trust is not a trust described in § 4947(a)(1).

2. Section 4947(a)(2)

Section 4947(a)(2) provides, in substance, that a trust which is not exempt from tax under § 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in § 170(c)(2)(B) (split-interest trusts), and that has amounts in trust for which a deduction was allowed under § 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, shall be subject to some of the private foundation rules, including §§ 4941 and 4945.

Proposed Trust is a split-interest trust because it provides for distributions to charitable and non-charitable beneficiaries. Under the facts of this request, the determination of whether Proposed Trust is a trust described in § 4947(a)(2) depends on whether Proposed Trust meets the requirements of § 170(f)(2), a charitable remainder annuity trust under § 664(d)(1), a charitable remainder unitrust under § 664(d)(2), or a charitable lead trust under § 2522.

a. Section 664

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Section 664(d)(1) provides that a charitable remainder annuity trust is a trust:

(A) from which a sum certain (which is not less than 5 percent nor more than 50 percent of the initial net fair market value of all property placed in trust) is to be paid, not less often than annually, 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 such individual or individuals,

(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in § 170(c),

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g)), and

(D) the value (determined under § 7520) of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in trust.

Section 664(d)(2) provides that a charitable remainder unitrust is a trust:

(A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 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,

(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in § 170(c),

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g)), and

(D) with respect to each contribution of property to the trust, the value (determined under § 7520) of such remainder interest in such property is at least 10

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percent of the net fair market value of such property as of the date such property is contributed to the trust.

Article 2, section 2.2 allows for payments to non-charitable beneficiaries. Proposed Trust, however, does not qualify as a charitable remainder annuity trust under § 664(d)(1) because the discretionary payments allowed under section 2.2 are not for a sum certain to be paid at least annually. In addition, Proposed Trust does not meet the requirements of a charitable remainder unitrust under § 664(d)(2)(A) because the payments are not expressed in terms of a fixed percentage of the trust assets to be paid at least annually. Payments to the non-charitable beneficiaries may or may not be made in any given year. In addition, the amount of the payments, when made, will be discretionary. Therefore, based on the facts submitted and the representations made, Proposed Trust does not qualify as a charitable remainder annuity trust or a charitable remainder unitrust under § 664.

b. Section 2522

Section 2501 imposes a tax on the transfer of property by gift by an individual.

Section 2511 provides that the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2522(a) provides that in computing taxable gifts for the calendar year, there shall be allowed as a deduction the amount of all gifts made during such year to or for the use of a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 2522(c)(2), in pertinent part, disallows the gift tax charitable deduction where a donor transfers an interest in property (other than an interest described in 170(f)(3)(B)) to a person, or for a use, described in 2522(a), and an interest in the same property is retained by the donor, or is transferred or has been transferred (for less than an adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in 2522(a), unless --

(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in 664) or a pooled income fund (described in 642(c)(5)), or

(B) in the case of any other interest, such interest is in the form of a guaranteed annuity or is a fixed percentage distributed yearly of the fair market value of the property (to be determined yearly).

Under § 25.2522(c)-3(c)(2)(vi)(a), a guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually for a

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specified term of years, or the life or lives of certain individuals. An amount is determinable if the exact amount which must be paid under the conditions specified in the instrument of transfer can be ascertained as of the date of the gift.

Proposed Trust does not qualify as a charitable remainder annuity trust (described in § 664(d)(1)) or a charitable remainder unitrust (described in § 664(d)(2)). Proposed Trust, accordingly, does not meet the requirements for a deduction under § 2522(c)(2)(A). In addition, the payments authorized under Article 2, section 2.2 are not expressed in terms of a determinable amount. There is no requirement that the payments must even be made, let alone be made annually. Furthermore, the payments are not restricted to a specified term of years or for the life or lives of certain individuals. The charitable payments, therefore, do not meet the requirements of a guaranteed annuity under § 25.2522(c)-3(c)(2)(vi)(a). Finally, the payments are not expressed in terms of a fixed percentage of the fair market value of the Proposed Trust property to be determined and distributed yearly. Therefore, the provisions in Proposed Trust do not meet the requirements for a deduction under § 2522(c)(2)(B).

c. Section 170

Section 170(f)(2)(A) provides that in the case of property transferred in trust, no deduction shall be allowed under this section for the value of a contribution of a remainder interest unless the trust is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664), or a pooled income fund (described in § 642(c)(5)).

Section 170(f)(2)(B) provides in pertinent part that no deduction shall be allowed under this section for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of such interest for purposes of applying § 671.

Section 1.170A-6(c)(2)(i) provides, in pertinent part, that an income interest is a “guaranteed annuity interest” only if it is an irrevocable right pursuant to the governing instrument of the trust to receive a guaranteed annuity. 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 the life or lives of certain individuals, each of whom must be living at the date of transfer and can be ascertained at such date.

Proposed Trust does not meet the requirements of a charitable remainder annuity trust (described in § 664(d)(1)) or a charitable remainder unitrust (described in § 664(d)(2)). Accordingly, no charitable deduction will not be allowed under § 170(f)(2)(A). In addition, as previously discussed, the payments are not expressed in terms of a guaranteed annuity payment nor are they expressed in terms of a fixed percentage of the fair market value of the Proposed Trust property to be determined

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and distributed yearly. Therefore, the provisions in Proposed Trust do not meet the requirements for a deduction under § 170.

Section 4947(a)(2) Conclusion

Proposed Trust does not meet the requirements of § 170(f)(2), a charitable remainder annuity trust (described in § 664(d)(1)), a charitable remainder unitrust (described in § 664(d)(2)), or a charitable lead trust for purposes of § 2522(c)(2)(B). Thus, Proposed Trust does not qualify under § 170(f), § 642(c)(5), § 664, § 2055 or § 2522 as a split-interest trust for which a charitable deduction will be allowed. Therefore, based on the facts submitted and the representations made, we conclude that Proposed Trust is not a trust described in § 4947(a)(2).

Based on the facts submitted and the representations made, Proposed Trust is not a trust described in §§ 4947(a)(1) or 4947(a)(2). Accordingly, Proposed Trust will not be subject to the private foundation excise tax rules pursuant to the application of the provisions found under § 4947.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning the applicability of § 2036(b) or whether full and adequate consideration is to be paid for the acquisition of the stock.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings it is subject to verification on examination.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent to Trustee.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
Melissa Liquerman
Chief, Branch 9
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy of this letter for § 6110 purposes