

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:2 – PLR-118148-04

Date:

September 30, 2005

Legend

W =

X =

Y =

Z =

Trust =

State =

Court =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

\$a =

\$b =

\$c =

Warrants =

Investment Firm =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Dear

This is in response to your letter, dated March 3, 2004, and subsequent correspondence, submitted on behalf of X and Trust, requesting a ruling that for federal tax purposes, the transfer of \$a (the "Transferred Funds") to Trust, a charitable remainder unitrust, will be deemed to have never constituted part of the corpus of Trust at any time. In addition, you have requested rulings that a return of the Transferred Funds to X, reduced by the amount of unitrust distributions received by X and Y that were attributable to the Transferred Funds and increased by earnings attributable to the Transferred Funds, will not adversely affect Trust's qualification as a charitable remainder unitrust under § 664(d)(2) of the Internal Revenue Code and will not constitute an act of self-dealing by X under § 4941(d)(1)(E) or a payment to a disqualified person under § 4946.

The information submitted states that X, as settlor, and Z, as trustee, established Trust under the laws of State on Date 1. Trust was intended to qualify as a charitable remainder unitrust under § 664(d)(2). X and Y, X's spouse, are the income beneficiaries of Trust.

In Year 1, Z, acting as X's personal financial advisor, advised X to make a personal investment in Warrants. In Date 2, X invested \$b of X's personal funds in Warrants. However, X became dissatisfied with the performance of her personal

investment in Warrants. On Date 3, X signed a redemption notice prepared by Z directing that her personal investment in Warrants be liquidated and the proceeds wired to an account at Investment Firm. X understood that the proceeds were to be wired to her personal money market account pending further decisions on investment of the funds. When reading the description of the account in the redemption notice, X believed that the account described was her personal money market account. However, the account described in the redemption notice was in fact, an account belonging to Trust. Therefore, on Date 4, the Transferred Funds, the liquidated amount of X's personal investment in Warrants, were wired to an account owned by Trust. Upon the transfer, the Transferred Funds were placed in a separate fund within Trust's account. At all times since the transfer, the Transferred Funds were invested solely in short-term interest bearing instruments.

In Year 3, X contacted her personal attorney, W, asking him to review Z's administration of Trust. On Date 5, W sent X a letter mentioning the deposit of the Transferred Funds into Trust's account. X notified W that she had never intended to donate the Transferred Funds to Trust and asked W to determine what remedial action could be taken to retrieve the Transferred Funds. No charitable deduction was taken by X relating to the Transferred Funds. However, the value of the Transferred Funds was used when calculating unitrust distributions to X and Y for Year 2, Year 3, and Year 4.

On Date 6, the Court entered a judgment directing that the trustee of Trust restore to X the amount of \$c, from the principal of Trust, on the grounds that no valid donation was made of the Transferred Funds by X to Trust. The amount of \$c equals the amount of the Transferred Funds reduced by the amount of unitrust distributions received by X and Y that were attributable to the Transferred Funds as of Date 6 and increased by the earnings attributable to the Transferred Funds as of Date 6. The judgment also stated that \$c, the authorized amount of trust principal to be restored to X, shall be reduced to the extent that any future distributions to X and Y are attributable to the Transferred Funds. This judgment is conditioned on X receiving a favorable private letter ruling from the Internal Revenue Service that the principal distribution of \$c may be made without adversely affecting the status of Trust as a charitable remainder unitrust under § 664(d)(2).

Upon the receipt of a favorable letter ruling, X, Y and Trust will amend their tax returns for the Year 2, Year 3, and Year 4 taxable years. X, Y, and Trust will amend their tax returns as if X had always held the Transferred Funds in her own personal money market account. X will be treated as having made the same investments as Trust. The amended returns will be adjusted to take into account the amount of income X and Y have already reported due to the unitrust distributions they received that were attributable to the Transferred Funds. X and Y will report any interest generated by the Transferred Funds as a result of the Transferred Funds being invested in short-term interest bearing instruments.

Section 664(d)(2) sets forth the requirements for a trust to qualify as a charitable remainder unitrust. Section 664(d)(2)(A) provides that a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of the assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of whom 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. No amount other than the above-described payments may be paid to or for the use of any person other than an organization described in § 170(c). Following the termination of the payments described above, the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c). Section 664(d)(2)(D) provides that the value (determined under § 7520) of such remainder interest must be at least ten percent of the initial net fair market value of all property placed in the trust.

Section 4941 imposes an excise tax on any act of self-dealing between a private foundation and any of its disqualified persons as defined in § 4946.

Section 4941(d)(1)(E) provides that an act of self-dealing includes any transfer to, or use by or for the benefit of, a disqualified person, of any of the income or assets of a private foundation.

Section 4946 defines a disqualified person as a substantial contributor, or that person's spouse, to a private foundation.

Section 4947(a)(2) describes split-interest trusts as those that are not exempt from federal income tax under § 501(a), not all of the unexpired interests in which are devoted to purposes in § 107(c)(2)(B), and which have amounts in trust for which a deduction was allowed under § 170, § 545(B)(2), § 642(c), § 2055, § 2106(a)(2), or § 2522.

Section 53.4947-1(c)(1)(ii) provides that a split-interest trust is subject to the provisions of § 507 (except as provided in § 53.4947-1(e)), § 508(e) (to the extent applicable to a split-interest trust), § 4941, § 4943 (except as provided in § 4947(b)(3)), § 4944 (except as provided in § 4947(b)(3)), and § 4945 in the same manner as if such trust were a private foundation.

Section 53.4947-1(c)(2)(i) provides, in general, that under § 4947(a)(2)(A), § 4941 does not apply to any amounts payable under the terms of a split interest trust to income beneficiaries unless a deduction was allowed under § 170(f)(2)(B), § 2055(e)(2)(B) or § 2522(e)(2)(B) with respect to the income interest of any such beneficiary.

As a charitable remainder unitrust under § 664(d)(2), Trust is a split-interest trust described in § 4947(a)(2). Therefore, Trust is treated as a private foundation and, except as provided in § 53.4947-1(c)(2)(i), is subject to § 4941, which imposes an excise tax on acts of self-dealing. X and Y are disqualified persons with respect to Trust because X is a substantial contributor to Trust and Y is X's spouse.

Based solely on the facts and the representations submitted, and the Court order, the Transferred Funds will be deemed to have never constituted part of the corpus of Trust at any time for federal tax purposes. In addition, we conclude that the restoration to X of \$c from Trust, as directed by the Court order, will not disqualify Trust as a CRUT under § 664(d)(2), and will not constitute an act of self-dealing under § 4941(d)(1)(E) with respect to X, or a payment to a disqualified person under § 4946. These rulings are conditioned on (1) X, Y, and Trust amending their tax returns for the Year 2, Year 3, and Year 4 taxable years, (2) X and Y reporting any interest generated by the Transferred Funds as a result of the Transferred Funds being invested in short-term interest bearing instruments, (3) the trustee of Trust reducing the amount of \$c, the Trust principal to be restored to X, by any distributions to X and Y that are attributable to the Transferred Funds that occurred after Date 6, the date of the Court order, and that occur before the restoration to X, and (4) the trustee of Trust increasing the amount of \$c, the Trust principal to be restored to X, by any earnings attributable to the Transferred Funds that occurred after Date 6, the date of the Court order, and that occur before the restoration to X.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the operation of Trust under any other provision of the Code.

A copy of this letter should be attached to the first federal tax return that reflects this transaction. A copy is enclosed for that purpose.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X.

Sincerely yours,

J. Thomas Hines
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes