

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Person To Contact:

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PLR-133446-16

Date:

May 01, 2017

## LEGEND

Trust =

Grantor =

Date 1 =

Agreement =

Article =

Charity =

PLR-133446-16

X =State =Substitutor =

Dear :

This is in response to your letter dated October 19, 2016, and subsequent correspondence submitted on behalf of Trust, requesting rulings regarding the conversion of Trust from a nongrantor trust to a grantor trust.

### FACTS

The information submitted states that on Date 1, Grantor, as settlor and initial trustee, created Trust pursuant to Agreement. Agreement provides that until the X anniversary of the initial contribution date, an amount equal to the annuity amount will be distributed to Charity. Trust represents that it was previously allowed income tax deductions pursuant to § 642(c)(1) for the amounts of gross income included in the annuity amount each year.

Trust is seeking to amend Agreement to delete and replace Article pursuant to the laws of State. The amended Article permits the Substitutor to have the power, exercisable at any time in a nonfiduciary capacity (within the meaning of § 675(4)), without the approval or consent of any person in a fiduciary capacity, to acquire or reacquire Trust principal by substituting other property of an equivalent value, determined as of the date of such substitution. Substitutor is not a trustee of Trust. Substitutor and Grantor are siblings.

In connection with the aforementioned amendment, Grantor seeks the following rulings:

- (1) The conversion of Trust from a nongrantor trust to a grantor trust (assuming the Substitutor is found to hold the substitution power in a nonfiduciary capacity) is not a taxable transfer of property held by Trust to Grantor as settlor for income tax purposes;
- (2) The conversion of Trust from a nongrantor trust to a grantor trust is not an act of self-dealing that would result in a tax under § 4941; and
- (3) The conversion of Trust from a nongrantor trust to a grantor trust would result in an income tax charitable deduction for Grantor in the year of conversion under § 170.

## LAW AND ANALYSIS

Ruling Request 1

Section 671 of the Internal Revenue Code provides that where it is specified in subpart E that the grantor or another person shall be treated as the owner of any portion of a trust, there then shall be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 of the Code in computing taxable income or credits against the tax of an individual.

Section 675(4) provides, in part, that the grantor shall be treated as the owner of any portion of a trust over which the grantor has a power of administration exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of § 675(4), the term “power of administration” includes a power to reacquire the trust corpus by substituting other property of an equivalent value.

Rev. Rul. 77-402, 1977-2 C.B. 222, holds that when the grantor and owner of a trust which holds a partnership interest subject to liabilities renounces all grantor trust powers over that trust during life, the grantor is treated as having transferred the interest, and will recognize gain or loss. The ruling states that the result would also be the same if the trust were treated as a grantor trust by reason of powers exercisable by a party other than the grantor and ceased to be a grantor trust upon the release or renunciation of those powers by such other party or upon the expiration or lapse of such powers.

Rev. Rul. 85-13, 1985-1 C.B. 184, holds that a grantor who acquired the corpus of a trust in exchange for an unsecured promissory note was considered to have indirectly borrowed the trust corpus resulting in grantor trust treatment. As a result, the transfer of trust assets to the grantor was not a sale for federal income tax purposes and the grantor did not acquire a cost basis in the assets of the trust. The ruling concluded that the grantor became the owner of the trust corpus which he had indirectly borrowed and thus was taxable on the trust's income and, as the deemed owner of the trust assets, could not engage in a transaction with the trust that would be respected for income tax purposes. It did not conclude that the grantor realized the amount of the indirect borrowing or any portion of that amount as income.

Rev. Rul. 77-402 concludes that the lapse of grantor trust status during the grantor-owner's life may have income tax consequences, but does not impose such consequences on a non-grantor trust that becomes a grantor trust. Rev. Rul. 85-13 describes the income tax effects of a non-grantor trust becoming a grantor trust, which effects did not include the realization or recognition of any income by the grantor-owner by reason of the conversion. Given the lack of authority imposing such consequences,

we conclude that the conversion of Trust from a non-grantor trust to a grantor trust will not be a transfer of property to Grantor from Trust under any income tax provision.

### Ruling Request 2

Section 4947(a)(2), provides in relevant part, that in the case of 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), and which has amounts in trusts for which a deduction was allowed under § 170 (or other charitable deduction provisions), §4941 shall apply as if such trust were a private foundation.

Section 4941 imposes an excise tax, paid by the disqualified person, on each act of self-dealing between a private foundation and a disqualified person for each year in the taxable period, and requires correction of the act of self-dealing.

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

Section 4946(a) provides definitions and rules with respect to a disqualified person with respect to a private foundation. A disqualified person includes in part, a substantial contributor to the foundation, a foundation manager, or a family member.

Section 4946(d) defines that members of family for purposes of §4946(a)(1), includes only the individuals spouse, ancestors, children, grandchildren, great grandchildren, and the spouses of children, grandchildren, and great grandchildren.

Rev. Proc. 2007-45, 2007-2 C.B. 89, section 8.09(1) provides in part, that the exercising of a power to substitute trust assets as described in § 675(4) may result in an act of self-dealing under § 4941.

Currently Trust is a split interest trust described in § 4947(a)(2) and is subject to the self-dealing rules described in § 4941. In order for an act of self-dealing under § 4941 to occur, the act needs to occur between a disqualified person as described in § 4946 and a private foundation.

The Substitutor is not considered a disqualified person under § 4946(a) because Substitutor, as a sibling of Grantor, is not treated as a family member as described in § 4946(d). Therefore, the conversion of the trust will not be an act of self-dealing under § 4941, since there is no disqualified person involved.

Ruling Request 3

Section 170(a)(1) allows a federal income tax charitable deduction in the taxable year in which the payment is made.

Section 170(f)(2)(B) provides, in part, that no deduction is allowed under § 170 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.

Rev. Proc. 2007-45, 2007-2 C.B. 89, provides guidelines for creating charitable lead annuity trusts including sample trust agreements as well as explanations of the various provisions involving in these sample agreements. It also describes some tax consequences to different actions involving these trusts. Rev. Proc. 2007-45, section 8.01(2) provides that the donor to a grantor charitable lead annuity trust may claim a federal income tax charitable deduction under § 170(a) in the year that assets are irrevocably transferred to the trust.

Upon the conversion of Trust from a nongrantor trust to a grantor trust, the owner of the grantor trust can claim a federal income tax charitable deduction under § 170(a) only if property has been transferred to the grantor trust from the nongrantor trust. Because the conversion of Trust from a nongrantor trust to a grantor trust is not a transfer of property held by Trust for income tax purposes, Grantor is unable to take an income tax charitable deduction under § 170(a).

### CONCLUSIONS

Based on the information submitted and the representations made, we conclude that: (1) the conversion of Trust from a nongrantor trust to a grantor trust is not a transfer of property held by Trust to Grantor as settlor of Trust for income tax purposes; (2) the conversion of Trust from a nongrantor trust to a grantor trust is not an act of self-dealing that would result in a tax under § 4941 because the Substitutor is not considered a disqualified person under § 4946(a); and (3) the conversion of Trust from a nongrantor trust to a grantor trust would not result in an income tax charitable deduction to Grantor in the year of conversion under § 170 .

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, this ruling is limited solely to the conversion of the trust, and we are providing no opinion as to whether an act of self-dealing as described in § 4941 may occur upon the exercise of the power to substitute assets as described in § 675(4). See Section 8.09 of Rev. Proc. 2007-45. Furthermore, we express no opinion regarding the

federal gift tax consequences of the proposed transaction. Specifically, we are not ruling on whether the proposed conversion will have any gift tax consequences to Grantor.

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

The ruling contained in this letter is 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 ruling request, it is subject to verification on examination.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Trust's authorized representatives.

Sincerely,

Bradford R. Poston  
Senior Counsel, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

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