

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:02 PLR-104150-03

Date:

September 30, 2003

H =

W =

Trust =

Trustee =

State =

Court =

D1 =

D2 =

D3 =

Dear :

This letter responds to your letter dated January 16, 2003, and subsequent correspondence, submitted on behalf of Trustee, requesting rulings concerning the termination of Trust.

The information submitted states that H and W established Trust under the laws of State on D1. Trust was intended to qualify as a charitable remainder unitrust (CRUT) under § 664(d)(2) of the Internal Revenue Code. Under the Trust instrument, H and W receive annual unitrust distributions equal to seven percent of the net fair market value of Trust assets for their concurrent and consecutive lifetimes. Upon the death of H or W the entire unitrust amount is to be paid to the survivor. H and W have signed an affidavit under penalties of perjury that they are aware of no medical condition expected

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to result in a shorter-than-average longevity.

Trustee is the current trustee of Trust. Paragraph 12 of the Trust instrument provides that the trustee can add, remove, or change the percentage allocations of the charitable remainder beneficiaries. On D2, pursuant to paragraph 12 of the Trust instrument, Trustee designated Trustee as the sole charitable remainder beneficiary. Trustee is recognized as exempt from federal income tax under § 501(c)(3) and is not a private foundation under § 509(a) pursuant to §§ 509(a)(1) and 170(b)(1)(A)(vi).

H, W, and Trustee have agreed that Trust should be terminated. Trustee filed a petition for the early termination of Trust in Court. Under the petition Trustee is authorized to terminate Trust. Upon the termination of Trust, Trustee is to distribute to H and W the actuarial value of their unitrust interest to be determined using the discount rate in effect under § 7520 on the date of termination and using the methodology under § 1.664-4 of the Income Tax Regulations for valuing interests in a CRUT. Any distribution of Trust assets in kind will be made pro rata between H and W. The balance of the Trust estate will be distributed to Trustee as the charitable remainder beneficiary. On D3, Court granted the petition subject to Trustee's receipt of a favorable letter ruling.

Section 507 provides a tax imposed under § 507(c) on the termination of an entity's status as a private foundation under § 509(a) where the termination is pursuant to §§ 507(a)(1) or 507(a)(2).

Section 507(a)(1) provides for a termination of private foundation status after the entity's voluntary notice to the Internal Revenue Service for such termination and its payment of the termination tax under § 507(c).

Section 507(a)(2) provides for involuntary termination of private foundation status that can be initiated by the Internal Revenue Service.

Sections 507(b)(1)(A) and 507(b)(1)(B) each describe a method for termination of private foundation status under § 509(a) that is not subject to tax under § 507.

Revenue Ruling 2003-13, 2003-4 I.R.B. 305 (January 27, 2003), indicates that, under § 1.507-1(b)(7), a transfer of all of the assets of a private foundation entity does not result in the termination of the transferor's private foundation status under § 509(a), unless the distribution is under § 507(b)(1)(A), or the foundation voluntarily elects to terminate under § 507(a)(1), or an involuntary termination under § 509(a)(2) applies.

Section 4941 imposes excise tax on any act of self-dealing between a private foundation and any of its disqualified persons defined in § 4946. Under § 4941(d), an act of self-dealing includes any transfer to, or use by or for the benefit of, a disqualified person of any of the assets or income of the private foundation.

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Taxes Regulations provides that an exempt organization under § 501(c)(3) is not a disqualified person under

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§ 4946 for purposes of self-dealing under § 4941.

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), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522. Section 4947(a)(2) provides, in pertinent part, that §§ 507 and 4941 shall apply as if such split-interest trusts were private foundations under § 509(a).

Section 4947(a)(2)(A) provides, in pertinent part, that the provisions of § 4947(a)(2) do not apply with respect to the amounts payable under the terms of such split-interest trust to its income beneficiaries.

Sections 53.4947-1(c)(2) and 53.4947-1(c)(2)(ii), Example (1), indicate, in pertinent part, that the payments of the income by a charitable remainder unitrust to its individual income beneficiaries do not result in any tax on self-dealing under § 4947.

Section 53.4947-1(e)(1) provides that the provisions of § 507(a) shall not apply to a trust described in § 4947(a)(2) by reason of any payment to a beneficiary that is directed by the terms of the governing instrument and is not discretionary with the trustee, or, in the case of a discretionary payment, by reason of, or following the expiration of, the last remaining charitable interest in the trust.

Section 53.4947-1(e)(2), Example (3) indicates that a § 4947(a)(2) trust's payments to its charitable organization remainder beneficiary upon the trust's termination will not result in a termination of the trust's private foundation status within the meaning of § 507(a).

Trust under § 4947(a)(2) will complete its payments to its income and remainder beneficiaries in an early manner, meaning that the trust will pay both the income beneficiaries and the charitable remainder beneficiary the lump sums computed under the Code as the present equivalent of the otherwise future periodic payments owed to those life and remainder beneficiaries.

Section 4941 applies to Trust, which is treated for certain purposes as a private foundation pursuant to § 4947(a)(2), and also applies to disqualified persons with respect to Trust. Under the facts above, we find that the proposed early termination of the charitable remainder unitrust will not result in any act of self-dealing under § 4941.

Section 507(a) applies to Trust which is treated for certain purposes as a private foundation pursuant to § 4947(a)(2). Similar to § 53.4947-1(e)(2), Example (3), Trust's final lump sum payment to its charitable remainder beneficiary organization will not be considered any termination within the meaning of § 507(a) of Trust's private foundation status under § 509(a). Without any termination under § 507(a), no termination tax under § 507 applies to Trust.

Section 1015(b) provides that if property is acquired by a transfer in trust (other

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than by a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer.

Section 1.1015-2(a)(2) provides that the principles stated in § 1.1015-1(b) apply in determining the basis of property where more than one person acquires an interest in property by transfer in trust.

Section 1.1015-1(b) provides that property acquired by gift has a uniform basis, and that the proportionate parts of that basis represented by the interests of the life tenant and remainder interest holder are determined under rules provided in § 1.1014-5. Section 1001(e)(1), however, provides that in determining gain or loss from the sale or disposition of a term interest in property, that portion of the adjusted basis of the interest which is determined pursuant to § 1015 (to the extent that the adjusted basis is a portion of the entire adjusted basis of the property) shall be disregarded. Under § 1001(e)(2), a "term interest in property" includes an income interest in a trust. Section 1001(e)(3) provides that § 1001(e)(1) does not apply to a sale or other disposition which is a part of a transaction in which the entire interest in property is transferred to any person or persons. See also § 1.1001-1(f).

Section 1222(3) provides that the term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than one year.

Section 1221(a) defines the term "capital asset" as property held by the taxpayer with certain listed exceptions not applicable here.

Section 1223(2) provides that in determining the period for which a taxpayer has held property however acquired there shall be included the period for which the property was held by any other person, if the property has the same basis in the taxpayer's hands as it would have in the hands of that other person.

Rev. Rul. 72-243, 1972-1 CB 233, provides that the proceeds received by the life tenant of a trust, in consideration for the transfer of the life tenant's entire interest in the trust to the holder of the remainder interest, are treated as an amount realized from the sale or exchange of a capital asset under § 1222. The right to income for life from a trust estate is a right in the estate itself. See McAllister v. Commissioner, 157 F.2d 235 (2d Cir.), cert. denied, 330 US 826 (1946).

Although the proposed transaction takes the form of a distribution of the present values of the respective interests of H and W and the remainder interest holder, in substance it is a sale of H and W's interest to the remainder interest holder. The amount received by H and W as a result of the termination of Trust is an amount received from the sale or exchange of a capital asset. Rev. Rul. 72-243. Because H and W's basis in the life estate is a portion of the entire basis of the property under § 1015(b), and because the disposition of H and W's interest is not part of a transaction

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in which the entire interest in Trust is transferred to a third party, H and W's adjusted basis in their interest is disregarded. § 1001(e). The H and W's holding period in the life interest exceeds one year. Accordingly, under § 1222(3) the entire amount realized by H and W as a result of the early termination of Trust will be long-term capital gain.

After applying the relevant law to the information provided and the representations made, we conclude as follows:

1. The early termination of Trust and the early distribution of its assets to H, W, and Trustee (as the charitable remainder beneficiary) will not result in tax under § 507 on Trust.
2. The early termination of Trust and the early distribution of its assets to H, W, and Trustee (as the charitable remainder beneficiary) will not result in tax under § 4941 on Trust or its disqualified persons.
3. The entire amount realized by H and W as a result of the early termination of Trust will be long-term capital gain.

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

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) 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 Trustee and Trust's other authorized representative.

Sincerely yours,

J. THOMAS HINES  
Chief, Branch 2  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: 2

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