

INTERNAL REVENUE SERVICE

Number: **200127023**
Release Date: 7/6/2001
Index Nos.: 664.01-00
 1001.00-00
 1015.03-00

CC:PSI:2 - PLR-107635-00

April 4, 2001

Trust =

A =

D1 =

Dear

This is in reply to your letter dated March 30, 2000, and subsequent correspondence, submitted on behalf of A, requesting certain rulings concerning the proposed termination of Trust.

A is the settlor and the non-charitable beneficiary of Trust, a charitable remainder unitrust. Trust was established on D1, with a twenty year term. The unitrust amount is to be paid to A for a period of twenty years in equal installments at the end of each semiannual period, except that the trustee is required to prorate the unitrust amount on a daily basis for a short taxable year, and for the taxable year in which the Trust term expires. If A dies within the twenty year term the payments will be made as A may appoint by will, or in default of such appointment, to A's estate for the duration of the term.

A, the trustee of Trust, and the charitable beneficiary of Trust have agreed that Trust shall be terminated. Upon the termination of Trust, the trustee of Trust shall determine the actuarial value of A's interest and the charity's interest pursuant to § 7520 of the Internal Revenue Code and will distribute Trust assets representing such interests to A and to the charitable beneficiary in termination of Trust.

Section 664(b) provides that the amounts distributed by a charitable remainder trust to the beneficiary of the annuity or

unitrust payment are characterized in the hands of the recipient first as ordinary income, second as capital gain, third as other income, and fourth as trust corpus. Both current and prior undistributed amounts from a tier must be exhausted before distributions are deemed to be made from the next tier.

Section 664(b) provides rules to determine the character of the annual unitrust amounts distributed by a charitable remainder unitrust to the unitrust beneficiary. Any regular unitrust amount distributed to A by Trust prior to the termination of Trust will have the characteristics in the hands of A determined under § 664(b).

However, money and property received by A upon the termination of Trust does not represent a distribution of an annual unitrust amount; therefore, § 664 is inapplicable to this amount. Rather, A is disposing of A's interest in Trust in exchange for money and property in a transaction that is governed by § 1001.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of any property received.

Section 1001(c) provides that the entire amount of the gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1001(e)(1) provides that in determining gain or loss from the sale or other disposition of a term interest in property, that portion of the adjusted basis of such interest which is determined pursuant to § 1015, (to the extent that such 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 the general rule of § 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.

Section 1015(b) provides that if property was acquired after December 31, 1920, by a transfer in trust (other 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 such transfer.

Section 1.1001-1(f)(1) of the Income Tax Regulations provides that for purposes of determining the gain or loss from the sale or other disposition of a term interest in property, a taxpayer shall not take into account that portion of the adjusted basis of such interest, which is determined pursuant to § 1015 (relating to the basis of property acquired by gift or by a transfer in trust) to the extent that such adjusted basis is a portion of the adjusted uniform basis of the entire property (as defined in § 1.1014-5).

Section 1.1014-5(a)(1) defines the term "adjusted uniform basis" as the uniform basis of the entire property adjusted as required by the §§ 1016 and 1017 to the date of sale or other disposition of any interest in the property.

Section 1.1015-1(b) provides that property acquired by gift has a single or uniform basis although more than one person may acquire an interest in such property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017. However, the value of the proportionate parts of the uniform basis represented, for instance, by the respective interests of the life tenant and remainderman are adjustable to reflect the change in the relative values of such interest on account of the lapse of time. The portion of the basis attributable to an interest at the time of its sale or other disposition shall be determined under the rule provided in § 1.1014-5. In determining gain or loss from the sale or other disposition after October 9, 1969, of a term interest in property (as defined in § 1.1001-1(f)(2)) the adjusted basis of which is determined pursuant, or by reference, to § 1015, that part of the adjusted uniform basis assignable under the rules of § 1.1014-5(a) to the interest sold or otherwise disposed of shall be disregarded to the extent and in the same manner provided by § 1001(e) and § 1.1001-1(f).

Rev. Rul. 72-243, 1972-1 C.B. 233, provides that a sale of an income interest in a trust is a sale of a capital asset within the meaning of §§ 1221 and 1222. The holding period for purposes of determining whether gain or loss from the disposition of an income interest is long term or short term commences on the date the taxpayer first held such interest.

Section 4947(a)(2) provides 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 purposes described in § 170(c)(2)(B), and which 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, § 507 (relating to the termination of private foundation status), § 508(e) (relating to governing instruments), § 4941 (relating to taxes on self-dealing), § 4943 (relating to taxes on excess business holdings) except as provided in subsection (b)(3), § 4944 (relating to investments which jeopardize charitable purpose), except as provided in § 4947(b)(3), and § 4945 (relating to taxes on taxable expenditures) shall apply as if such trust were a private foundation.

Section 4941(a)(1) imposes a tax on any act of self-dealing between a private foundation and a disqualified person as defined in § 4946.

Section 4946(a)(1)(A) describes a disqualified person to include a "substantial contributor."

Section 53.4947-1(c)(2)(i) of the Foundation and Similar Excise Taxes Regulations provides, in essence, that under § 4947(a)(2)(A), the self-dealing provision under § 4941 and certain other private foundation rules do not apply to amounts payable under the terms of a split-interest trust to income beneficiaries for which a charitable deduction was allowed with the creation of the split-interest trust.

A, as settlor of Trust, is a disqualified person within the meaning of § 4946(a)(1)(A). The annual distribution of the Trust's unitrust amount to A is not an act of self-dealing by virtue of § 53.4947-1(c)(2)(i). The actuarial amount paid to A representing A's interest in Trust is derived solely from A's income right in Trust. Just as the unitrust amount paid over time is excluded from self-dealing, so too will the payment of A's interest in the trust constitute an exception to self-dealing under § 53.4947-1(c)(2)(i) because the payment is derived from A's legal right to the unitrust amount under the Trust agreement.

Accordingly, we conclude as follows: A is selling A's interest in Trust to the remainderman. Provided that the money and other property received by A are distributed to A in accordance with A's interest in Trust, the amount A will realize from the sale of A's interest in Trust is the amount of money and the fair market value of the property received by A.

Pursuant to § 1001(e)(1), the portion of the adjusted uniform basis assigned to A's interest in Trust is disregarded. The exception contained in § 1001(e)(3) is not applicable, because the entire interest in Trust's assets is not being sold, or otherwise disposed of, to a third party. Accordingly, for purposes of this transaction, A has no basis in A's interest in

Trust. Therefore, the amount of gain A must recognize under § 1001(c) is the amount A realized from the disposition of A's interest in Trust. The gain realized by A from the disposition of A's interest will be long term capital gain.

We further conclude that no act of self-dealing, as defined in § 4941(d)(1) will result from the termination of Trust and the distribution of the assets of Trust to A and the charity.

The above conclusions are based on the assumptions that the proposed termination of Trust is not prohibited by state law; that the proposed termination will be made pursuant to a court order resulting from a proceeding to which the state attorney general is a party; and that the amounts distributed to A are determined and distributed pursuant to the valuation rules set forth in § 7520. This ruling is also contingent on the fact that any distribution of assets in kind is made in a pro rata manner.

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) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to A.

Sincerely yours,
J. THOMAS HINES
Chief, Branch 2
Office of the Associate
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes