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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4 - PLR-123545-00
Date:
SEPTEMBER 26, 2001

Re:

Legend:

Date 1 =
Taxpayer =

Trust Agreement =
Bank =

X =
Y =
Academy =

Dear :

This is in response to a letter dated October 26, 2000, and subsequent correspondence, submitted on behalf of the Taxpayer, requesting rulings regarding the transfer of Taxpayer's unitrust interest in a charitable remainder unitrust in exchange for an annuity as described below.

Facts

The facts submitted and representations made are as follows:

On Date 1 Taxpayer executed Trust Agreement, establishing a charitable remainder unitrust (Trust) with Bank as Trustee. Taxpayer transferred to Trust assets with an aggregate adjusted basis of $X and an aggregate fair market value of $Y.

Under the terms of Trust, Taxpayer is to receive, for life, a unitrust interest equal to 5 percent of the net fair market value of Trust assets determined as of the first day of the taxable year of Trust. The unitrust interest is payable in equal quarterly installments, first from income and, to the extent income is insufficient, from principal. Any Trust income in excess of the unitrust amount is to be added to corpus. As of the end of the quarter preceding Taxpayer's death, the Trustee is to distribute the trust corpus to Academy, an organization described in § § 170(b)(1)(A), 170(c), 2055(a) and 2522(a).

Academy is currently in need of funds to be used for the construction of an academic building. Taxpayer proposes to transfer his unitrust interest in Trust to Academy. In consideration for Taxpayer's transfer of his unitrust interest, Academy will pay Taxpayer an annuity for Taxpayer's life. It is represented that the annuity will be paid from Academy's general funds and not from the specific property received by the Academy from Trust as a result of Taxpayer's transfer. The annuity will be nonassignable or will be assignable only to Academy. Taxpayer will be the only annuitant. Taxpayer's right to receive annuity payments from Academy will be transferred to Taxpayer on the date that he transfers his unitrust interest to Academy and will commence on that date. It is represented that the annuity payable to Taxpayer will provide for a specified sum, payable not less often than annually for Taxpayer's life. The annuity will terminate on Taxpayer's death, and no additional payments will be due. The terms of the annuity will prohibit any commutation, prepayment, or refund.

Taxpayer represents that he did not divide his interest in the property transferred to Trust on Date 1 in order to avoid the partial interest rule of § 170(f)(3)(A).

We assume that the Trust is a charitable remainder unitrust within the meaning of § 664(d)(2).

You have asked that we rule as follows:

1. For the year in which Taxpayer transfers the entire balance of his unitrust interest to Academy, Taxpayer will be entitled to a charitable income tax deduction under § 170(a)(1) of the Internal Revenue Code, to the extent the date of transfer present value of Taxpayer's unitrust interest exceeds the date of transfer present value of the annuity payments to be made by Academy to Taxpayer.

2. For the year in which Taxpayer transfers the entire balance of his unitrust interest to Academy, Taxpayer will be entitled to a charitable gift tax deduction under § 2522(a), to the extent the date of transfer present value of Taxpayer's unitrust interest exceeds the date of transfer present value of the annuity payments to be made by Academy to Taxpayer.

3. To the extent that Trust realized capital gains income that was not included in the unitrust amounts paid to, and recognized by, Taxpayer in prior years, Taxpayer's transfer of his unitrust interest to Academy will not cause that capital gains income to be included in Taxpayer's gross income for the taxable year of the transfer.

4. For purposes of applying § 1011(b) to the calculation of the gain realized upon Taxpayer's receipt of payments from the charitable gift annuity purchased from Academy, Taxpayer's adjusted basis in the unitrust interest being transferred will be determined by allocating Taxpayer's aggregate adjusted basis in the property transferred to the Trustee at Trust's formation between (i) Taxpayer's unitrust interest and (ii) Academy's remainder interest, in proportion to the respective values of those interests as those values were determined on the date of transfer to the Trustee.

Law and Analysis

Ruling Request 1

Section 170(a)(1) allows an income tax deduction for any contribution to or for the use of organizations described in § 170(c).

Section 170(f)(3)(A) allows a charitable contribution deduction for the contribution of a partial interest in property only to the extent that the value of the interest contributed would be allowable as a deduction if such interest had been transferred in trust. Section 170(f)(2) allows a charitable contribution deduction for the contribution in trust of a unitrust interest (that is, a fixed percentage distributed yearly of the fair market value of the trust property, to be determined yearly). Section 1.170A-7(a)(2)(i) of the Income Tax Regulations provides, however, that a deduction will not be allowed where the property in which a partial interest exists was divided in order to create such interest and thus, avoid § 170(f)(3)(A).

Section 1.170A-1(d)(1) of the Income Tax Regulations provides that in the case of an annuity purchased from an organization described in § 170(c), a taxpayer is allowed a deduction for the excess of the amount paid over the value of the annuity at the time of the purchase. Section 1.170A-1(d)(2) states that the value of the annuity is determined in accordance with § 1.101-2(e)(1)(iii)(b)(2).

Section 170(f)(8) requires a contemporaneous written acknowledgment for all contribution deductions of $250 or more. The acknowledgment must be obtained by the taxpayer on or before the earlier of the date on which the taxpayer files a return for the taxable year in which the contribution was made or the due date (including extensions) for filing such return. When the amount of the deduction for noncash gifts exceeds $500, the donor must complete the relevant portions of Form 8283 and include Form 8283 with the return for the year of the contribution. According to § 1.170A-13(c) of the regulations, a donor who contributes property, other than certain publicly traded securities, and claims a charitable contribution deduction in excess of $5,000 must satisfy additional substantiation requirements.

Section 1.1011-2(a)(1) provides that the reduction provisions of § 170(e) and the percentage limitations of § 170(b) apply in determining whether a taxpayer entering into a bargain sale with a charitable entity is entitled to a charitable contribution deduction.

Rev. Rul. 86-60, 1986-1 C.B. 302, holds that the transfer by the grantor life-interest beneficiary of the retained annuity interest in a charitable remainder annuity trust that the grantor held for four years to the charitable remainder beneficiary qualifies for a charitable contribution deduction under § 170.

We accept Taxpayer's representation that the Trust property, in which Taxpayer's partial interest exists, was not divided in order to avoid the rules of § 170(f)(3)(A). Thus, § 1.170A-7(a)(2)(i) of the regulations does not cause disallowance of the charitable contribution deduction in this case.

As stated above, § 1.170A-1(d)(1) provides that in the case of an annuity purchased from an organization described in § 170(c), a taxpayer is allowed a deduction for the excess of the amount paid over the value of the annuity at the time of the purchase. In the instant case, the amount paid by Taxpayer for the annuity is the value of his unitrust interest.

A. Reductions in Charitable Contribution Deductions

Section 170(e)(1)(A) reduces the amount allowable as a charitable contribution deduction by the amount of gain that would not be long-term capital gain if the property were sold. Section 170(e)(1)(B) further limits a charitable contribution deduction by the amount of gain that would be long-term capital gain for certain contributions of tangible personal property and contributions to or for the use of certain private foundations.

A life interest in a trust is a right in the estate itself and thus, is a capital asset. McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946), cert. denied, 330 U.S. 826 (1947); Rev. Rul. 72-243, 1972-1 C.B. 233.

In the instant case, the sale of Taxpayer's unitrust interest would result in long-term capital gain. Because the unitrust interest is not tangible personal property and will not be contributed to a private foundation, § 170(e)(1)(B) does not apply. Accordingly, the deductible amount is not reduced under § 170(e)(1).

B. Percentage Limitations

Section 170(b)(1)(C)(i) provides that, in the case of a contribution of capital gain property to an organization described in § 170(b)(1)(A), to which § 170(e)(1)(B) does not apply, the total amount of contributions of such property which may be taken into account for determining the income tax deduction shall not exceed 30 percent of the taxpayer's contribution base for the year. Section 170(b)(1)(C)(iv) defines "capital gain property" as a capital asset, the sale of which at its fair market value at the time of the contribution would result in long-term capital gain.

In the instant case, Taxpayer proposes to contribute his unitrust interest, which is capital gain property, to an organization described in § 170(b)(1)(A). Section 170(e)(1)(B) does not apply. Accordingly, Taxpayer's contribution deduction is subject to the 30 percent limitation of § 170(b)(1)(C)(i).

Accordingly, based on the facts submitted and the representations made, we rule that, for the year in which Taxpayer transfers the entire balance of his unitrust interest to Academy, Taxpayer will be entitled to a charitable income tax deduction under § 170(a)(1), to the extent that the date of transfer present value of Taxpayer's unitrust interest exceeds the date of transfer present value of the annuity payments to be made by Academy to Taxpayer, subject to the percentage limitations of § 170(b)(1)(C)(i) and any other requirements and limitations under § 170.

Ruling Request 2

Section 2501(a)(1) imposes a tax, for each calendar year, on the transfer of property by gift by any individual, resident or nonresident.

Section 2511 provides that the tax imposed by section 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.

Under § 2512(a), if a gift is made in property, the value of the property on the date of the gift is the amount of the gift. Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration received shall be deemed a gift.

Under § 25.2512-5(a) of the Gift Tax Regulations, the fair market value of an annuity or unitrust interest is its present value, determined in accordance with § 25.2512-5(d).

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) 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) (a unitrust interest).

Under § 25.2522(c)-3(d)(2)(v) of the Gift Tax Regulations, the present value of a unitrust interest is determined by subtracting the present value of all interests in the transferred property other than the unitrust interest from the fair market value of the transferred property. Under § 25.2522(c)-3(d)(2)(ii), the present value of a remainder interest in a charitable remainder unitrust is to be determined under § 1.664-4.

Rev. Rul. 80-281, 1980-2 C.B. 282, considers a situation where A purchases an annuity from N, an organization described in §§ 170(c) and 2522(a). The annuity is

payable out of the general funds of N charity. The ruling holds that A is allowed a gift tax charitable deduction under § 2522(a) for the excess of the amount paid by A to N charity, over the value of the annuity received by A. The value of the annuity received is determined under the actuarial tables contained in § 25.2512-5. See Rev. Rul. 84-162, 1984-2 C.B. 200. The ruling further states that, because the annuity was paid from the general funds of N charity, A has not retained an interest in the funds transferred to charity and § 2522(c) does not apply.

Situation 1 of Rev. Rul. 86-60, 1986-1 C.B. 302, considers a situation where A, in 1980, creates a charitable remainder annuity trust pursuant to which A retained the right to receive an annuity interest for life. On A's death, the trust corpus is to pass to charity. In 1984, A transfers A's entire annuity interest to the charitable remainder beneficiary. Following the transfer, A did not retain any interest in the trust, and neither at that time nor at any prior time did A make a transfer of trust property for private purposes. Although the transfer of the remainder interest to charity divided A's prior interest, that transfer was for charitable, not private purposes. Consequently, A's transfer of the annuity interest to charity was not required to be in a form described in § 2522(c)(2)(B) and § 25.2522(c)-3(c)(2) in order to qualify for the charitable deduction. Accordingly, A's transfer of the annuity interest to charity qualifies for a deduction under § 2522(a).

The facts in this case are substantially identical to those described in Situation 1 of Rev. Rul. 86-60. Taxpayer proposes to transfer his entire unitrust interest to Academy. After the transfer, he will not retain any interest in Trust. Further, Taxpayer has not made a transfer for private purposes either before or at the time of his transfer of his unitrust interest to Academy. Although Taxpayer's Date 1 transfer to Academy of the remainder interest in Trust divided Taxpayer's prior interest in the property that funded Trust, that transfer was for charitable, not private, purposes.

Further, Taxpayer's transfer of his entire unitrust interest in exchange for an annuity paid from Academy's general funds is substantially similar to the exchange of a sum of money for an annuity paid from a charity's general funds described in Rev. Rul. 80-281.

Accordingly, based on the facts submitted and the representations made, we rule that, for the year in which Taxpayer transfers the entire balance of his unitrust interest to Academy, Taxpayer will be entitled to a charitable gift tax deduction under § 2522(a), to the extent the date of transfer present value of Taxpayer's unitrust interest exceeds the date of transfer present value of the annuity payments to be made by Academy to Taxpayer. The present value of the unitrust interest and annuity are determined in accordance with § 7520 and § 25.2512-5(d).

Ruling Request 3

We conclude that, to the extent the trustee of Trust realized capital gain income in prior years, which income was not included in the unitrust amounts paid to Taxpayer

and thereby recognized by Taxpayer, that capital gain will not be currently included in Taxpayer's income by reason of his transfer of his unitrust interest to Academy.

Ruling Request 4

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 that section, on the sale or exchange of property shall be recognized.

Section 1011(b) provides that if a charitable contribution deduction is allowed by reason of a sale, then the adjusted basis for determining gain shall be that portion of the adjusted basis which bears the same ratio to the adjusted basis as the amount realized bears to the fair market value of the property.

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 §§ 1014, 1015, or 1041 (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 that is a part of a transaction in which the entire interest in property is transferred to any person or persons.

Section 1.1001-1(f)(3) of the Income Tax Regulations provides that § 1001(e)(1) does not apply to a sale of a term interest in property as part of a single transaction in which the entire interest in the property is transferred to a third person. See Example (4) of § 1.1014-5(c) of the Income Tax Regulations.

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

Example (5) in § 1.1014-5(c) of the regulations illustrates the above principles in a factual situation analogous to the one present in this case. In Example (5), a decedent left property to H for life, then to D for life, with the remainder passing to G. Two years after the decedent's death, H sells his life estate to D for $32,000. H recognized gain of $32,000, the amount realized from the sale, because the portion of the adjusted uniform basis assigned to H's life estate is disregarded pursuant to § 1001(e). Three years later, D sells both life estates to G for $40,000. For purposes of determining gain or loss on the sale by D, the portion of the adjusted uniform basis

assigned to H's life interest and the portion assigned to D's life interest are not taken into account under § 1001(e). However, D's cost basis in H's life interest, minus deductions for the amortization of such interest, is taken into account.

Section 1015(b) provides that the basis of property acquired by transfer in trust (other than by transfer in trust by a gift, bequest, or devise) is the same as it would be in the hands of the grantor.

Under § 1.1015-2(a)(2), the uniform basis rules under § 1.1015-1 apply where more than one person acquires an interest in property transferred in trust. Under § 1.1015-1(b), property acquired by gift has a single or uniform basis although more than one person may acquire an interest in the property. The portion of the basis attributable to an interest (such as the interest of a life tenant) at the time of its sale or other disposition is determined under § 1.1014-5. In determining gain or loss from the sale or other disposition of a term interest in property, as defined in § 1.1001-1(f)(2), the adjusted basis of which is determined by reference to § 1015, that part of the adjusted uniform basis assignable to the interest sold or otherwise disposed of will be disregarded to the extent and in the manner provided by § 1001(e) and § 1.1001-1(f).

Section 1.1011-2(a)(4)(i) of the regulations provides that § 1011(b) and § 1.1011-2 apply where property is sold or exchanged in return for an annuity and a charitable contribution deduction is allowed by reason of the sale or exchange.

Section 1.1011-2(a)(4)(ii) of the regulations provides that gain on an exchange described in § 1.1011-2(a)(4)(i) of the regulations is reported as provided in example (8) of § 1.1011-2(c) if the annuity received in exchange for property is nonassignable or is assignable to the charitable organization to which the property is sold or exchanged, and if the transferor is the only annuitant or the transferor and a designated survivor annuitant or annuitants are the only annuitants.

In the instant case, because Taxpayer's basis in his unitrust interest is in a trust, that basis is determined pursuant to § 1015. Thus, in determining Taxpayer's basis in his unitrust interest upon his transfer of the unitrust interest to the Academy in exchange for an annuity interest from the Academy, the portion of the adjusted uniform basis assigned to Taxpayer's unitrust interest will be disregarded pursuant to § 1001(e)(1). The exception to § 1001(e)(1) in § 1001(e)(3) is not applicable, because the remainder beneficiary is not receiving the entire interest in Trust in a single transaction.

As stated above, Taxpayer's unitrust interest is a capital asset. The annuity Taxpayer will receive from Academy will be nonassignable or will be assignable only to Academy, and Taxpayer will be the only annuitant. Accordingly, upon the transfer of his unitrust interest in the Trust to the Academy in exchange for an annuity payable by the Academy, Taxpayer will have long-term capital gain in the amount of the value of the annuity, reported as provided in example (8) of § 1.1011-2(c) of the regulations.

Except as specifically ruled herein, we express no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions 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.

Sincerely yours,
George L. Masnik
Chief, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for section 6110 purposes