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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:4-PLR-118273-00

Date:
January 10, 2002

Re:

Legend:

Taxpayer -
Child -
Corporation -
Plan -
CRUT -
Date 1 -
Date 2 -
Year 1 -
Year 2 -
$A -
$B -
x -

Dear :

This is in response to your letter requesting rulings concerning the Federal income and gift tax treatment of the proposed transfer to a qualified charitable remainder unitrust.

The submitted information indicates that Taxpayer is presently employed by Corporation and has been a participant in the Corporation's profit sharing plan (the Plan) for more than five years. The Plan is represented as being a qualified plan under § 401(a) of the Internal Revenue Code and tax exempt under § 501(a). As of Date 1, Taxpayer's account under the Plan was funded with x shares of Corporation stock having a value of approximately $A dollars. Corporation stock is publicly traded on the New York Stock Exchange. Taxpayer's child (Child) is currently designated as the primary beneficiary of the account. The Plan permits its participants to elect to have lump-sum distributions paid out in-kind with Corporation stock.

The cost basis of the Corporation stock in the Taxpayer's Plan account is approximately $B, which represents both employer and employee contributions. The difference between the cost basis of the stock and its fair market value is referred to as the net unrealized appreciation.

The Taxpayer had planned to retire from the Corporation on or about Date 2 and shortly after that date, will attain age 55. All of the assets in the Taxpayer's account balance will be distributed to the Taxpayer outright following the retirement date and prior to the end of the calendar year in which Taxpayer retires.

The Taxpayer proposes to "rollover" a portion of the Corporation stock distributed to him from the Plan account to an individual retirement account (IRA) described in § 408. Within twelve months of retirement, Taxpayer will sell a portion of the Corporation stock distributed to him that was not "rolled over." In addition, Taxpayer proposes to contribute the remaining "non-rollover" Corporation stock to a charitable remainder unitrust (CRUT), which Taxpayer will create. The contribution of stock to the CRUT will be less than 10 percent of the value of the outstanding Corporation stock. Taxpayer represents that the CRUT will comply with the requirements of § 664 and the regulations thereunder. Under the terms of the CRUT, a unitrust amount will be paid to Taxpayer during his lifetime. On Taxpayer's death, the trust corpus is to be distributed to certain public charities described in §§ 170(c), 2055(a) and 2522(a) designated in the instrument. The Taxpayer will act as initial trustee of the CRUT. The Taxpayer may contribute other property to the CRUT.

If any profit sharing contribution is made in Year 2 for Year 1, Taxpayer will immediately receive a taxable distribution of the full amount.

For purposes of this ruling, we assume that the CRUT will comply with the requirements of § 664 and the regulations thereunder, and that Taxpayer will have separated from service within the meaning of § 402(d)(4)(A)(iii).

You have requested the following rulings:

1. The proposed distribution of the entire balance of the Plan after retirement will meet the requirement of a lump sum distribution within one year of the receipt of the balance to the credit of Taxpayer's Plan balance within the meaning of § 402(e)(4)(D)(i), despite a potential additional Year 1 profit sharing contribution that would be made during Year 2.

2. The net unrealized appreciation, within the meaning of § 402(e)(4), is the difference between the cost basis and the fair market value of the non-rollover shares on the plan distribution date. Taxpayer will not, under § 402(e)(4)(B), recognize ordinary income on that portion of the non-rollover share plan distribution representing the net unrealized appreciation.

3. Any taxable gain on the subsequent sale of the non-rollover shares will be treated as

capital gain income on the sale of a capital asset held in excess of 12 months to the extent of the original net unrealized appreciation, regardless of the time period between the sale date and the distribution date. Post-distribution gain in excess of the net unrealized appreciation amount will be taxed at the applicable capital gain rate based on the holding period of the stock from the distribution date to the sale date.

4. No portion of the Plan distribution will be subject to the 10 percent early distribution penalty under § 72(t)(2)(A)(v) because Taxpayer will meet the exception under § 72(t)(2)(A)(v) for distributions made to an individual after attaining 55 years of age following separation from service.

5. Taxpayer will not recognize any immediate taxable income, gain or loss from the act of contributing stock received from the Plan to the CRUT.

6. Taxpayer will qualify for an income and gift tax charitable deduction for the contribution of the non-rollover shares to the CRUT equal to the fair market value of the stock at the time of the transfer less the present value of Taxpaer's retained unitrust interest.

7. The stock transferred to the CRUT will retain Taxpayer's cost basis and holding period.

8. The gain from any subsequent sale by the CRUT of the non-rollover shares will be exempt from immediate direct taxation Taxpayer and to the CRUT, assuming the CRUT does not have unrelated trade or business income in the year of the sale. The amount of any gain, to the extent of the net unrealized appreciation, from the sale of the non-rollover shares will be characterized as capital gain income from the sale of a capital asset held in excess of 12 months for purposes of the distribution characterization rules described in § 664(b) and the regulations thereunder. Gain in excess of the net unrealized appreciation will be characterized according to the holding period of the stock from the distribution date to the sale date.

<u>Issues #1 - #5</u>:

Section 402(a) states that any amount actually distributed to any distributee by an employees' trust described in § 401(a) which is exempt from tax under § 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under § 72 (relating to annuities).

Section 402(d)(4)(A) provides that the term "lump sum distribution" has the meaning given such term by subsection (d)(4)(A) (without regard to the minimum period of service requirement in subsection (d)(4)(F)). Section 402(d)(4)(A) provides, in pertinent part, that the term "lump sum distribution" means the distribution or payment within one taxable year of the receipt of the balance to the credit of an employee which becomes payable to the recipient - (iii) on account of the employee's separation from service, from a trust which forms a part of a plan described in § 401(a) and which is exempt under § 501(a). If a distribution constitutes the balance to the credit, such distribution should not be treated as other than a lump sum distribution merely because an additional amount attributable to the employee's last year of service is credited to the employee's account and is distributed in the following year.

Section 402(d)(4)(F) provides that no amount distributed to an employee from or under a plan may be treated as a lump sum distribution under subparagraph (A) unless the employee has been a participant in the plan for five or more taxable years before the taxable year in which such amounts are distributed.

Section 402(e)(4)(B) provides that, for purposes of §§ 402(a) and 72, in the case of a lump sum distribution which includes securities of the employer corporation, there shall be excluded from the gross income the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation.

Neither the Internal Revenue Code nor the regulations, promulgated thereunder, preclude a distribution from being treated as a lump sum distribution under § 402(e)(4)(D), for purposes of § 402(e)(4)(B) even if a portion of the distribution is rolled over or directly transferred into an IRA.

Section 402(e)(4)(C) provides that, for purposes of subparagraph (B), net unrealized appreciation and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Treasury Secretary.

Section 1.402(a)-1(b)(1)(i)(a) of the Income Tax Regulations provides, in general, that if a distribution constitutes a lump sum distribution, the amount to be excluded from income is the entire net unrealized appreciation attributable to that part of the lump sum distribution which consists of securities of the employer.

Section 1.402(a)-1(b)(2)(i) provides, in pertinent part, that the amount of net unrealized appreciation excludable under § 1.402(a)-1(b)(1)(i)(a) is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust. Thus, if a distribution consists in part of securities which have appreciated in value and in part of securities which have depreciated in value, the net unrealized appreciation shall be considered to consist of the net increase in value of all of the securities included in the distribution.

Notice 98-24, 1998-1 C.B. 929, provides that the amount of net unrealized appreciation which is not included in the basis of the securities in the hands of the distributee at the time of the distribution is considered a gain from the sale or exchange of a capital asset held for more than 18 months to the extent that such appreciation is realized in a subsequent taxable transaction. The actual period that an employer security was held by a qualified plan need not be calculated in order to determine whether, with respect the net unrealized appreciation, the disposition qualifies for the rate for capital assets held for more than 18 months. However, with respect to any further appreciation in the employer securities after distribution from the plan, the actual holding period in the hands of the distributee determines the capital gains rate that applies.

Accordingly, with respect to ruling request #1, the proposed distribution in Year 1 to Taxpayer of his entire Plan account balance will be treated as a lump sum distribution within the meaning of § 402(e)(4)(D) for purposes of § 402(e)(4)(B), despite the partial rollover of such distribution and a potential additional Year 1 profit sharing contribution that would be distributed from Plan in a subsequent year.

We further conclude, with respect to ruling request #2, that Taxpayer will not, in accordance with § 402(e)(4)(B), recognize ordinary income on that portion of non-rolled over stock representing net unrealized appreciation (i.e., the difference between the cost basis and the fair market value on the Plan distribution date).

With respect to ruling request #3, we conclude that any taxable gain on the subsequent sale of the shares not rolled over will be treated as capital gain income on the sale of a capital asset held in excess of 12 months to the extent of the original net unrealized appreciation, regardless of the time period between the sale date and the distribution date. Post-distribution gain in excess of the net unrealized appreciation amount will be taxed at the applicable capital gain rate based on the holding period of the stock from the distribution date to the sale date.

Section 72(t)(1) provides that if any taxpayer receives any amount from a qualified retirement plan as defined in § 4974(c), including a plan qualified under § 401(a), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

Section 72(t)(2) sets forth several distribution situations that are excepted from the tax imposed under § 72(t)(1). Section 72(t)(2) provides in subparagraph (v) that, in general, distributions which are made to an employee after separation from service after attainment of age 55 are excepted from the tax imposed under § 72(t)(1).

Notice 87-13, 1987-1 C.B. 432, 441, provides in Question and Answer - 20, in pertinent part, that pursuant to § 72(t)(A)(v), distributions made to an employee after the employee separated from service will not be subject the tax imposed under § 72(t)(1) as long as such distribution from service occurred during or after the calendar year in which the employee attained age 55.

In this case, Taxpayer attained age 55 in calendar Year 1 and separated from service of Corporation in the same calendar year. Taxpayer will be receiving a lump sum distribution from the Plan by the end of the calendar Year 1. Accordingly, with respect to ruling request #4, we conclude that no portion of the Plan distribution, as described, will be subject to the 10 percent early distribution penalty under § 72(t)(2)(A)(v).

With respect to ruling request #5, generally, a donor will not recognize gain on the contribution of appreciated property to charity. However, a donor may recognize gain where there is a pre-arranged plan whereby the donor is under an obligation to enter into transactions involving the donated property that have a benefit to the donor. See Blake v. Commissioner, 697 F.2d 473 (2d Cir. 1982), aff'g T.C. Memo. 1891-579 (donee obligated to sell appreciated stock received from the donor and use the proceeds to buy donor's yacht at an inflated price).

In this case, there is no indication that there is a pre-arranged plan involving the CRUT's disposition of the shares contributed by Taxpayer. Accordingly, assuming that CRUT qualifies as a charitable remainder unitrust under § 664, we conclude with respect to ruling request #5, that Taxpayer will not recognize gain or loss as a result of his contribution of stock to CRUT.

Issue #6

Section170(a)(1) allows as a deduction, any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year. If a charitable contribution is made in other than money, § 1.170A-1(c) of the Income Tax Regulations provides, in part, that the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in §§ 170(e)(1) and 1.170A-4(a).

Section 170(e)(1) provides, in certain circumstances, for a reduction in the amount of the charitable contribution of property. Section 170(e)(1)(A) provides that the amount of a charitable contribution is reduced by the amount of gain which would not have been long-term capital gain if the property had been sold by the taxpayer at its fair market value (determined at the time of the contribution). In addition, § 170(e)(1)(B)(ii) provides that in the case of a charitable contribution to or for the use of a private foundation (as defined in § 509(a)), other than a private foundation described in § 170(b)(1)(E)), the amount of the contribution is also reduced by the amount of the gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of the contribution). The reduction for the contributions to private foundations does not apply to the contributions to a charitable remainder trust, when the trust provides that only charities described in § 170(b)(1)(A) can be remainder beneficiaries of the trust. See § 1.170A-6(d), Example 9.

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 1 year, if and to the extent such gain is taken into account in computing gross income.

Section 170(f)(2)(A) provides that in the case of property transferred in trust, no deduction shall be allowed under § 170 for the value of a contribution of a remainder interest unless the trust is a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664), or a pooled income fund (described in § 642(c)(5)).

Section 1.170A-6(b)(2) provides that the fair market value of a remainder interest in a charitable remainder unitrust is computed under § 1.664-4. However, in some cases a reduction in the amount of a charitable contribution of the remainder interest may be required under §§ 170(e) and 1.170A-4. Id.

In the present case, Taxpayer intends to contribute the Corporation stock to CRUT, a charitable remainder unitrust. Taxpayer will be allowed a charitable contribution deduction under §§ 170(a) and 170(f)(2)(A).

The amount of the contribution deduction will be the fair market value of the remainder interest in CRUT computed under § 1.664-4, reduced as provided in §§ 170(e)(1) and 1.170A-4. Since only charities described in §§ 170(b)(1)(A) and 170(c) can be the remainder beneficiaries of CRUT, the reduction for a contribution to private foundations (as defined in § 509(a) other than private foundations described in § 170(b)(1)(E)) will not apply. We have ruled in ruling request #3 that, if Taxpayer sold the Corporation stock for the fair market value at the time of the distribution, any gain would be long-term capital gain. If Taxpayer were to sell the corporation stock not more than one year after the distribution, any additional gain in the value of the stock after the distribution would be short-term capital gain. Section 1222(3). Thus, if Taxpayer contributes the Corporation stock to CRUT no more than one year after the distribution, the amount of the charitable contribution deduction will be limited to the fair market value of the stock at the time of distribution.

Section 170(b)(1) provides limitations on how much an individual can deduct as charitable contributions in a taxable year. This limitation is based on a percentage of a taxpayer's adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under § 172). The amount that Taxpayer may deduct will be subject to the percentage limitations in § 170(b)(1).

You also request a ruling that Taxpayer will qualify for a gift tax charitable deduction for the contribution of the non-rollover shares to the CRUT equal to the fair market value of the stock at the time of the transfer less the present value of Taxpayer's retained unitrust interest.

Section 2501(a) provides that a tax is imposed for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511(a) provides that the gift tax 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.

Section 25.2511-2(b) of the Gift Tax Regulations provides that as to any property of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. Section 25.2511-2(c) provides that a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

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).

Section 25.2522(c)-3(d) provides, in part, that the amount of the deduction in the case of a contribution of a partial interest in property is the fair market value of the partial interest on the date of the gift. The fair market value of an annuity, life estate, term for years, remainder, reversion, or unitrust interest is its present value on the date of the gift. Section 25.2522(c)-3(d)(2)(ii) provides that the present value of a remainder interest in a charitable remainder unitrust is determined under § 1.664-4 of the Income Tax Regulations.

In this case, after execution of the CRUT, Taxpayer will not retain any power to change the charitable beneficiaries of CRUT. Accordingly, Taxpayer's transfer to CRUT will be a completed gift under § 25.2511-2(b) of the remainder interest in CRUT. Assuming CRUT qualifies as a charitable remainder unitrust, as described in § 664 and the applicable regulations, Taxpayer's transfer to CRUT will qualify for a gift tax charitable deduction under § 2522(a). The amount deductible will be the present value of the remainder interest in CRUT, determined in accordance with § 25.2522-3(d)(2)(ii) as of the date of the transfer.

Issue #7:

Section 1015(a) provides, in part, that if property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value.

Section 1.1015-1(a) provides that, in general, in the case of property acquired by gift after December 31, 1920 (whether by a transfer in trust or otherwise), the basis of the property for the purpose of determining gain is the same as it would be in the hands of the preceding owner by whom it was not acquired by gift. The same rule applies in determining loss unless the basis (adjusted for the period prior to the date of the gift in accordance with §§ 1016 and 1017) is greater than the fair market value of the property at the time of the gift. In such case, the basis for determining loss is the fair market value at the time of the gift.

Section 1223(2) provides that, in determining the period for which the taxpayer has held property however acquired, there shall be included the period for which the property was held by any other person if, under Chapter 1 of the Internal Revenue Code, the property has, for the purposes of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of the other person.

The basis of the stock in the hands of the CRUT will be determined under § 1015. Assuming that the basis of the stock in the hands of the CRUT will be the same as the stock in the hands of Taxpayer and based on the facts and representations submitted, we conclude that the Corporation stock transferred to the CRUT will retain the Taxpayer's cost basis and holding period for purposes of any subsequent sale by the CRUT.

Issue #8:

Section 664(c) provides, in part, that a CRUT shall, for any taxable year, not be subject to any tax imposed by subtitle A, unless such trust, for such year, has unrelated business taxable income (UBTI) (within the meaning of § 512, determined as if part III of subchapter F applied to such trust).

Based on the facts and representations submitted, we conclude that the gain from any subsequent sale by the CRUT of the "non-rollover" Corporation stock will not be subject to tax, unless the CRUT, for the year of such sale, has UBTI. The amount of any gain to the extent of the net unrealized appreciation, from the sale of the "non-rollover" shares, will be characterized as capital gain from the sale of a capital assets held in excess of 12 months for purposes of the distribution characterization rules described in § 664(b) and § 1.664-1(d). Gain in excess of the net unrealized appreciation will be characterized according to the holding period of the stock from the distribution date to the sale date.

The conclusions are based on the assumption that the CRUT qualifies as a charitable remainder unitrust described under § 664. No opinion is expressed as to whether the CRUT meets the requirements of that section and the regulations thereunder.

A copy of this letter should be attached to any income and gift tax returns that are filed relating to these matters.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically set forth above, no opinion is expressed concerning the Federal tax consequences of the facts described above under the cited provisions or 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.

Sincerely,
George Masnik
Chief, Branch 4
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure
Copy for 6110 purposes