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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:2 - PLR-144083-02
Date:
March 4, 2003

Trust =

Donor =

A =

B =

C =

D =

D1 =

D2 =

Charity 1 =

Charity 2 =

Bank =

Dear :

This letter responds to the letter dated August 9, 2002, and subsequent correspondence, submitted on behalf of the Trust by its authorized representative, requesting certain rulings regarding the proposed termination of the Trust.

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The information submitted states that the Trust was created on D1 by the Donor, and was intended to qualify as a charitable remainder unitrust (CRUT) under § 664(d)(2) of the Internal Revenue Code. The current trustees of the Trust are Charity 1 and Bank (the Trustees). Donor was the initial beneficiary of the Trust, with a right to receive the unitrust amount as defined in the Trust for life. After the death of Donor, the unitrust amount is divided between two shares as defined in a formula provided in the Trust. The first share is payable to A for life, then to B for life, then to C for life, then to D for life. The second share is payable to C for life, then to D for life, then to A for life, then to B for life. However, all unitrust payments must terminate no later than the twentieth anniversary of the death of the Donor. Upon the earlier of the twentieth anniversary of the death of the Donor or the death of the last of A, B, C, and D, the Trust will terminate and the trust property will be distributed to Charity 1 and Charity 2, in the proportions set forth in the Trust.

The Donor retained a power under the Trust to terminate the interest of any of A, B, C, or D. The Donor died on D2. Donor's will included an exercise of the power resulting in the termination of the interests of C and D.

A, B, Bank, Charity 1 (both as a trustee and a remainder beneficiary) and Charity 2 have agreed that the Trust should be terminated. The Trustees propose to determine the actuarial value of the income interests of A and B and the remainder interests of Charity 1 and Charity 2 pursuant to § 7520 and distribute Trust assets equal to such values to the beneficiaries at the termination of the Trust.

The distributions will be made in lump sums equal to the respective value of the beneficiaries' interest as of the date of termination. The values will 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 CRUTs. Any distribution of assets in kind will be made in a pro-rata manner. The termination procedure will comply with applicable state law, which is represented as permitting early termination of a charitable trust upon the petition of the trustee of such trust with the appropriate state court. The Trustees represent that the termination will be made only upon such petition to the appropriate court by the Trustees and pursuant to an order of such court approving such termination.

A's physician is represented as being a specialist in neurology, has been practicing medicine for twenty-seven years, and has been A's physician for eight years. The physician has recently conducted a physical examination of A and has signed an affidavit, under penalties of perjury, that to the best of the physician's knowledge and belief, A has no medical condition that is expected to result in a shorter longevity than that set forth in the regulations for a person of A's age.

B's physician is represented as being a specialist in obstetrics and gynecology, has been practicing medicine for eight years, and has been B's physician for one year. The physician has recently conducted a physical examination of B and has signed an affidavit, under penalties of perjury, that to the best of the physician's knowledge and

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belief, B has no medical condition that is expected to result in a shorter longevity than that set forth in the regulations for a person of B's age.

A and B have also signed affidavits, under penalties of perjury, that to the best of their knowledge and belief, they have no medical conditions that are expected to result in a shorter longevity than that set forth in the regulations for persons of their ages.

Section 61(a)(3) of the Code provides that gross income includes gains derived from dealings in property.

Section 507(a) provides that, except as provided in § 507(b), a private foundation may terminate its private foundation status only under the specific rules set forth in § 507(a).

Section 507(c) provides for the imposition of a termination tax on certain private foundation terminations described in § 507(a).

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, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

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, the 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 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 by the amount of gain or decreased by the amount of loss recognized to the grantor on such transfer.

Section 4941(a)(1) imposes an excise tax on each act of self-dealing between a disqualified person and a private foundation.

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

Section 4946(a) provides that the term “disqualified person” with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), a family member of a substantial contributor (including children), and foundation manager (including a trustee).

Section 4946(a)(1)(D), together with § 4946(d), defines the term “disqualified person” to include a spouse of a substantial contributor, among others.

Section 4947(a)(2) provides generally that split-interest trusts are subject to the provisions of §§ 507, 4941, and 4945 in the same manner as if such trusts were private foundations, but, under § 4947(a)(2)(A), not with respect to any amounts payable under the terms of such trusts to income beneficiaries, unless a deduction was allowed under § 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

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 that 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 §§ 1016 and 1017 on 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 interests 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).

Section 53.4947-1(c)(2)(i) of the Foundation and Similar Excise Taxes Regulations provides that under § 4947(a)(2)(A), § 4941 does not apply to any amounts payable under the terms of a split-interest trust to income beneficiaries unless

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a deduction was allowed under § 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B) with respect to the income interest of such beneficiary.

Section 53.4947-1(e) provides that § 507(a) does not apply to payments to an income beneficiary of a trust that are considered “payable under the terms of such trust” and “directed by the terms of the governing instrument of the trust and not discretionary with the trustee.”

Rev. Rul. 72-243, 1972-1 C.B. 233, provides that the 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.

As a CRUT under § 664(d)(2), the Trust is a split-interest trust described in § 4947(a)(2) and, therefore, subject to § 4941, which imposes an excise tax on acts of self-dealing. A and B are disqualified persons with respect to the Trust, under § 4946, because they are members of the family of the substantial contributor. Because the Trust is a split-interest trust, it is treated as a private foundation under § 4947(a).

A critical question is whether early termination may be expected to result in a greater allocation of the Trust’s assets to the income beneficiaries, to the detriment of the charitable beneficiaries, than a non-early termination. The Trust’s proposed allocation method is reasonable if the income beneficiaries have no knowledge of medical conditions or other circumstances likely to result in a shorter life expectancy than that predicted by the actuarial tables. Otherwise, an early termination would tend to deprive the charitable beneficiaries of their benefit and would be inconsistent with the charitable deduction allowed to the donor of the Trust.

We conclude that the proposed termination of the Trust will not constitute a direct or indirect act of self-dealing within the meaning of § 4941 because of all of the following circumstances: state law allows the early termination; all beneficiaries favor the early termination; the Trustees will use the regulations’ formula for determining the present values of the income and remainder interests in a charitable remainder trust; the income beneficiaries’ physicians have conducted examinations of the income beneficiaries and stated under penalty of perjury that they find no medical conditions expected to result in shorter-than-average longevity (under § 1.72-9); the income beneficiaries have signed similar statements; and any distribution of assets in kind will be made in a pro-rata manner.

Section 507(c) provides for the imposition of a termination tax on certain private foundation terminations described in § 507(a). Section 507(a) does not apply, however, to payments to an income beneficiary of a trust that are considered “payable under the terms of such trust” and “directed by the terms of the governing instrument of the trust and not discretionary with the trustee.” See § 53.4947-1(e). As discussed above, the payments to the income beneficiaries as the result of the proposed termination should be viewed as payable under the terms of the Trust. In addition, the proposed early

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termination will not result in a greater allocation of the Trust assets to the income beneficiaries, to the detriment of the charitable remainder beneficiaries, than a non-early termination and is not discretionary with the Trustees. The proposed allocation method is reasonable because the income beneficiaries and their physicians have no knowledge of medical conditions or other circumstances likely to result in shorter life expectancies than those predicted by the actuarial tables. Therefore, we additionally conclude that the Trust is permitted to terminate early without resulting in the imposition of termination tax under § 507(c).

We further conclude as follows: the life income beneficiaries are selling their interests in the Trust to the remaindermen. Provided that the money and other property received by the life income beneficiaries are distributed to them in accordance with their interests in the Trust, the amount the life interest beneficiaries will realize from the sale of their interests in the Trust will be the amount of money and the fair market value of the property received by them.

Pursuant to § 1001(e)(1), the portion of the adjusted uniform basis assigned to the life income beneficiaries' interests in the Trust is disregarded. The exception contained in § 1001(e)(3) is not applicable because the entire interest in the Trust's assets is not being sold, or otherwise disposed of, to a third party. Accordingly, for purposes of this proposed transaction, the life income beneficiaries have no bases in their interests in the Trust. Therefore, the amount of gain the life beneficiaries must recognize under § 1001(c) is the amount they realize from the disposition of their interests in the Trust. The gain realized by the life income beneficiaries from the disposition of their interests in the Trust will be long-term capital gain.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the proposed transaction. In particular, we express no opinion as to whether the Trust meets the definition of a CRUT under § 664(d)(2).

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

Pursuant to a power of attorney on file with this office, copies of this letter are being forwarded to the Trust's authorized representatives.

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

Enclosures: 2

Copy of this letter

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