

The information submitted states that X established Trust under the laws of State on D1. Trust is a charitable remainder unitrust (CRUT) within the meaning of §664(d)(2) of the Internal Revenue Code. Under Trust instrument, X receives a unitrust amount equal to 10 percent of the net fair market value of Trust's assets valued as of the first day of each taxable year in quarterly installments. Trustees are the current trustees of Trust. The term of Trust is for twenty years commencing on D1. Upon termination, all Trust assets are to be distributed to Foundation. Foundation is exempt from federal income tax under section 501(c)(3) and is not a private foundation under § 509(a) pursuant to §§ 509(a)(1) and § 170(b)(1)(A)(vi).

Trustees filed a petition with Court of State seeking court approval for Trust's early termination. The Attorney General of State stated that it had no objections to Trust's termination. Upon the termination of Trust, Trustee is to distribute to X the actuarial value of its 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. The balance of the Trust estate will be distributed to Foundation as the charitable remainder beneficiary.

Section 507 provides for a tax imposed under section 507(c) on the termination of an entity's status as a private foundation under section 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.

Section 4947(a)(2) provides 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 of the 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 tax on taxable expenditures) shall apply as if such trust were a private foundation.

Section 53.4947-1(e)(1) of the Foundations and Similar Excise Taxes Regulations provides that the provisions of § 507(a) shall not apply to a trust described in § 4947(a)(1) or (2) by reason of any payment to a beneficiary that is directed by the terms of the governing instrument of the trust 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) provides examples of the application of § 53.4947-1(e)(1). Example (3) provides that a § 4947(a)(2) trust's payment to its charitable organization remainder beneficiary upon the trust's termination will not be considered a termination of the trust's private foundation status within the meaning of § 507(a). Under the example, the payment of cash and/or stock in order to cease the annuity liability pursuant to the trust terms does not constitute a termination under § 507(a).

Trust, in accordance with the terms of the trust document, is required to make mandatory payments to X and it has fulfilled this obligation to date. The decision by all parties to have an early termination of Trust and distribute the trust property does not render the payment any less mandatory nor does it make this action discretionary with the trustee. Section 53.4947-1(e)(2), Example 3, of the regulations further supports the general rule that the payout of the charitable obligation does not constitute a § 507(a) transaction. Lastly, the Attorney General of State stated it had no objections to Trust's early termination. Accordingly, the proposed early termination of Trust and the distribution of its property to X and Foundation will not constitute a termination of a private foundation under § 507.

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

Section 4947(a)(2)(A) provides that § 4947(a)(2) does not apply to any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under §§ 170(f)(2)(B), 2055(e)(2)(B), or 2522(c)(2)(B).

Section 53.4946-1(a)(8) provides that for purposes of self-dealing under § 4941, an exempt organization is not a disqualified person.

The proposed early termination of Trust and the distribution of Trust's property to X and Foundation will not be an act of self-dealing under § 4941. This is because Foundation is not a disqualified person. Therefore, the early termination payments made by Trust to X and Foundation will not constitute an act or acts of self-dealing under § 4941.

Section 4945(a)(1) imposes a tax on a private foundation's making any taxable expenditure as defined in § 4945(d).

Section 4945(d) defines the term "taxable expenditure" as any amount paid or incurred by a private foundation-(1) to carry on propaganda, or otherwise to attempt, to influence legislation, within the meaning of subsection (e), (2) except as provided in subsection (f), to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive, (3) as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of subsection (g), (4) as a grant to an organization unless-(A) such organization is described in paragraph (1), (2), or (3) of § 509(a) or is an exempt operating foundation (as defined in § 4940(d)(2), or (B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h), or for any purpose other than one specified in §170(c)(2)(B).

Section 53.4945-6(a) defines the term "taxable expenditure," as used under § 4945(d)(5), to include any amount paid or incurred by a private foundation for any purpose other than one specified in § 170(c)(2)(B). Thus, ordinarily, only an expenditure for an activity which, if it were a substantial part of the organization's total activities, would cause loss of tax exemption, is a taxable expenditure under § 4945(d)(5).

Section 53.4945-6(b)(1)(v) provides that any payment which constitutes a qualifying distribution under § 4942(g) or an allowable deduction under § 4940 ordinarily will not be treated as a taxable expenditure under § 4945(d)(5).

Trust's expenditure to a charitable organization as required under its trust instrument is in furtherance of a § 170(c)(2)(B) purpose in fulfillment of its charitable requirement as provided for in its governing instrument. Therefore, there is no taxable expenditure under § 4945(d)(5) relating to the proposed transaction.

Section 1015(b) provides that if property is acquired 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 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), the "term interest in property" includes a term 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.

Although the proposed transaction takes the form of a distribution of the present values of the respective interests of X and Foundation, in substance it is a sale of X's interest to Foundation, the remainder interest holder. The amount received by X as a result of the termination of Trust is an amount received from the sale or exchange of a capital asset. Because X's basis in the unitrust income interest is a portion of the entire basis of the property under §1015(b), and because the disposition of X's interest is not part of a transaction in which the entire interest in Trust is transferred to a third party, X's adjusted basis in X's interest is disregarded under §1001(e). X's holding period in the interest exceeds one year. Accordingly, under §1222(3) the entire amount realized by X as a result of the early termination of Trust will be long-term capital gain.

Accordingly, subject to Court approval of the early termination of Trust, we conclude that the proposed early termination of Trust and the distribution of Trust's property to X and Foundation in proportion to the present value of their respective interests will not constitute a termination of a private foundation under § 507. Additionally, the proposed early termination of Trust and the distribution of the Trust's property to X and Foundation in proportion to the present value of their respective interests will not be an act of self-dealing under § 4941. Further, the proposed early termination of Trust and the distribution of Trust's property to X and Foundation in proportion to the present value of their respective interests will not be a taxable expenditure under § 4945. Finally, we also conclude that the entire amount realized by X 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 fact described above under any other provision of the Code.

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Trustees and X.

Sincerely,
J. Thomas Hines
Chief, Branch 2
Office of Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosures (2)

cc: