



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

A =
B =
C =
D =
E =
F =
G =
H =
I =
J =
K =
L =

Dear :

We have considered your ruling request dated June 7, 2005, as to the proper treatment of the termination of C and whether termination constitutes an act of self-dealing under section 4941 of the Internal Revenue Code.

A and B established C as a charitable remainder unitrust described in section 664(d)(3) of the Code, and a split interest trust under section 4947(a)(2). The trust agreement provides that the annual "unitrust amount" that A and B receive shall equal the smaller of: (a) the trust income for any taxable year as defined in section 643(b) of the Code; and (b) a "fixed percentage" of 10 percent of the net fair market value of the trust assets. In addition, the unitrust provides that A and B are to receive any amount of trust income for such year that is in excess of 10 percent, but only to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as the fixed percentage of the net fair market value of the trust assets on the relevant valuation dates (the "net income make-up feature"). The trust as written would terminate when both A and B shall have died.

A and B serve as trustees of C. A and B are the sole non-charitable income beneficiaries of C. The charitable remaindermen of C are: E, F, G, H, I, J, K, and L. E through L are all organizations described in section 501(c)(3) of the Code, and are publicly supported organizations under section 509(a).

A and B wish to terminate C by in effect selling their income interest in C to the charitable remaindermen, E through L, for an amount equal to the present value of A and B's life income interest in C. In the initial ruling request it was stated that the values of the beneficiaries' interests in the trust will be determined using the discount rate in effect under Code section 7520 on the date of termination and using the methodology under Treasury Regulation 1.664-4 for valuing interests in charitable remainder trusts.

The law of state D permits early termination of the trust, provided there is agreement among the trustees and beneficiaries. By an Agreement dated October 11, , the trustees, income beneficiaries, and charitable beneficiaries have agreed to the termination of C. The Attorney General of D has formally approved the proposed early termination of C.

A's date of birth is June 28, and B's date of birth is August 31, . They are aware of no physical condition that would decrease their normal life expectancies. With the June 7, 2005, ruling request, A and B submitted statements from their personal physician confirming that he had examined A and B and that there was no indication that A or B's life expectancy was less than would otherwise be expected for persons of their respective ages.

In a letter dated December 27, 2006, on behalf of A and B, individually and as trustees, C agreed with the special valuation factor proposed by the Internal Revenue Service.

RULINGS REQUESTED

A and B have requested the following rulings:

- (1) Early termination of C will not constitute an act of self-dealing under section 4941(a)(1) of the Code by A or B as trustees or as donors with respect to C.
- (2) The proposed termination of C will not be subject to a termination tax under section 507 of the Code.

LAW

Section 507(c) of the Code imposes a tax on a private foundation under certain circumstances.

Section 664 of the Code exempts from income tax charitable remainder unitrusts, which it defines as those from which a fixed percentage of the net fair market value of its assets is paid to at least one person not an organization described in section 170(c) for a term of years, after which the remainder interest is transferred to an organization described in section 170(c).

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

Section 4941(d)(1) of the Code defines self-dealing as including any direct or indirect:

- (A) sale or exchange, or leasing of property between a private foundation and a disqualified person, or
- (E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) of the Code provides that for purposes of this subchapter, the term "disqualified person" means, with respect to a private foundation, a person who is—

- (A) a substantial contributor to the foundation,
- (E) a foundation manager (within the meaning of section (b)(1)).

Section 4946(a)(2) of the Code provides that for purposes of paragraph (1), the term "substantial contributor" means a person who is described in section 507(d)(2).

Section 4946(b) of the Code provides that for purposes of this subchapter, the term "foundation manager" means, with respect to any private foundation:

- (1) an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation, and
- (2) with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

Section 4947(a)(2) of the Code provides, in pertinent part, that in the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests of which are devoted to charitable purposes, and which has amounts in trust for which a charitable deduction was allowed, sections 507 and 4941 apply as if such trust were a private foundation.

Section 4947(a)(2)(A) of the Code provides that section 4947(a)(2) shall not apply with respect to any amounts payable under the terms of such trust to non-charitable income beneficiaries..

Section 53.4947-1(c)(2)(ii) of the Foundation and Similar Excise Taxes Regulations provides, in essence, that payments of income by a charitable remainder unitrust to its individual income beneficiaries do not result in any tax on self-dealing under section 4947.

Section 1.7520-3(b)(1)(ii) of the Federal Income Tax Regulations provides that the standard 7520 annuity, life estate, or remainder factor may not be used to value a restricted beneficial interest. However, a special factor may be used to value a restricted beneficial interest in some circumstances. Section 1.7520-3(b)(1)(i)(C) provides that the standard factor for an ordinary remainder interest represents the present worth of the right to receive \$1.00 at the end of a defined period. Section 1-7520-3(b)(1)(i)(B) provides that the standard factor for an ordinary life estate interest represents the right to receive the use of \$1.00 for a defined period.

ANALYSIS

C is a split-interest trust described in sections 4947(a)(2). By being described in section 4947(a)(2), C is subject to the provisions of sections 507, 4941, and 4945, as if it were a private foundation. The income beneficiaries, A, and B, are disqualified persons with respect to C within the meaning of section 4946(a)(1)(A) by virtue of being settlors of C.

In this case, the charitable remainder beneficiaries are public charities so for purposes of section 4941 and 4946, the income beneficiaries are not disqualified persons with respect to the charitable remainder beneficiaries.

Section 4941 applies to certain transactions between private foundations and disqualified persons. By early termination, C will distribute lump sums to the income beneficiaries, A and B, and Charitable Remaindermen, equal to the actuarial value of their respective interests in C (taking into account the net-income provisions of the trust), and the distributions are also treated as a constructive sale or exchange between A and B and the Charitable Remaindermen of the trust. See Rev. Rul. 69-486.

Generally payments to the income beneficiary, A and B, from C, would constitute self-dealing. However, because the distribution to the income beneficiaries equals the actuarial value of the income interest, taking into account the net-income provisions of the trust, the exception to self-dealing provided by section 53.4947-1(c)(2)(i) of the regulations applies and the distribution will not be an act of self-dealing. Furthermore, because the Charitable Remaindermen are public charities, section 4941 does not apply to the transaction between A and B and the Charitable Remaindermen.

The appropriate calculation of the actuarial value of the income interest of A and B, taking into account the net-income provisions of the trust, requires the use of a reasonable method for the calculation which does not inappropriately inflate the income beneficiaries' interest to the detriment of the Charitable Remaindermen.

One reasonable method to calculate the actuarial value of the income and remainder interests is the following:

The computation of the remainder interest is found using a special factor as indicated in section 1.7520-3(b)(1)(ii) of the regulations. The special remainder factor is found by using the methodology stated in section 1.664-4 for computing the factor for a remainder interest in a unitrust, with the following modification: where section 1.664-4(a)(3) of the regulations provides an assumption that the trust's stated payout percentage is to be paid out each year, instead the assumed payout shall be that of a fixed percentage which is equal to the lesser of the trust's stated payout percentage or the section 7520 rate for the month of termination. The special factor for the non-charitable payout interest is 1 minus the special remainder factor.

Based on this methodology, the calculation of A and B's income interest in C may be demonstrated by the following example:

The section 7520 rate for December 2006 is 5.8 percent. Assuming the termination occurs in December 2006, the lesser of this rate and the trust's state payout percentage is 5.8 percent. The ages (at nearest birthday) of the payout recipients, until December 28, 2006, are 57 and 70.

Assuming a termination before December 28, 2006, and based on Table 90CM, interest at 5.8 percent, an unadjusted payout rate of 5.8 percent, and quarterly payments made at the end of each quarter, the present value of the remainder interest in a unitrust which falls in at the death of the last to die of two persons aged 57 and 70 is \$0.26620 for each \$1.00 of the trust estate. The present value of the payout interest in the same unitrust until such death is \$1.00 minus \$0.26620 or \$0.73380 for each \$1.00 of the trust estate.

In this case, the income beneficiaries are not expected to receive more than they would during the full term of the trust under the above-described methodology for valuing their interest in a charitable remainder trust with a net income make-up feature. Further, state law provides for early termination under the facts presented.

In addition, A and B's personal physician has conducted a physical examination and has stated that he finds no medical condition expected to result in a shorter-than-average longevity (under section 1.72-9 of the Regulations); and A and B have signed similar statements under penalties of perjury.

Furthermore, because the effect of the transaction is to vest the income interest and remainder interest in the remainder beneficiary, the trust no longer will be a split-interest trust and section 4947(a)(2) will no longer apply and section 507 will not apply.

CONCLUSIONS

Therefore, we rule that:

- (1) Early termination of C will not constitute an act of self-dealing under section 4941(a)(1) of the Code by A and B as trustees or as donors with respect to C using the methodology described herein for the date of termination.
- (2) The proposed termination of C will not be subject to a termination tax under section 507 of the Code

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. Also, we express no opinion as to the tax consequences of the transactions under other provisions of the Code.

Pursuant to Power of Attorney on file in this office, a copy of this letter is being sent to A and B's authorized representative. A copy of this letter should be kept in A and B's permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter. You should keep a copy in your permanent records.

Sincerely

Theodore R. Lieber
Acting Manager, Exempt Organizations
Technical Group 2

Enclosure: Notice 437