Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200304025**
Release Date: 01/24/2003
Index Number: 507.00-00; 664.00-00; 4941.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:02 PLR-108126-02
Date:
October 23, 2002

Legend

H =

W =

Trust =

Foundation =

Trust 2 =

Trust 3 =

State =

D1 =

D2 =

Dear :

This letter responds to your letter dated January 21, 2002, and subsequent correspondence, submitted on behalf of Trust, requesting rulings concerning the partition of Trust, a charitable remainder unitrust, into two separate trusts.

The Trust was formed on D1 under the laws of State, and was a charitable remainder unitrust under § 664 of the Internal Revenue Code, providing a distribution to H and W, or the survivor, of a unitrust amount equal to the lesser of trust income or five percent of the beginning of the year value of the Trust assets. The unitrust amount for any year also includes any amount of trust income for any year that is in excess of the amount required to be distributed to the extent the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as five percent of the net fair market value of the assets. At the time of the death of both beneficiaries, the remaining Trust assets were to be distributed to the Foundation. The Foundation is exempt from federal income tax under § 501(c)(3) and is classified as a private foundation.

On D2, Trust was partitioned into two separate trusts, Trust 2 and Trust 3, each containing the same provisions as Trust. Each investment held in Trust was divided equally between Trust 2 and Trust 3. At the time of the partition, there was no deficiency to be made up with respect to the net income make-up provisions of Trust.

Trust 3 represents that upon the partition of Trust into two trusts, and upon the distributions by Trust to Trust 2 and Trust 3, any in-kind transfers of Trust assets to Trust 2 and Trust 3 fairly represented the basis and values of the assets held at the time of such transfer.

H and W propose to convey their unitrust interests in Trust 3 to the Foundation, the remainder beneficiary, at which time Trust 3 will terminate. In consideration for their unitrust interests in Trust 3, H and W will receive a lump sum distribution from Trust 3 equal to the present value of their unitrust interests effective on the date of termination determined by using the discount rate in effect under § 7520 on the date of termination, and by using the methodology under § 1.664-4 of the regulations for valuing interests in charitable remainder trusts. Trust 3 represents that when the Foundation holds both the unitrust and the remainder interests of Trust 3, Trust 3 will terminate under the State doctrine of termination by merger.

Trust 3 represents that the law of State allows the early termination of Trust 3. H and W, as income beneficiaries of Trust 3, and the Foundation together with the Office of the Attorney General for State, on behalf of the remainder beneficiary, received approval of the State court for the proposed transaction.

H and W have signed an affidavit under penalties of perjury that they are aware of no medical condition expected to result in a shorter-than-average longevity.

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(b)(2) provides that in the case of the transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 664 (d)(2) provides that for purposes of § 664, a charitable remainder unitrust is a trust -- (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in §170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals, (B) from which no amount other than the payments described in § 664(d)(2)(A) and other than qualified gratuitous transfers described in § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in § 170(c), (C) following the termination of the payments described in § 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employer securities (as defined in § 664(g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in § 4975(e)(7)) in a qualified gratuitous transfer (as defined in § 664(g)), and (D) with respect to each contribution of property to the trust, the value (determined under § 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

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

Section 4941(d)(1)(E) provides that the term “self-dealing” means any direct or indirect 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) 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 a foundation manager (including a trustee).

Section 4946(a)(1)(D), together with § 4946(d), define 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 trust to income beneficiaries, unless a deduction was allowable under

§§ 170(f)(2)(B), 2055(e)(2)(B), or 2522(e)(2)(B).

Section 1.507-1(b)(6) of the Income Tax Regulations provides, in part, that if a private foundation transfers all or part of its assets to one or more other private foundations pursuant to a transfer described in § 507(b)(2), such transfer foundation will not have terminated its private foundation status under § 507(a)(1).

Section 1.507-3(c)(1) provides, in part, that as used in § 507(b)(2) of the Code, the term “other adjustment, organization or reorganization” shall include any partial liquidation or any other significant disposition of assets to one or more private foundations.

Section 1.507-3(c)(2)(ii) provides that the term “significant disposition of assets” means the transfer of 25 percent or more of the net assets of the foundation at the beginning of the year, which disposition may be made in a single year or in a series of related dispositions over more than one year.

Section 1.507-4(b) provides that private foundations which make transfers described in §§ 507(b)(1)(A) or (2) are not subject to the tax imposed under § 507(c) with respect to such transfers.

Section 1.664-3(a)(3)(ii) provides that a trust is not a charitable remainder unitrust if any person has the power to alter the amount to be paid to any named person other than an organization described in § 170(c) if such power would cause any person to be treated as the owner of the trust, or any portion thereof, if subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code were applicable to such trust.

Section 1.664-3(a)(4) provides, in part, that the trust may not be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than an organization described in § 170(c). Notwithstanding the preceding sentence, the grantor may retain the power exercisable only by will to revoke or terminate the interest of any recipient other than an organization described in § 170(c).

Section 53.4947-1(c)(2)(i) of the Foundation and Similar Excise Tax Regulations (“foundation regulations”) provides that under § 4947(a)(2)(A) of the Code, § 4941 does not apply to any amounts payable under the terms of a split-interest trust to income beneficiaries unless a deduction was allowed under § 170(f)(2)(B), or § 2522(e)(2)(B) with respect to the income interest of any such beneficiary.

In the present case, Trust 2, and Trust 3 contain the same provisions and beneficiaries as Trust, and the investments once held by Trust are equally divided between Trust 2 and Trust 3. Therefore, the unitrust and remainder beneficiaries are entitled to the same benefits immediately after the partition as before.

As a charitable remainder unitrust, 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. Although split-interest trusts are not § 501(c)(3) or § 4947(a)(1) private foundations that are exclusively charitable, they are subject to § 507 termination rules that are appropriate. Section 4947(a)(2) subjects split-interest trusts to the provisions of § 507. Section 507(b)(2) is applicable to the division of Trust. Since Trust transferred all of its net assets to Trust 2 and Trust 3, under § 1.507(b)(6) of the regulations, Trust will not have terminated its private foundation status under § 507(a)(1). Accordingly, the excise tax imposed under § 507(c) is not applicable to it.

H and W are disqualified persons with respect to Trust 3, under § 4946, because they are substantial contributors to Trust 3. Because Trust is a split-interest trust, it is treated as a private foundation under § 4947(a)(2).

The only interest that H and W had in Trust was the payment of the unitrust amount under the provisions of § 664(d)(2). Upon the division of Trust, and before the proposed distribution of Trust 3's assets, they are receiving the same unitrust payments as before, except that the payment is derived from two trusts, instead of one. Thus, prior to Trust 3's termination, they are likely to receive more or less the same unitrust payment as before. However, it makes no difference for purposes of § 4941 whether either one or both is receiving more or less of a unitrust payment after the division of Trust assets. Section 53.4947-1(c)(2)(i) of the foundation regulations provides, in substance, that the amounts payable under charitable remainder split-interest trusts to the income beneficiaries are not subject to § 4941 (or § 507 or § 4945). Thus, the disqualified persons are insulated from self-dealing as far as each of their income interests in Trust is concerned based on the fact that the unitrust payment is the same before and after the division of Trust. Since neither of the disqualified persons, H and W, receive any additional interest in the assets of the trust principal, no self-dealing transaction will occur withing the meaning of § 4941(d).

Regarding the proposed termination of Trust 3 after the transfer of assets to it by Trust, the critical question for self-dealing purposes is whether early termination may be expected to result in a greater allocation of Trust 3's assets to the income beneficiary, to the detriment of the charitable beneficiary, the Foundation, than a non-early termination. H and W's proposed allocation method is reasonable if the income beneficiary has no knowledge of a medical condition or other circumstance likely to result in a shorter life expectancy than that predicted by the actuarial tables. Otherwise, an early termination would tend to deprive the Foundation of its benefit and would be inconsistent with the charitable deduction allowed to H and W.

We conclude that the proposed termination of Trust 3, by the conveyance of H and W's unitrust interests to Foundation, 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; Trust

3 will use the regulations' formula for determining the present values of the income and remainder interest in a charitable remainder trust; and H and W have signed affidavits under penalties of perjury that they are aware of no medical condition expected to result in a shorter-than-average longevity.

Based solely on the representations made and the information submitted, we have reached the following conclusions:

1. The partition of Trust into Trust 2 and Trust 3 will not cause either Trust, Trust 2 or Trust 3 to fail to qualify as charitable remainder trusts under § 664.

2. Following the partition of Trust, the proposed conveyance of all of H and W's interest in Trust 3 to Foundation, followed by the termination of and distribution of all assets by Trust 3 to H, W, and the Foundation in proportion to the valuation, under the rules of § 7520 of the respective term and remainder interests, will not constitute a prohibited transaction within the meaning of § 4941 and § 4947.

3. Following the partition of Trust, the proposed termination and distribution of assets by Trust 3 will not constitute a termination of private foundation status within the meaning of § 507.

The above conclusions are based on the assumptions that the proposed termination of Trust 3 is not prohibited by State law; that the proposed termination will be made pursuant to a court order resulting from a proceeding to which the State attorney general is a party; and that the amounts distributed are determined and distributed pursuant to the valuation rules set forth in § 7520. In addition, we conclude that the conveyance of H and W's unitrust interests in Trust 3 to the Foundation is a sale or disposition within the meaning of §1001(a) and that H and W have zero basis in their unitrust interests in Trust 3. Therefore, the amount H and W will realize from the sale of their interest in Trust 3 is the amount of money and the fair market value of the property distributed to H and W by Trust 3.

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

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to Trust and to Trust's other authorized representative.

Sincerely yours,

J. THOMAS HINES
Chief, Branch 2
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes