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**Internal Revenue Service**

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B09
PLR-150543-03
Date:
March 15, 2005

Re: Private Letter Ruling

LEGEND

Taxpayer =
Trust =

Date 1 =
Date 2 =
$a =
State 1 =
Wife =
State 2 =
Year 1 =
Date 3 =
District Court =

Date 4 =
Family Foundation =

Dear :

This is in response to your letter of August 19, 2003, and subsequent correspondence, in which you requested rulings regarding the tax consequences of a proposed division of a charitable remainder unitrust (CRUT).

The facts submitted and representations made are summarized as follows: Taxpayer created Trust on or about Date 1. Taxpayer represents that Trust qualifies as a net-income with makeup charitable remainder unitrust (NIMCRUT) under the provisions of § 664(d)(2) of the Internal Revenue Code (Code). Taxpayer is the sole trustee and sole unitrust beneficiary of Trust. The remainder beneficiaries of Trust are

charitable organizations described in §§ 170(b)(1)(A), 170(c), 2055(a) and 2522(a) as shall be designated by Taxpayer.

Trust's assets consist primarily of stock, bonds, membership interests in limited liability companies and limited partnerships, and investments in real estate. Currently, Trust distributes to Taxpayer in quarterly installments a unitrust amount equal to the lesser of (i) the trust income for the taxable year, and (ii) ten percent of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust. The unitrust amount for any year also includes any amount of trust income for such year that is in excess of the amount required to be distributed under (ii), to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as ten percent of the net fair market value of the trust assets. As of Date 2, the value of Trust's assets was approximately $a.

At the time Trust was created, Taxpayer was a resident of State 1. Accordingly, Trust provides that State 1 law governs the interpretation of Trust. Taxpayer and Wife changed their residence to State 2 in Year 1. In Date 3, Taxpayer filed a petition with District Court requesting a transfer of the place of administration of Trust and the governing law of Trust to State 2. By order dated Date 4, District Court granted the petition subject to receipt of a favorable ruling from the Internal Revenue Service or a determination that a ruling was not necessary.

Taxpayer and Wife are the founders, trustees, and substantial contributors to Family Foundation. Family Foundation is a chartitable organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a).

Taxpayer proposes to make contributions of an undivided portion of his unitrust interest in Trust to Foundation. In order to accomplish this result, Taxpayer, in his individual capacity and as trustee of Trust, proposes the following transaction. First, Taxpayer, as trustee, will divide Trust into two separate trusts, Trust A and Trust B. The terms of Trust A and Trust B will be the same as the terms of Trust. Taxpayer, as trustee, will then allocate to Trust A and Trust B assets that are fairly representative of the aggregate adjusted bases of Trust's assets and their overall appreciation or depreciation. Trust A will consist of a certain percentage of the pre-division value of Trust. Trust B will consist of the remaining percentage of such value. Finally, Taxpayer will contribute his unitrust interest in Trust B to Family Foundation and designate Family Foundation as the remainder beneficiary of Trust B. Taxpayer represents that under State 2 law, the segregation of assets into Trust B, the contribution to Family Foundation of Taxpayer's unitrust interest in Trust B, and the designation of Family Foundation as the remainder beneficiary of Trust B, will result in a merger of the unitrust and remainder interests in Trust B.

Taxpayer, as trustee of Trust, proposes to amend Trust to make it clear that the trustee may divide Trust in the manner proposed and may make present

transfers of undivided interests in the corpus that coincide with the undivided interest in the unitrust interests that Taxpayer makes.

Taxpayer represents that he did not divide his interest in the property contributed to Trust in 1995 in order to avoid the partial interest rule of § 170(f)(3)(A).

You have requested the following rulings with regard to the proposed division of Trust:

1. Reformation and amendment of Trust to change the place of administration and governing law, and to add a provision specifically authorizing division of Trust into separate trusts and further authorizing transfers of property to charitable organizations during the term of the trust upon the occurrence of a merger or partial merger of the unitrust and remainder interests, will not affect Trust's status as a charitable remainder untirust within the meaning of § 664(d)(2).

2. For the year or years in which Taxpayer transfers an undivided portion of his unitrust interest to a charitable organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a), Taxpayer will be entitled to a charitable income tax deduction under § 170(a)(1) to the extent of the present value of the unitrust interest transferred as of the date of transfer, calculated as provided in §§ 664 and 7520 and § 25.2512-5 of the Gift Tax Regulations.

3. For the year or years in which Taxpayer transfers an undivided portion of his unitrust interest to a charitable organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a), Taxpayer will be entitled to a charitable gift tax deduction under § 2522(a) to the extent of the present value of the unitrust interest transferred as of the date of transfer, calculated as provided in §§ 664, 7520, and § 25.2512-5.

4. The division of Trust by Taxpayer, as trustee of Trust, into Trust A and Trust B and the inter vivos distribution to a qualifying charity of the entire corpus of Trust B corresponding to the undivided unitrust interest gifted by Taxpayer will not cause Trust A to cease to be a trust as described in § 664(d)(2).

5. If at the time of any transfers by Taxpayer of an undivided portion of his unitrust interest to a charitable organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a), Trust has realized capital gain income in prior years, which income was not included in the unitrust amounts paid to Taxpayer and therefore not recognized by Taxpayer, capital gain will not then be included in Taxpayer's income

by the reason of his transfer of a portion of his unitrust interest to a charitable organization.

6. Any gifts by Taxpayer and Trust to Family Foundation, provided that it is then recognized as a tax-exempt organization as described in § 501(c)(3) and as a private operating foundation as described in § 4942(j)(3), will not be treated as direct or indirect acts of self-dealing under § 4941.

RULINGS 1 and 4

Section 664(c) provides, generally, that a charitable remainder unitrust shall be exempt from federal income tax.

Section 664(d)(2) provides that 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 by § 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 1.664-3(a)(4) of the Income Tax Regulations provides that no amount other than the unitrust amount may be paid to or for the use of any person other than an organization described in § 170(c). However, the governing instrument may provide that any amount other than the unitrust amount shall be paid (or may be paid in the discretion of the trustee) to an organization described in § 170(c) provided that, in the case of distributions in kind, the adjusted basis of the property distributed is fairly representative of the adjusted basis of the property available for payment on the date of payment.

In this case, Taxpayer proposes to modify Trust to (i) change the place of administration of Trust to State 2, (ii) change the governing law of Trust to State 2, and

(iii) add a provision allowing the trustee to divide Trust and make present transfers from the trust to charitable organizations. Based on the facts presented and representations made, we conclude that the proposed modifications to Trust will not affect Trust's status as a charitable remainder untirust within the meaning of § 664(d)(2).

Following the modification of Trust, Taxpayer proposes to divide Trust into Trust A and Trust B. The terms of Trust A and Trust B would be the same as the terms of Trust. Taxpayer would then contribute to Family Foundation his unitrust interest in Trust B and designate Family Foundation as the remainder beneficiary of Trust B, thereby effectuating a merger of interests under State 2 law. Although this merger will cause a termination of Trust B, Trust A will continue to be in the form of and will continue to function as a charitable remainder unitrust within the meaning of § 664(d)(2). Thus, the division of Trust into Trust A and Trust B and the inter vivos distribution of the entire corpus of Trust B to Family Foundation will not cause Trust A to cease to function as a charitable remainder unitrust within the meaning of § 664(d)(2).

RULING 2

Section 170(a)(1) provides that there shall be allowed as a deduction any charitable contribution (as described in § 170(c)) payment of which is made within the taxable year.

Section 170(f)(3)(A) provides that a contribution (not made by a transfer in trust) of less than the taxpayer's entire interest in property is not allowed as a charitable contribution deduction except to the extent such contribution would have been allowed as a deduction had it been transferred in trust.

Section 170(f)(3)(B)(ii) provides that § 170(f)(3)(A) does not apply to a contribution of an undivided portion of the taxpayer's entire interest in property.

Sections 1.170A-6(a)(2) and 1.170A-7(a)(2)(i) provide that a deduction is allowed for a contribution of a partial interest in property if such interest is the taxpayer's entire interest in the property, such as an income interest or a remainder interest. If, however, the property in which such partial interest exists was divided in order to create such interest and thus avoid certain provisions of § 170(f), the deduction will not be allowed.

Rev. Rul. 86-60, 1986-1 C.B. 302, Situation 1, considered whether a donation qualifies for the charitable contribution deduction under § 170, if a taxpayer, A, who is the grantor and life beneficiary of a charitable remainder annuity trust (CRAT) donates A's annuity interest in the CRAT to the remainder beneficiary of the CRAT. In 1980, A had created a CRAT described in § 664(d)(1). A retained an annuity interest in the CRAT for life. Although A had previously divided the interest A held in the property, the division was not to avoid § 170(f)(2)(A). The reminder beneficiary was X, a charitable organization described in § 170(c). In 1984, A transferred the annuity interest in the CRAT to X. Rev Rul. 86-60 concludes, based on §§ 1.170A-6(a)(2)

and 1.170A-7(a)(2)(i) of the regulations, that the gift by A, the grantor, to the remainder beneficiary of A's retained life annuity in the CRAT qualifies for a charitable contribution deduction under § 170.

The present case is analogous to Situation 1 of Rev. Rul. 86-60. In the present case, Taxpayer retained a unitrust interest in Trust, which he created on or about Date 1. Now Taxpayer proposes to transfer a portion of his unitrust interest to Family Foundation, a charity described in §§ 170(b)(1)(A) and 170(c). Unlike the situation in Rev. Rul. 86-60, Trust will be divided into two trusts, Trust A and Trust B. Taxpayer proposes to contribute his unitrust interest in Trust B, which will be segregated from Trust, instead of all of his interest in Trust. Taxpayer represents that Family Foundation's unitrust and reminder interests will merge, and Family Foundation will be entitled to an immediate distribution of the Trust B corpus.

It is represented that Taxpayer did not divide his interest in the property originally transferred to the Trust to avoid the partial interest rules. Taxpayer now intends in effect to contribute an undivided portion of his entire current interest in the property to Family Foundation. Taxpayer intends to do this by dividing Trust into two trusts, then contributing his interest in Trust B to Family Foundation. Similar to taxpayer A in Rev. Rul. 86-60, Taxpayer would be entitled to a charitable contribution deduction for a contribution of an undivided portion of his unitrust interest in Trust to Family Foundation under the rule in § 170(f)(3)(B)(ii). That Taxpayer, as trustee, will divide Trust before making the contribution does not adversely affect the charitable contribution deduction. Therefore, Taxpayer's transfer of his interest in Trust B will qualify for a charitable contribution deduction under § 170.

The value of Taxpayer's contribution under § 170 will be the present value of the right to receive unitrust payments as provided in Trust B for a term starting on the date of the transfer of the unitrust interest to Family Foundation and ending on Taxpayer's date of death. The deduction will be subject to any applicable limitations under § 170, including § 170(b), and subject to any applicable limitations under other sections of the Code.

RULING 3

Section 2501(a)(1) imposes a tax, for each calendar year, on the transfer of property by gift by any individual, resident or nonresident.

Section 2511 provides that the tax imposed by section 2501 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.

Under § 2512(a), if a gift is made in property, the value of the property on the date of the gift is the amount of the gift. Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, the

amount by which the value of the property exceeds the value of the consideration received shall be deemed a gift.

Under § 25.2512-5(a) of the Gift Tax Regulations, the fair market value of an annuity or unitrust interest is its present value, determined in accordance with § 25.2512-5(d).

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) (a unitrust interest).

Under § 25.2522(c)-3(d)(2)(v), the present value of a unitrust interest is determined by subtracting the present value of all interests in the transferred property other than the unitrust interest from the fair market value of the transferred property. Under § 25.2522(c)-3(d)(2)(ii), the present value of a remainder interest in a charitable remainder unitrust is to be determined under § 1.664-4.

Situation 1 of Rev. Rul. 86-60 considers a situation where A, in 1980, creates a charitable remainder annuity trust pursuant to which A retained the right to receive an annuity interest for life. On A's death, the trust corpus is to pass to charity. In 1984, A transfers A's entire annuity interest to the charitable remainder beneficiary. Following the transfer, A did not retain any interest in the trust, and neither at that time nor at any prior time did A make a transfer of trust property for private purposes. Although the transfer of the remainder interest to charity divided A's prior interest, that transfer was for charitable, not private purposes. Consequently, A's transfer of the annuity interest to charity was not required to be in a form described in §§ 2522(c)(2)(B) and § 25.2522(c)-3(c)(2) in order to qualify for the charitable deduction. Accordingly, A's transfer of the annuity interest to charity qualifies for a deduction under § 2522(a).

The facts in this case are similar to those described in Situation 1 of Rev. Rul. 86-60, except that Taxpayer intends to divide Trust into Trust A and Trust B. Following the division of Trust, Taxpayer will transfer his entire unitrust interest in Trust B to Family Foundation and will name Family Foundation as the remainder beneficiary of Trust B, thereby effectuating a merger of interests under state law. After the transfer, Taxpayer will not retain any interest in Trust B. Further, Taxpayer has not made a transfer for private purposes either before or at the time of his unitrust interest in Trust B to Family Foundation.

Based on the foregoing, we conclude that for the year in which Taxpayer transfers the entire balance of his unitrust interest in Trust B to Family Foundation, Taxpayer will be entitled to a gift tax charitable deduction under § 2522(a) to the extent of the present value of the unitrust interest transferred as of the date of transfer.

RULING 5

Based solely on the facts and the representations submitted, we conclude that no amounts should be included in Taxpayer's gross income by reason of the prior capital gains realized by Trust, in connection with Taxpayer's charitable contribution of a portion of his unitrust interest. The above conclusion is based on the fact that at the time Trust is divided the assets allocated to Trust A and Trust B must be fairly representative of the aggregate adjusted bases of the Trust assets and that the division of the assets between Trust A and Trust B must be on a pro rata basis with respect to each major class of investments held at the date of the division, and within each class, must be fairly representative of the overall appreciation or depreciation of the assets therein.

RULING 6

Section 4941 imposes excise tax on any act of self-dealing between a private foundation and any of its disqualified persons defined in § 4946.

Section 4941(d)(1)(E) provides that an act of self-dealing includes any transfer to, or use by or for the benefit of, a disqualified person, of any of the income or assets of a private foundation. However, § 4941 does not prohibit a disqualified person's cash or donations going for no consideration to such person's private foundation.

Section 53.4941(d)-2(f)(2) of the Foundation and Similar Excise Tax Regulations provides that an incidental or tenuous benefit to a disqualified person does not constitute an act of self-dealing.

Section 4947(a)(2) describes split-interest trusts as those that are not exempt from federal income tax under § 501(a), not all of the unexpired interests in which are devoted to purposes in § 107(c)(2)(B), and which have 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. Section 4947(a)(2) provides that the term “disqualified person” does not include any organization that is described in § 501(c)(3), other than an organization described in § 509(a)(4).

As a charitable remainder unitrust under § 664(d)(2), Trust is a split-interest trust described in section § 4947(a)(2) and is, therefore, subject to § 4941, which imposes an excise tax on acts of self-dealing. Taxpayer and Wife are disqualified persons with respect to Trust because they are the creators or, and are substantial contributors to Trust.

Section 53.4946-1(a)(8) states that an organization described in § 501(c)(3) is not a disqualified person with respect to another entity that is or is treated as a private foundation, unless it is an organization described in § 509(a)(4). The division of the Trust and the transfer of assets to Family Foundation will not constitute an act of self-dealing. The proposed transaction will not adversely affect the interest of any charitable beneficiary and will instead accelerate the benefit by providing operating funds at an earlier date than under the current terms of Trust.

Accordingly, we rule that any gifts by Taxpayer and Trust to Family Foundation, provided that Family Foundation is then recognized as a tax-exempt organization as described in § 501(c)(3) and as a private operating foundation as described in § 4942(j)(3), will not be treated as direct or indirect acts of self-dealing under § 4941 and the regulations thereunder.

The above conclusion is based on the assumption that the proposed transaction is not prohibited by state law, and that the proposed transaction will be made pursuant to a court order resulting from a proceeding of which the state attorney general has been given notice.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we do not express or imply an opinion regarding whether Trust otherwise qualifies as a CRUT under § 664(d)(2). In addition, we express no opinion as to the method of determining the present value of the unitrust interest in Trust B for purposes of calculating the amount of the income and gift tax charitable deductions under § 170(c) or 2522(a).

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 your authorized representative.

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 an 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.

Sincerely,

Melissa C. Liquerman
Branch Chief, Branch 9
(Passthroughs & Special Industries)

Enclosures
Copy for 6110 purposes

cc: