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LEGEND

Trust 1 =
Trust 2 =
Grantors =
Charity 1 =
Charity 2 =
State =
$ x =
D1 =
D2 =
D3 =
a =
b =
c =

Dear :

This ruling is in response to your letter dated November 21, 2005. In your letter, you requested rulings that: (1) the amount realized as a result of the early terminations of Trust 1 and Trust 2 will be considered long-term capital gain; (2) the early terminations of Trust 1 and Trust 2 will not result in the imposition of a termination tax under § 507 of the Internal Revenue Code; and (3) the early terminations of Trust 1 and Trust 2 will not be considered self-dealing under § 4941 and result in the levy of an excise tax against the Grantors or Charity 1.

FACTS

Trust 1 and Trust 2 are charitable remainder unitrusts within the meaning of § 664(d)(2). Grantors, husband and wife, are the sole contributors of trust property and are the sole income beneficiaries. The Grantors established Trust 1 on D1, and Trust 2 on D2. Charity 1 is the trustee and charitable remainder beneficiary of Trust 1 and Trust 2. Charity 1 is an organization described in § 501(c)(3) and is classified as a public charity described in § 509(a)(1) and § 170(b)(1)(A)(vi). The information submitted states that the operations of Trust 1 and Trust 2 are governed by the laws of State.

Trust 1 directs Charity 1, as trustee of Trust 1, to pay Grantors a unitrust amount of a percent of the net fair market value of Trust 1's assets valued as of the first day of each taxable year. Upon the death of Grantors, Trust 1 will terminate and Charity 1 is required to distribute the greater of (i) the amount of money which bears the same ratio of the balance of Trust 1 upon the death of the survivor of Grantors as the sum of $ x had to the balance of Trust 1 on D3, or (ii) the total balance of Trust 1 upon the death of the survivor of Grantors less any amounts or percentages which either Grantor designated to be paid to other charities that qualify under § 501(c)(3) to Charity 1. Grantors and Charity 1 have agreed to terminate Trust 1. Notwithstanding the Trust 1 provisions governing distributions at termination, upon the termination of Trust 1: (1) Charity 1 will distribute to Grantors the actuarial value of their unitrust interest using the 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 charitable remainder unitrust; (2) any distribution of assets to Grantors will be made pro rata between the Grantors; and (3) the balance of the assets of Trust 1 will be distributed to Charity 1 as the charitable remainder beneficiary.

Trust 2 directs Charity 1, as trustee of Trust 2, to pay Grantors a unitrust amount of b percent of the net fair market value of Trust 2's assets valued as of the first day of each taxable year. Upon the death of Grantors, Trust 2 will terminate and Charity 1 is required to distribute the remainder of the principal and income of Trust 2 to Charity 1 less any amounts or percentages which either Grantor designated to be paid to other charities, but in no case less than c percent. Grantors and Charity 1 have agreed to terminate Trust 2. Notwithstanding the Trust 2 provisions governing distributions at termination, upon the termination of Trust 2: (1) Charity 1 will distribute to Grantors the actuarial value of their unitrust interest using the rate in effect under § 7520 on the date of termination and using the methodology under § 1.664-4 for valuing interests in a charitable remainder unitrust; (2) any distribution of assets to Grantors will be made pro rata between the Grantors; and (3) the balance of the assets of Trust 2 will be distributed to Charity 2, a publicly supported charitable organization exempt from taxation under § 501(c)(3) and described in § 509(a)(1) and § 170(b)(1)(A)(iv).

LAW AND ANALYSIS

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 an income 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).

Rev. Rul. 72-243, 1972-1 C.B. 233, provides that the proceeds received by the life tenant of a trust, in consideration for the transfer of the life tenant's entire interest in the trust to the holder of the remainder interest, are treated as an amount realized from the sale or exchange of a capital asset under § 1222. The right to income for life from a trust estate is a right in the estate itself. See McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946), cert. denied, 330 U.S. 826 (1947).

Section 1221(a) defines a “capital asset” as property held by the taxpayer, whether or not connected with a trade or business, with certain listed exceptions not applicable in the instant ruling.

Section 1222(3) provides that “long-term capital gain” is gain from the sale or exchange of a capital asset held for more than one year.

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 unitrust income interests of Trust 1 and Trust 2 to Grantors, in substance it is a sale of Grantors’ unitrust income interests. The amount received by Grantors as a result of the terminations of Trust 1 and Trust 2 is an amount received from the sale or exchange of property. Rev. Rul. 72-243. Because Grantors’ basis in the unitrust income interest is a portion of the entire basis of the property under §1015(b), and

because the disposition of Grantors' interest is not part of a transaction in which the entire interest in Trust is transferred to a third party, Grantors' adjusted basis in Grantors' interest is disregarded under §1001(e). Therefore, the Grantors have no basis in their interests in Trust 1 and Trust 2, and the amount of gain recognized will be the amount realized from the disposition of their interests in Trust 1 and Trust 2. The Grantors' holding periods in the interests exceed one year. Accordingly, the entire amount realized by Grantors as a result of the early terminations of Trust 1 and Trust 2 will be long-term capital gain.

Section 507(a)(1) provides in part, that the status of a private foundation shall be terminated if the entity provides notice to the Internal Revenue Service that it is terminating its private foundation status and pays the termination tax under § 507(c).

Section 4941(a)(1) imposes an 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)(A) provides, in part, that an act of self dealing includes any sale or exchange between a disqualified person and 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 the trust), a family member of a substantial contributor (including children), and a foundation manager (including a trustee).

Section 53.4946-1(a)(8) of the Foundation and Similar Excise Tax Regulations provides that for purposes of § 4941 only, the term "disqualified person" shall not include any organization which is described in § 501(c)(3) (other than an organization described in § 509(a)(4)).

Section 4947(a)(2)(A) 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 § 170(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. Furthermore, split-interest trusts are subject to the rules of §§ 507, 508(e), 4941, 4943 (except (b)(3)), 4944(except as provided in (b)(3)), and 4945.

Section 53.4947-1(c)(2)(i) of the Foundation and Similar Excise Tax 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 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.

Rev. Rul. 69-486, 1969-2 C.B. 159 concerns a non-pro rata distribution of trust property in kind by a trustee who had no authority to make such a distribution and did so

as a result of a mutual agreement by the beneficiaries, one of which is a charitable organization. The distribution was made as a final distribution of trust property. The trust property consisted of notes which had not appreciated in value and common stock that appreciated in value. By agreement, all of the notes were distributed to the charity and the stock to the individual beneficiary. The ruling held that the distribution was equivalent to a pro rata distribution of the stock and notes to both followed by an exchange of the charity's share of the common stock for the individual's pro rata share of the notes.

Trust 1 and Trust 2 are both described in § 4947(a)(2) by having income beneficiaries (Grantors) and a charitable remainderman (Charity 1), described in §§ 509(a)(1) and 170(b)(1)(A)(vi). By being described in § 4947(a)(2), Trust 1 and Trust 2 are subject to the provisions of §§ 507, 4941, and 4945, as if they are private foundations. The Grantors are disqualified persons with respect to Trust 1 and Trust 2 within the meaning of § 4946(a)(1)(A). However, the Grantors are not disqualified persons with respect to Charity 1 because Charity 1 is a public charity described in § 509(a).

Section 4941 applies to certain transactions between private foundations and disqualified persons. By early termination, Trust 1 and Trust 2 will distribute lump sums to the Grantors, Charity 1, and Charity 2 equal to the actuarial value of their interests in Trust 1 and Trust 2, and the distributions will also be treated as a constructive sale or exchange between the Grantors and Charity 1 or Charity 2. See Rev. Rul. 69-486.

Generally payments to the Grantors by Trust 1 and Trust 2 would constitute self-dealing. However, because the distribution to the income beneficiary equals the actuarial value of the income interest, the exception to self-dealing provided by § 53.4947-1(c)(2)(i) of the Foundation and Similar Excise Tax Regulations applies and the distribution will not be an act of self dealing. Furthermore, because Charity 1 and Charity 2 are public charities, § 4941 does not apply to the transaction.

Furthermore, because the effect of the transactions is to vest the income interest and remainder interest in the remainder beneficiaries, the trusts will no longer be split interest trusts and § 4947(a)(2) and § 507 will not apply.

Accordingly, the early terminations of Trust 1 and Trust 2 will not result in the imposition of a termination tax under § 507(c), and will not be considered acts of self-dealing under § 4941.

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.

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.

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

Sincerely,

CLIFFORD M. HARBOURT
Special Counsel to the Associate Chief Counsel
(Income Tax & Accounting)

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