TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

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

Number: **201332012**
Release Date: 8/9/2013

Date: May 14, 2013

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Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Uniform Issue List

664.00-00
4947.00-00

Legend:

Grantor =
Company =
Trustee =
Fund =
x =

Dear :

This is in response to your ruling request dated September 27, 2011 regarding federal tax consequences under various sections of the Internal Revenue Code of the proposed transactions described below.

FACTS

The information submitted provides that you were created by Grantor as a net income make-up charitable remainder unitrust ("NIMCRUT") under I.R.C. § 664(d)(3) and Treas. Reg. § 1.664-3(a)(1)(i)(b) to benefit Grantor. You state that Grantor contributed your initial corpus which consists of Grantor's common stock shares in Company. Presently, Trustee serves as your trustee. Your organizing trust document "Trust Agreement" provides that upon Grantor's death, Trustee shall distribute your entire remaining income and corpus to Fund, the charitable remainder, an organization described in I.R.C. § 501(c)(3) and classified as a public charity under I.R.C. § 509(a). Nonetheless, Grantor has the power to change the remainder thus, giving Grantor the authority to substitute the remainder with another organization(s) exempt under I.R.C. § 501(c)(3) and classified as a public charity under I.R.C. § 509(a) as the charitable remainder(s). Pursuant to the Trust Agreement, Trustee also has limited power to amend Trust Agreement for the sole purpose to ensure that you continue to qualify as charitable remainder unitrust within the meaning of I.R.C. § 664.

You state that under Section 2 of the Trust Agreement, Trustee shall pay Grantor during Grantor's lifetime "a Unitrust amount in annual installments equal to the lesser of:

> (a) the Trust income for the taxable year, as defined in I.R.C. § 643(b) of the Code and the regulations thereunder and in accordance with this Section 2 and Section 12(i) of this Trust, and (b) x percent (x%) of the net fair market value of the assets of this Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount for any year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) above, to the extent that the aggregate of the amounts paid in prior years was less than aggregate of the amounts computed as x percent (x%) of the net fair market value of the Trust assets on the valuation dates.

Following your creation as a unitrust, the Internal Revenue Service ("Service") on December 10, 1998, issued final regulations under Treas. Reg. § 1.664-3 regarding charitable remainder unitrusts which provides, in part, that proceeds from sale or exchange of corpus contributed to a unitrust must be allocated to the unitrust's corpus, not to the unitrust's income. See T.D. 8791, 63 F.R. 68188, 1991-1 C.B. 364. Treas. Reg. § 1.664-3(a)(1)(i)(b)(3) of those final regulations provides, in part, that proceeds from the sale or exchange of any assets contributed to the trust must be allocated to principal and not to trust income at least to the extent of the fair market value of those assets on the date of their contribution. Additionally, the preamble to those regulations indicates that taxpayers do not have to treat the make-up amount as a liability when valuing the assets of a NIMCRUT. The governing instrument of the Trust complies with Treas. Reg. § 1.664-3(a)(1)(i)(b)(3) as promulgated in those final regulations with respect to the property used to fund the Trust initially, but will not comply with respect to additional contributions to the Trust. The governing instrument of the Trust also includes a make-up liability provision.

You state that Trust Agreement conforms to Treas. Reg. § 1.664-3(a)(1)(i)(b)(3) with respect to the corpus used for your initial funding. However, the Trust Agreement fails to comply with Treas. Reg. § 1.664-3(a)(1)(i)(b)(3) in that it prevents Trustee from accepting additional corpus on your behalf. As such, certain provisions of the present Trust Agreement prevents you from being able to continue to qualify as a charitable remainder unitrust as intended by Grantor. These provisions include the "make-up liability" provision and the provision requiring that "all realized capital gains, other than gain realized on shares of [Company's] common stock contributed to [you] by [Grantor] ... shall be allocated to [your] income and shall be distributed as part or all of [your] amounts."

Because Trust Agreement lacks conformity with the final regulations under Treas. Reg. § 1.664-3, Trustee has been restricted from being able to accept additional property contributed to you. Trustee based on Trustee's limited power to amend the Trust Agreement, petitioned the appropriate state court ("Court") to permit your reformation. You state that reformation is

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necessary to achieve Grantor's intent, enabling you to continue to qualify as a charitable remainder unitrust under I.R.C. § 664. Subsequently, the Attorney General of the appropriate state filed an Answer with the Court acquiescing to your reformation. Grantor and Fund, pursuant to sworn affidavits, supports your reformation.

The Court entered a judgment which ordered your reformation. The Court struck out the entire second and third paragraphs of Section 2 of Trust Agreement, thereby deleting:

a. The "make-up liability" provision; and
b. The provision that require proceeds from sale or exchange of any corpus Grantor contributed to you be allocated to your income, and not your corpus.

The Court also added a new provision/paragraph to Trust Agreement which requires you to allocate to your corpus any proceeds from sale or exchange of any corpus Grantor contributed to you, and not to your income, to the extent of the fair market value of those assets on the date of their contribution to you. Further, you state that no deductions were claimed or allowed for your income interests under I.R.C. §§ 170(f)(2)(B), 2055(e)(2)(B) or 2522(c)(2)(B).

You represent that the elimination of the "make-up liability" provision "would increase the net fair market value of the Unitrust assets and correspondingly increase the Unitrust Amount. Increasing the Unitrust Amount in prior years could enlarge the limitation on payments made to Income Beneficiaries on account of the excess income and could in turn increase the Unitrust Amount payable to the Income Beneficiaries over what they would have received under the Trust Agreement in absence of the reformation."

RULINGS REQUESTED

Based on the above facts, you requested the following rulings:

1. Reformation of the Trust Agreement as ordered by the Court will not cause you to fail to qualify as charitable remainder unitrust under I.R.C. § 664.

2. Reformation of the Trust Agreement as ordered by the Court will not constitute an act of self-dealing under I.R.C. § 4941(d)(1) which would subject you to taxation under I.R.C. § 4947(a)(2).

RULING 1

LAW & ANALYSIS

I.R.C. § 664(d)(2) provides that for purposes of I.R.C. § 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 I.R.C. § 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 I.R.C. § 664(d)(2)(A) and other qualified gratuitous transfers described in I.R.C. § 664(d)(2)(C) may be paid to or for the use of any person other than an organization described in I.R.C. § 170(c), (C) following the termination of the payments described in I.R.C. § 664(d)(2)(A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in I.R.C. § 170(c) or is to be retained by the trust for such a use or, to the extent the remainder interest is in qualified employee securities (as defined in I.R.C. § 664(g)(4)) all or part of such securities are to be transferred to an employee stock ownership plan (as defined in I.R.C. § 4975(e)(7)) in a qualified gratuitous transfer (as defined by I.R.C. § 664(g)), and (D) with respect to each contribution of property in the trust, the value determined under I.R.C. § 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 of such property is contributed to the trust.

I.R.C. § 664(d)(3) provides that notwithstanding the provisions of I.R.C. § 664(d)(2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year – (A) the amount of the trust income, if such amount is less than the amount required to be distributed under I.R.C. § 664(d)(2)(A), and (B) any amount of the trust income which is in excess of the amount required to be distributed under I.R.C. § 664(d)(2)(A), to the extent that (by reason of I.R.C. § 664(d)(3)(A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

Treas. Reg. § 1.664-3(a)(4) of the Income Tax Regulations ("regulations") provides, in part, that [a charitable remainder trust] may be subject to a power to invade, alter, amend, or revoke for the beneficial use of a person other than an organization described in I.R.C. § 170(c).

Based solely on the facts and representations submitted, we conclude that the judicial reformation of the Trust Agreement described above will not cause you to fail to qualify as a NIMCRUT under I.R.C. § 664.

RULING 2

LAW & ANALYSIS

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

I.R.C. 4941(d)(1)(E) provides that the term "self dealing" means any direct or indirect transfer to or for the use of, or for the benefit of, a disqualified person of the income or assets of a private foundation.

I.R.C. 4946(a) provides that the term "disqualified person" with respect to a private foundation, among others, includes (a) a substantial contributor to the foundation (b) an owner of more than 20 percent of the beneficial interest of a trust or unincorporated enterprise and (c) the members of the family of those individuals described in (a) and (b).

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I.R.C. 4947(a)(2) provides that in the case of a trust which is not exempt from tax under I.R.C. § 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in I.R.C. § 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under I.R.C. §§ 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522; and among others, I.R.C. § 4941 (relating to taxes on self-dealing) shall apply as if such trust were a private foundation.

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

Treas. Reg. 53.4941(a)-1(a)(1) provides in general, I.R.C. § 4941(a)(1) imposes an excise tax on each act of self-dealing between a disqualified person (as defined in I.R.C. § 4946(a)) and a private foundation.

Treas. Reg. 53.4941(d)-2(f) provides that a transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation shall constitute an act of self-dealing.

Treas. Reg. 53.4947-1(c)(2)(ii) provides, that payments of income by a charitable remainder unitrust to its individual income beneficiaries do not result in any tax on self-dealing by virtue of the application of I.R.C. § 4947 unless a deduction was allowed under I.R.C. §§ 170(f)(2)(B), 2055(e)(2) (B), or 2522(c)(2)(B) with respect to the income interest of any such beneficiary.

As a charitable remainder unitrust, you are considered to be a split-interest trust described under I.R.C. § 4947(a)(2) and are subject to I.R.C. § 4941, which imposes an excise tax on acts of self-dealing. The involvement of disqualified persons in certain transactions with you, constitutes self-dealing under I.R.C. § 4941. Under I.R.C. § 4946, Trustee, as foundation manager and Grantor, as a substantial contributor and sole beneficiary, are disqualified persons with respect to you.

The analysis is two-fold in that we must determine first, whether the self-dealing rules of Chapter 42 apply to Grantor based on Grantor's position as an income beneficiary of you and secondly, whether there are any self-dealing issues with regards to Grantor as a substantial contributor based on Grantor's participation in any self-dealing transaction involving you.

You state that the elimination of the "make-up liability" provision would increase the net fair market value of your assets and in turn, increases the amount you can pay/transfer to Grantor, a disqualified person. Treas. Reg. § 53.4941(d)-2(f) provides that a transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation, may constitute an act of self-dealing. Thus, the issue is whether your transfer of your income resulting from the elimination of the "make-up provision" to Grantor amounts to self-dealing. Under I.R.C. § 4947(a)(2), the self-dealing rules of I.R.C. § 4941 do not apply to any amounts payable under the terms of a split-interest trust to income beneficiaries as long as no deduction was allowed for such income interests under I.R.C. §§ 170(f)(2)(B), 2055(e)(2) (B), or 2522(c)(2)(B) with respect to the income interest of any such beneficiary. See Treas. Reg. § 53.4947-1(c)(2)(ii). You represent that no deductions, under the above Code sections, were claimed or allowed for your income interests. As a result, the self-dealing rules of I.R.C. § 4941 do not apply to Grantor as an income beneficiary.

Regarding whether Grantor as a substantial contributor is subject to the self-dealing rules of I.R.C. § 4941, the circumstances presented above indicate that there is no act of self-dealing. You submitted affidavits in support of the judicial reformation noting that the reformation is necessary to achieve Grantor's intent and to enable you to continue to qualify as a charitable remainder unitrust under I.R.C. § 664.

Accordingly, the judicial reformation of the Trust Agreement, authorizing removal of the make-up liability provision, will not constitute an act of self-dealing under I.R.C. § 4941 and thus, you will not be subject to the excise taxes under I.R.C. § 4947(a)(2).

RULINGS

Based on the information submitted, we rule as follows:

1. The reformation of your Trust Agreement as ordered by the Court will not cause you to fail to qualify as charitable remainder unitrust under I.R.C. § 664.

2. The reformation of your Trust Agreement as ordered by the Court will not constitute an act of self-dealing under I.R.C. § 4941(d)(1) which would subject you to taxation under I.R.C. § 4947(a)(2).

This ruling will be made available for public inspection under I.R.C. § 6110 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 organization that requested it. Section 6110(k)(3) 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. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your 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.

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In accordance with the Power of Attorney currently on file with the Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore R. Lieber
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437