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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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UIL Code: 507.01-01
4941.00-00
4945.00-00
642.00-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:
Son =
Foundation =

Dear :

This is in response to your letter dated June 1, 2012 in which you requested certain rulings with respect to I.R.C. §§ 507, 4941, 4945, and 642.

Background:

You are an irrevocable charitable lead annuity trust that is treated as a private foundation. You were formed under Article IV of your trust agreement ("Trust Agreement"). You were initially funded by your founder, who is now deceased. Under your original terms your initial annuity payment was three percent of the initial fair market value of your trust fund. In each year after that the annuity payment was to equal the previous year's annuity amount multiplied by a certain factor. The annuity payments are made to one or more qualified charitable organizations, where a qualified charitable organization means any organization described in §§ 170(c), 2055(a), or 2522(a), chosen by a designated appointer. Your designated appointer is Son, the son of your founder. As the appointer, Son chooses not only the qualified charitable organization, but also your trustee. The initial trust terms provided that any remaining principle at the end of twenty years of annuities would go to Son.

Throughout the twenty years of annuities, of which you are now in year fifteen, Son has chosen to provide the annuity payments to Foundation. Foundation is exempt from Federal income tax under § 501(a) as an organization described in § 501(c)(3) and is classified as a private foundation within the meaning of § 509(a). Son is a founder of Foundation and retains the ability to appoint and remove members of the Board of Directors of Foundation.

Your trustee has determined, given the required payout amounts, that you will run out of funds by your eighteenth year. The annuity payment in that year will be higher than the amount remaining in the trust fund and you will be unable to finish the final two years of the annuity payments and no funds will remain for Son. Given the likely end of your ability to continue paying annuities your trustee petitioned the court to amend your terms allowing you to terminate this year and pay all of the remaining funds to Foundation. Son would receive none of the payments from you and has represented that he has relinquished any and all claims regarding payments under the Trust Agreement. The court granted your amendments conditional upon receiving a ruling request from

the Service indicating that there are no negative tax consequences.

Rulings Requested:

1. The distribution of your remaining assets to Foundation will not terminate your status as a private foundation under § 507(a)(1) and cause you to be subject to a termination tax under § 507(c).

2. The distribution of your remaining assets to Foundation will not be an act of self-dealing under § 4941.

3. The distribution of your remaining assets to Foundation will not be a taxable expenditure with respect to which you need to exercise expenditure responsibility under § 4945(h).

4. Foundation will not be required to exercise expenditure responsibility with respect to outstanding grants made to itself.

5. You will be allowed a deduction under § 642(c) for the taxable year in which the assets are distributed to Foundation in an amount equal to the annuity payment that otherwise would have been payable for the taxable year, prorated on a daily basis if the year of distribution is a short taxable year, to the extent paid from your gross income.

Law:

I.R.C. § 507(a) provides that the status of any organization as a private foundation shall be terminated only if such organization notifies the Secretary of its intent to accomplish such termination, or there have been willful and repeated acts, or a willful and flagrant act, giving rise to liability for tax under chapter 42, and the Secretary notifies such organization that it is liable for such tax.

I.R.C. § 507(b)(2) provides that for purposes of §§ 507, 508, and 509 in the case of a 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 tranferee foundation shall not be treated as a newly created organization.

I.R.C. § 507(d)(2) provides that a substantial contributor means any person who contributed or bequeathed an aggregate amount of more than $5,000 to the private foundation, if such amount is more than two percent of the total contributions and bequests received by the foundation.

I.R.C. § 642(c)(1) provides, in pertinent part, that a trust shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by § 170a)), any amount of the gross income, without limitation, which, pursuant to the terms of the governing instrument, during the taxable year, is paid out for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)).

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

I.R.C. § 4941(d)(1) defines self-dealing as the furnishing of goods, services, or facilities between a

disqualified person and a private foundation as well as the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

I.R.C. § 4945(a) imposes a twenty percent tax on each taxable expenditure of a private foundation.

I.R.C. § 4945(d) defines taxable expenditure as any amount paid or incurred by a private foundation as a grant to an organization unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h) or an amount paid for any purpose other than one specified in § 170(c)(2)(B).

I.R.C. § 4945(h) defines expenditure responsibility as the private foundation will assert all reasonable efforts and establish adequate procedures to see that the grant is spent solely for the purpose for which it was made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Secretary.

I.R.C. § 4946(a)(1) provides that a "disqualified person," with respect to a private foundation, includes a substantial contributor, as defined under § 507(d)(2), a foundation director or officer, and any spouse, ancestor, child, grandchild, great grandchild, of that contributor, director, or officer.

I.R.C. § 4947(a)(2) provides that in the case of a split-interest trust §§ 507, 4941, and 4945 shall apply to the trust as if it were a private foundation.

Treas. Reg. § 1.507-3(a)(2) provides that a transferee organization to which § 507(b)(2) applies shall succeed to the aggregate tax benefit of the transferor organization in an amount equal to the amount of such aggregate tax benefit multiplied by a faction the numerator of which is the fair market value of the assets transferred to such transferee and the denominator of which is the fair market value of the assets of the transferor immediately before the transfer.

Treas. Reg. § 1.507-3(a)(4) provides that if a private foundation incurs liability for one or more of the taxes imposed under chapter 42 prior to, or as a result of, making a § 507(b)(2) transfer to one or more private foundations, each transferee foundation shall be treated as receiving the transferred assets subject to such liability to the extent that the transferor does not satisfy such liability.

Treas. Reg. § 1.507-3(a)(9)(i) provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled by the same person or persons which effectively controlled the transferor private foundation such a transferee foundation shall be treated as if it were the transferor.

Treas. Reg. § 1.507-3(a)(9)(iii), *Example (2)*, describes a trust whose trustees created and controlled foundations R, S, and T. When the trust provides funds to R, S, and T in a 507(b)(2) transfer R, S, and T are treated as the trust for § 4945 purposes and are responsible for any expenditure responsibilities remaining under § 4945(d)(4) distributions. The example goes on to state, "Since R, S, and T are treated as [the trust] rather than as recipients of 'expenditure responsibility' grants, there are no expenditure responsibility requirements which must be exercised under §§ 4945(d)(4) and (h) with respect to the transfers of assets to R, S, and T."

Treas. Reg. § 1.507-3(c) provides that for the purposes of § 507(b)(2) the terms "other adjustment, organization, or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. The term significant disposition of assets" shall include any disposition for a taxable year where the aggregate of the dispositions to one or more private foundations is twenty-five percent or more of the fair market value of the net assets of the foundation at the beginning of the taxably year.

Treas. Reg. § 1.507-3(d) states that unless a private foundation voluntarily gives notice pursuant to § 507(a)(1), a transfer of assets described in § 507(b)(2) will not constitute a termination of the transferor's private foundation status under § 507(a)(1).

Treas. Reg. § 53.4946-1(a)(8) provides that for purposes of § 4941 only, the term "disqualified persons" shall not include any organization which is described in § 501(c)(3) (other than organizations described in § 509(a)(4)).

Treas. Reg. § 53.4947(e)(1) provides that for a split-interest trust the provision of § 507(a) will not apply by reason of any payment to a beneficiary that is directed by the terms of the governing instrument by reason of, or following, the expiration of the last remaining charitable interest.

Treas. Reg. § 53.4947(e)(2), *Example (2)*, provides that if H creates a trust under which X, a 501(c)(3) organization, receives money annually for a period of 20 years, remainder to S, H's son. When the final payment to X has been made at the end of the 20 year period in accordance with the terms of the trust, the provisions of § 4947(a)(2) will cease to apply to the trust, but the final payment to X will not be considered a termination of the trust's private foundation status within the meaning of § 507(a).

Revenue Ruling 2002-28, 2002-1 C.B. 241, provides, "A transfer of assets described in § 507(b)(2) does not constitute a termination of the transferor's private foundation status under § 507(a)(1) unless the transferor voluntarily gives notice pursuant to § 507(a)(1). *See* §§ 1.507-1(b)(6) and 1.507-3(d). The transferor foundation is not required to provide such notice. In Situation 1, *P*'s dissolution under state law has no effect on whether *P* has terminated its private foundation status for federal tax purposes." The ruling also goes on to state that the distributions are made to 501(c)(3) organizations, which cannot be disqualified persons for § 4941 purposes, therefore there is no self-dealing. The ruling also commented on § 4945 stating that, "because each transferor foundation transfers all of its assets to one or more private foundations effectively controlled by the same persons that effectively control the transferor, the transferee foundations are treated as though they were the transferor for purposes of § 4945. *See* § 1.507–3(a)(9)(i). Because the transferee foundations are treated as the transferor foundation rather than as recipients of expenditure responsibility grants, there are no expenditure responsibility requirements that must be exercised under § 4945(d)(4) or (h) with respect to the transfers to the transferee foundations. *See* § 1.507–3(a)(9)(i) and (iii)(example 2)."

Analysis:

RULING 1: The distribution of your remaining assets to Foundation will not terminate your status as a private foundation under § 507(a)(1) and cause you to be subject to a termination tax under § 507(c).

Because you have represented that you are a charitable lead unitrust which has amounts in trust for which a deduction was allowed under § 2055(e)(2)(B) and are a nonexempt split-interest trust within the meaning of § 4947(a)(2), § 507 (relating to termination of private foundation status), § 508(e) (relating to governing instruments) to the extent applicable to a trust described in this paragraph, § 4941 (relating to taxes on self-dealing), § 4943 (relating to taxes on excess business holdings) except as provided in subsection (b)(3), § 4944 (relating to investments which jeopardize charitable purpose) except as provided in subsection (b)(3), and § 4945 (relating to taxes on taxable expenditures) shall apply as if you were a private foundation.

Section 507(b)(2) applies to a significant disposition of assets by one private foundation to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income. See § 1.507–3(c)(1). Section 1.507-3(c)(2) provides that a transfer of all of a private foundation's assets to one or more private foundations constitutes a significant disposition. Here, you are seeking to distribute all of your remaining funds to Foundation prior to the end of your annuity term, and for no compensation from Foundation. Therefore, this qualifies as a § 507(b)(2) distribution.

A transfer of assets described in § 507(b)(2) does not constitute a termination of the transferor's private foundation status under § 507(a)(1) unless the transferor voluntarily gives notice pursuant to § 507(a)(1). See §§ 1.507–(b)(6) and 1.507–3(d). Pursuant to § 1.507-4(b), a private foundation that makes a transfer described in § 507(b)(2) is not subject to the tax imposed under § 507(c) with respect to such transfer. However, § 507(a) states that the status of any organization as a private foundation shall be terminated only if the organization notifies the Secretary of its intent to accomplish such termination or, with respect to the organization, there have been either willful repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) which gives rise to tax under Chapter 42. You have represented that you have not and will not notify the Secretary of your intent to terminate your status as a private foundation and that you have not ever either committed willful repeated acts (or failures to act) or committed a willful and flagrant act (or failure to act) which gives rise to tax under Chapter 42. Therefore, your proposed transfer of all your assets to Foundation under § 507(b)(2) will not terminate your private foundation status under § 507(a) and does not result in a termination tax imposed by § 507(c).

Additionally, § 53.4947(e)(1) provides that for a split-interest trust the provision of § 507(a) will not apply by reason of any payment to a beneficiary that is directed by the terms of the governing instrument by reason of, or following, the expiration of the last remaining charitable interest. This rule is further clarified by example in § 53.4947(e)(2), *Example (2)*, which discusses a scenario where H creates a trust under which X, a 501(c)(3) organization, receives money annually for a period of 20 years, with the remainder going to S, H's son. When the final payment to X has been made at the end of the 20 year period in accordance with the terms of the trust, the provisions of § 4947(a)(2) will cease to apply to the trust, but the final payment to X will not be considered a termination of the trust's private foundation status within the meaning of § 507(a). You have petitioned a judge to alter the language in your governing instrument to provide for a final payment to Foundation consisting of all of the remaining funds. This payment will constitute the last remaining charitable interest in your trust, therefore, the provision of § 507(a) will not apply without further notice by you to the Commissioner.

RULING 2: The distribution of your remaining assets to Foundation will not be an act of self-dealing under § 4941.

Section 4941 imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Under § 53.4946-1(a)(8), a "disqualified person" does not include organizations that are exempt from § 501(c)(3) other than organizations also described in *§ 509(a)*(4). Rev. Rul., 2002-28, supra, also discusses the distribution from a private foundation to another § 501(c)(3) organization stating that such a distribution is not subject to § 4941 due to the exception for § 501(c)(3) organizations. Here, your final distribution will be entirely to Foundation, a private foundation described in § 501(c)(3). Given that the recipient of your distribution is described in § 501(c)(3) such distribution will not be an act of self-dealing.

RULINGS 3 and 4: The distribution of your remaining assets to Foundation will not be a taxable expenditure with respect to which you need to exercise expenditure responsibility under § 4945(h) and Foundation will not be required to exercise expenditure responsibility with respect to outstanding grants made to itself.

With a § 507(b)(2) transfer, if all of the assets of a private foundation are transferred to another private foundation effectively controlled by the same person(s) the transferee foundation will be treated as if it were the transferor organization and would be subject to any liabilities not paid by the transferor. Sections 1.507-3(a)(4) and (9)(i). Since the transferee organization in such a transaction is treated as the transferor there are no expenditure responsibility requirements with respect to such transactions. Section 1.507-3(a)(9)(iii), *Example(2)*; Rev. Rul. 2002-28, supra. You have represented that there is effective control since your Son both appoints your trustee and determines the board of directors for Foundation. Given your representations of effective control, Foundation will be treated as you for § 4945 purposes. Since Foundation is treated as you there are no expenditure responsibility requirements that must be exercised under §§ 4945(d)(4) and (h) with respect to your transfer of assets to Foundation.

RULING 5: You will be allowed a deduction under § 642(c) for the taxable year in which the assets are distributed to Foundation in an amount equal to the annuity payment that otherwise would have been payable for the taxable year, prorated on a daily basis if the year of distribution is a short taxable year, to the extent paid from your gross income.

Based solely on the facts and representations submitted, we conclude that you should be allowed a deduction under § 642(c) for the year in which your assets are distributed to Foundation in an amount equal to the annuity payment that would have been payable for that taxable year pursuant to the terms of the Trust Agreement, to the extent paid from your gross income.

Except as specifically set forth above, we express no opinion as to the tax consequences of the transaction described above under the cited provisions of the Code or under any other provisions of the Code. In particular, we express no opinion as to whether or not the Foundation is described in §§ 170(c), 2055(a), and 2522(a) and whether the Foundation is a private foundation within the meaning of § 509(a) and is not described in § 509(a)(4).

Rulings:

1. The distribution of your remaining assets to Foundation will not terminate your status as a private foundation under § 507(a)(1) and cause you to be subject to a termination tax under § 507(c).

2. The distribution of your remaining assets to Foundation will not be an act of self-dealing under § 4941.

3. The distribution of your remaining assets to Foundation will not be a taxable expenditure with respect to which you need to exercise expenditure responsibility under § 4945(h).

4. Foundation will not be required to exercise expenditure responsibility with respect to outstanding grants made to itself.

5. You will be allowed a deduction under § 642(c) for the taxable year in which the assets are distributed to Foundation in an amount equal to the annuity payment that otherwise would have been payable for the taxable year, prorated on a daily basis if the year of distribution is a short taxable year, to the extent paid from your gross income.

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 organization 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. 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.

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

Sincerely,

Ronald Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437