



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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U.I.L. Numbers:

507.00-00  
664.00-00  
4941.00-00  
4947.02-00

Employer Identification Number:

LEGEND:

A =  
B =  
C =

N =

X =

Dear \_\_\_\_\_ :

This is in response to X's request dated Feb. 26, 2004 for a ruling regarding the proposed termination of a charitable remainder unitrust.

X is a Charitable Remainder Unitrust (the "Trust") described in section 664(d)(3) of the Internal Revenue Code (the "Code"), and a split-interest trust as defined in section 4947(a)(2). A is settlor of the Trust with C, a bank, serving as Trustee. As lifetime beneficiaries (the "Income Beneficiaries"), A and his wife, B, are interested parties.

The Trust was funded with shares of stock. At the time of the funding, A took a charitable contribution deduction under section 170 of the Code for contribution of the remainder interest.

Originally, the Trust Agreement provided that the Trust would pay the lesser of (i) 5% of the net fair market value of the trust assets, or (ii) the trust income for the taxable year. Any amount paid under (ii) would include income for the year that exceeded 5% of the net fair market value of the trust assets if, and to the extent that, the payments in prior years under (ii) were less than 5% of the fair market value of the assets. The Trust was reformed by order of the District Court several years ago. The Trust agreement now provides that C, the Trustee, shall pay annually to

A the unitrust amount of 5% of the net fair market value of the assets. Following A's death, the unitrust amount is to be paid to B for so long as she survives A. Upon the death of the last to die of A and B, the assets are to be distributed to the qualified charitable organizations named in the trust agreement (the "Remainder Beneficiaries"). The Trust represents that the Remainder Beneficiaries are all public charities as described in sections 501(c)(3) and 509(a). Pursuant to a Release executed by A, a special power of appointment granted to him in the Trust Agreement by which he could change the Remainder Beneficiaries was released.

The Remainder Beneficiaries are in need of financial assistance to carry out their charitable purposes. Consequently, the parties agree that it would be in everyone's best interest to terminate the trust and distribute the assets to all beneficiaries. The Trust Agreement contains no provision for early termination of the Trust.

The Trust is construed under the law of the State of N. X has presented an opinion from an N lawyer that when all of the beneficiaries of a trust created for successive beneficiaries consent and none of them is under any legal incapacity, the beneficiaries can compel the termination of a trust before its natural expiration if its continuance is necessary to carry out a material purpose for its creation. In the opinion of the attorney, it is well established that modification (including termination) can come about through agreement of the settlor and all of the beneficiaries. X submitted signed Agreements from the settlor and all beneficiaries stating that the trust should terminate and distribute the remaining trust assets to the beneficiaries in accordance with the actuarial value assigned to each beneficiary's interest in the trust.

X represents that upon termination, C will calculate the lump sum distributions using the discount rate in effect under section 7520 of the Code on the date of termination, and using the methodology under section 1.664-4 of the Income Tax Regulations for valuing interests in charitable remainder trusts. X submitted statements signed under penalty of perjury by A, B, and doctors that have examined A and B, that there are no conditions of which they are aware that would result in a shorter than normal life expectancy for A or B as set forth in the life expectancy tables at Regulations section 1.72-9.

**Ruling Requested:**

The Taxpayer requests a ruling that the proposed early termination of the Trust will not result in a termination tax pursuant to section 507(a), and that such termination will not constitute an act of self-dealing under section 4941(d) such that the "disqualified persons", as defined in section 4946, will not be subject to the taxes imposed under section 4941(a) and (b).

**Law:**

Section 507(a) of the Income Tax Code (Code) provides, generally, that, except as provided in section 507(b), the status of any organization as a private foundation shall be terminated only if---

- (1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such

termination, or

(2)(A) with respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c), and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

Section 507(c) of the Code imposes a tax on each organization whose private foundation status is voluntarily or involuntarily terminated under section 507(a).

Section 664 of the Code exempts from income tax charitable remainder unitrusts, which it defines as those from which a fixed percentage of the net fair market value of its assets is paid to at least one person not an organization described in section 170(c) for a term of years, after which the remainder interest is transferred to an organization described in section 170(c).

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

Section 4941(d)(1) of the Code provides that the term "self-dealing" includes any direct or indirect:

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person, and

(E) transfer to, or the use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946(a)(1) of the Code provides that the term "disqualified person" with respect to a private foundation includes a substantial contributor to a private foundation (including the creator of a trust), a family member of a substantial contributor, and a foundation manager.

Section 4947(a)(2) of the Code provides generally that split-interest trusts are subject to the provisions of section 507, 4941, and 4945 in the same manner as if such trusts were private foundations, but under section 4947(a)(2)(A), not with respect to any amounts payable under the terms of such trusts to income beneficiaries, unless a deduction was allowed under section 170(f)(2)(B), 2055(e)(2)(B), or 2522(c)(2)(B).

Section 53.4941-1(a)(8) of the Foundation and similar excise tax regulations (excise tax regulations) provides that for the purposes of section 4941 only, the term "disqualified person"

shall not include any organization which is described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Section 53.4941(d)-1(a) of the excise tax regulations provides that it is immaterial whether a transaction results in a benefit or a detriment to the private foundation in determining whether the transaction is an act of self-dealing.

Section 53.4941(d)-2(f)(2) of the excise tax regulations provides that the fact that a disqualified person received an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing.

Section 53.4947-1(c)(2)(i) of the excise tax regulations provides that under section 4947(a)(2)(A), section 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 sections 170(f)(2)(B), 2055(e)(2)(B), or 2522(c)(2)(B) with respect to the income interest of any such beneficiary.

Section 53.4947-1(e) of the excise tax regulations provides that the provisions of section 507(a) of the Code shall not apply to a trust described in section 4947(a)(1) or (2) by reason of any payment to a beneficiary that is directed by the terms of the governing instrument of the trust and is not discretionary with the trustee or, in the case of a discretionary payment, by reason of, or following, the expiration of the last remaining charitable interest in the trust.

Section 53.4947-1(e)(2) of the excise tax regulations sets forth the following relevant example:

Example (3). J creates a charitable remainder annuity trust described in section 664(d)(1) under which S, J's son, receives \$10,000 per year for life, remainder to be distributed outright to P, an organization described in section 501(c)(3). J is allowed a deduction under section 170 for the value of the remainder interest placed in trust for the benefit of P, and the provisions of section 4947(a)(2) apply to the trust. At the death of S, the trust will terminate and all assets will be distributed to P. However, such final distribution to P will not be considered a termination of the trust's private foundation status within the meaning of section 507(a).

Revenue Ruling 2003-13, 2003-4 C.B. 305, indicates that, under section 1.507-1(b)(7) of the regulations, a transfer of all of the assets of a private foundation entity does not result in the termination of the transferor's private foundation status under section 509(a) of the Code, unless the distribution is under section 507(b)(1)(A), or the foundation voluntarily elects to terminate under section 507(a)(1), or an involuntary termination under section 507(a)(2) applies.

X's request for a ruling involves two issues: (1) whether the early termination will constitute an act of self-dealing under section 4941(d), and (2) whether the early termination will result in a termination tax pursuant to section 507(a).

As a CRUT under section 664(d)(3) of the Code, the Trust is a split-interest trust described in section 4947(a)(2), and therefore, subject to section 4941, which imposes an excise tax on acts of self-dealing. A and B are disqualified persons with respect to the Trust under section 4946, because A is the creator of the trust and a substantial contributor, and B is A's spouse.

The tax on self-dealing applies to transfers to a disqualified person of the assets of a split-interest trust, except for "amounts payable under the terms of such trust to income beneficiaries." Section 4947(a)(2)(A) of the Code. State law provides for early termination under the facts presented. However, it does not settle the question of the proper allocation between the income and remainder beneficiaries.

A critical question is whether early termination may be expected to result in a greater allocation of the Trust's assets to the income beneficiaries, to the detriment of the charitable beneficiaries, than a non-early termination. The Trust's proposed allocation method is reasonable if the income beneficiaries have no knowledge of medical conditions or other circumstances likely to result in a shorter life expectancy than that predicted by the actuarial tables. Otherwise, an early termination would tend to deprive the charitable beneficiaries of their benefit and would be inconsistent with the charitable deduction allowed to the donor of the Trust.

We note that the trust termination is treated as a sale or exchange between the income and remainder beneficiaries, resulting in a taxable transaction for the income beneficiaries. However, there is no act of self-dealing resulting from the sale or exchange between the beneficiaries, as the charitable remainder beneficiaries are public charities and not private foundations.

We conclude that the proposed termination of the Trust will not constitute a direct or indirect act of self-dealing within the meaning of section 4941 of the Code because of all of the following circumstances: state law allows the early termination; all beneficiaries favor the early termination; the Trustees will use the regulations' formula for determining the present values of the income and remainder interests in a charitable remainder trust; the income beneficiaries' physicians have conducted examinations of the income beneficiaries and stated under penalty of perjury that they find no medical conditions expected to result in shorter-than-average longevity (under section 1.72-9); the income beneficiaries have signed similar statements; and the income beneficiaries are not disqualified persons with respect to any private foundation charitable remainder beneficiaries.

Section 507(c) of the Code provides for the imposition of a termination tax on certain private foundation terminations described in section 507(a). Section 507(a) of the Code applies to the Trust, which is treated for certain purposes as a private foundation pursuant to section 4947(a)(2). Section 507(a) does not apply, however, to payments to an income beneficiary of a trust that are considered "payable under the terms of such trust" and "directed by the terms of the governing instrument of the trust and not discretionary with the trustee." The payments here are equivalent to those made on such terms. Similar to section 53.4947-1(e)(2), Example (3) of the regulations, the Trust's final lump sum payment to its charitable remainder beneficiary organization will not be considered a termination under section 507(a) of the Trust's private

foundation status under section 509(a). Without a termination under section 507(a), no termination tax under section 507 applies to the Trust.

Therefore we rule that:

the proposed early termination of the Trust will not result in a termination tax pursuant to section 507(a); such termination will not constitute an act of self-dealing under section 4941(d); and therefore the “disqualified persons” (as defined in section 4946) with respect to the Trust will not be subject to the taxes imposed under section 4941(a) and (b).

Except as we have ruled above, we express no opinion as to the tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

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

Because this letter could help resolve future tax questions, you should keep a copy of this ruling 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.

Sincerely,

Jane Baniewicz  
Manager, Exempt Organizations  
Technical Group 2