



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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4941.00-00
4941.04-00
507.00-00

Contact Person:

Identification Number:

Telephone Number:

Fax Number:

Employer Identification Number:

A =
B =
C =
D =
E =

Dear _____ :

We have considered your ruling request dated August 17, 2004, on the proper treatment of the termination of B and whether the termination constitutes an act of self-dealing under section 4941 of the Internal Revenue Code.

A established B a charitable remainder unitrust. A serves as Trustee of B and C serves as Independent Special Trustee of B. A is now the sole non-charitable beneficiary of B. The charitable remainderman of B is E, an organization recognized as an exempt organization under section 501(c)(3) of the Code and as a private foundation.

A wishes to terminate B by selling his income interest in the trust to the charitable remainderman for an amount equal to the present value of A's life income interests in said trust. The actuarial values of the interest will be calculated using the discount rate in effect under section 7520 of the Code, and the methodology for valuing interests in a charitable remainder trust contained in section 1.664-4 of the Income Tax Regulations.

A is aware of no physical condition that would decrease his normal life expectancy. He was recently examined by his personal physician who has also confirmed that there is no indication that A's life expectancy is less than would otherwise be expected for a man of his age.

D law permits said early termination of the trust, provided there is agreement among the trustees and beneficiaries. There is no requirement that D's Attorney General or any court be involved in a trust termination in which all beneficiaries consent.

RULINGS REQUESTED

A requested the following rulings

- (1) early termination of B will not constitute an act of self-dealing under section 4941(a)(1) of the Code by A as trustee or as donor with respect to B.
- (2) early termination of B will not constitute an act of self-dealing under section 4941(a)(1) of the Code by C as Independent Trustee with respect to B, and
- (3) the proposed termination of B will not be subject to termination tax under Section 507 of the Code.

STATEMENT OF LAW

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 507(a) of the Code imposes substantial taxes on foundations that cease to qualify as private foundations, or commit acts giving rise to liability for tax under chapter 42.

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 defines self-dealing as including any direct or indirect;

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

(E) transfer to, or 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 for purposes of this subchapter, the term "disqualified person" means, with respect to a private foundation, a person who is--

(A) a substantial contributor to the foundation,

(B) a foundation manager (within the meaning of subsection (b)(1)),

(C) an owner of more than 20 percent of:

- (i) the total combined voting power of a corporation,
- (ii) the profits interest of a partnership, or
- (iii) the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation,

(D) a member of the family (as defined in subsection (d)) of any individual described in subparagraph (A), (B), or (C),

(E) a corporation of which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the total combined voting power,

(F) a partnership in which persons described in subparagraph (A), (B), (C), or (D) own more than 35 percent of the profits interest,

(G) a trust or estate in which persons described in subparagraph (A), (B), (C), or (D) hold more than 35 percent of the beneficial interest,

(H) only for purposes of section 4943, a private foundation--

- (i) which is effectively controlled (directly or indirectly) by the same person or persons who control the private foundation in question, or
- (ii) substantially all of the contributions to which were made (directly or indirectly) by the same person or persons described in subparagraph (A), (B), or (C), or members of their families (within the meaning of subsection (d)), who made (directly or indirectly) substantially all of the contributions to the private foundation in question, and

(I) only for purposes of section 4941, a government official (as defined in subsection (c)).

Section 4946(a)(2) of the Code provides that for the purposes of paragraph (1), the term “substantial contributor” means a person who is described in section 507(d)(2)

Section 4946(b) of the Code provides that for the purposes of this subchapter, the term “foundation manager” means, with respect to any private foundation:

- (1) an officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation), and
- (2) with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).

Section 4947(a)(2) of the Code provides, in pertinent part, that in the case of a trust

which is not exempt from tax under section 501(a), not all of the unexpired interests of which are devoted to charitable purposes, and which has accounts in trust for which a charitable deduction was allowed, sections 507 and 4941 apply as if such trust were a private foundation.

Section 4947(a)(2)(A) of the Code provides that section 4947(a)(2) shall not apply with respect to any amounts payable under the terms of such trust to non-charitable income beneficiaries.

Section 53.4941(d)-1 (a) of the Foundation and Similar Excise Taxes 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 regulations provides that the fact that a disqualified person receives 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(e) of the 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 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).

ANALYSIS

Section 4947(a)(2)(A) of the regulations provides that 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. State Law provides for early termination under the facts presented. However, it does not settle the proper allocation between the income and remainder beneficiaries. The question is whether early termination may reasonably be expected to result in a greater allocation of the trust assets to the income beneficiary, to the detriment of the charitable beneficiary. In this case, the income beneficiary is not expected to receive more than he would during the full term of the trust. The charitable remainder beneficiary might receive more because the donor has a right to change the remainder beneficiary, or designate an additional one and change the

proportions.

The following facts show that the early termination will not be to the detriment of the charitable beneficiary: State law allows the early termination and all beneficiaries favor it; the proposed division will not duplicate the intent of the trust in a different time frame because the trustee will use the Income Tax Regulations' formula for determining the present values of the income and remainder interests in a charitable remainder trust; the income beneficiary's physician has conducted a physical examination and stated under penalties of perjury that he finds no medical conditions expected to result in a shorter-than-average longevity (under section 1.72-9 of the Regulations); and the income beneficiary has signed a similar statement.

Therefore, we rule that:

- (1) early termination of B will not constitute an act of self-dealing under section 4941(a)(1) of the Code by A as trustee or as donor with respect to B.
- (2) early termination of B will not constitute an act of self-dealing under section 4941(a)(1) of the Code by C as Independent Trustee with respect to B, and
- (3) the proposed termination of B will not be subject to termination tax under Section 507 of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after 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 Internal Revenue Code provides that it may not be used or cited by others as precedent.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Also we express no opinion as to the tax consequences of the transactions under other provisions of the Code. 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. You should keep a copy for your permanent records.

Sincerely yours,

Debra Kaweck
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437