



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

Release Number: **200802032**

Release Date: 1/11/08

Date: October 16, 2007

UIL 4941.00-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

A =

B =

C =

D =

E =

F =

G =

H =

s =

t =

w =

z =

xy =

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

This is in response to your letter dated December 14, 2005, as supplemented by additional correspondence, requesting a ruling under section 4941 of the Internal Revenue Code (the Code) relating to a specific proposed transaction. You are referred to hereafter as C.

A, is the Personal Representative of the Estate of B and is the Trustee of the Charitable Remainder Trust created under the Last Will and Testament of B.

On July 31, \_\_\_\_\_, B executed a Will. The Will provided that all of B's assets, other than her personal property, were to be placed into a testamentary charitable remainder annuity trust (hereafter "the CRAT"). C (the taxpayer) is the only child of B. C is the life-income beneficiary of the CRAT. Pursuant to the Will, C was to receive an annual payment during her lifetime equal to six percent of the value of the trust as established for federal estate tax purposes. The Will further provided that at the end of C's life, the balance of the trust was to be distributed equally to D and E, exempt public charities under section 501(c)(3) of the Code. B died on December 23, \_\_\_\_\_ at the age of 81.

C represents that the purpose of the proposed transaction is to settle extensive litigation involved in the probate of the Will and subsequent administration of the CRAT, and thereby to avoid the expenses, delay, and uncertainties of continued litigation. The parties have reached a tentative agreement to settle several issues in various stages of litigation relating to the creation and funding of the CRAT as provided in the Will of B.

Under the terms of the proposed settlement agreement, the estate of B will distribute estate assets to the CRAT, which in turn will create a liquidating trust and ultimately fund such liquidating trust with virtually all of the assets of the CRAT. The liquidating trust will pay specific sums to D and E. Amounts remaining in the liquidating trust, after distributions to D and E and after payment of expenses, will ultimately be distributed to C, the annuity beneficiary of the CRAT. The CRAT will terminate after its assets have been distributed to the liquidating trust.

Approximately w was transferred to the CRAT in 1999. Also in 1999, w was distributed to C as an advance on her annuity distributions. No other annuity payments have been made so far. As a result of the examination of the estate tax return, the Internal Revenue Service determined the annual annuity payment to C as z. In March of 2004, assets valued at approximately xy were transferred from the estate to the CRAT.

The nature of the dispute, in summary, centers around the allegations by the estate of B and the CRAT that C misappropriated funds rightfully belonging to B's estate. C contends that the bulk of the assets of which A took possession through the civil litigation rightfully belong to C and that she is entitled to control those assets so that she can distribute those funds according to her mother's direction. C also made a claim against the estate for a debt owed her and for annuity payments under the CRAT.

Presently, all parties with an interest in the outcome of these issues—C, A, D, and E agree that the continued pursuit of these claims will result in the further dissipation of the assets in the estate and the trust. After several months of negotiation all the above parties have reached the conclusion that the settlement represents the best solution for all involved.

The settlement provides, in summary, that C's claims against the estate of B shall be allowed to the extent of s. Such amount shall be paid by the estate of B to A as the trustee, for the liquidation of assets for distribution pursuant to the terms of the settlement agreement and the terms of the CRAT. C will withdraw any claim, petition, appeal of judgment or other action with regard to or against the estate of B and the CRAT including but not limited to any Will contest, claims, lis pendens, or any other matter that would remain claims against or with regard to the estate, the CRAT, or the administration of either. C and A have stipulated to the dismissal of proceedings in the E, and to the release of all funds held in the name of C by G in the F to A. The settlement agreement provides that C shall surrender, disclaim, and renounce her interest in annuity payments from the CRAT from \_\_\_\_\_, 2005, forward. The courts shall determine the annuity payments due to C prior to that period and upon such determination, those amounts shall be paid to the liquidating trust for disposition in accordance with the terms of the liquidating trust. Such funds shall be transferred to the charitable remainder trust and then to the liquidating trust.

It is represented that the charitable beneficiaries, D and E, the personal representative, A, and

the CRAT through A shall provide notice to the Federal District Court for the State of H that their losses have been adequately provided for under the terms of the settlement agreement. The estate has approximately t in assets. After paying the administrative and attorneys' fees, and certain specified expenses, the estate will be closed and its remaining assets will be distributed to the CRAT. The CRAT will then distribute all of its assets to the liquidating trust.

It is represented that the liquidating trust is intended to be a grantor trust for income tax purposes, with C treated as grantor of the trust. C will be solely responsible for income tax liabilities associated with the payment of annuities from the CRAT, and termination of the CRAT, and the distribution of the CRAT's assets, and for any other tax liabilities that result from such matters.

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

1. The proposed early termination of the CRAT pursuant to the Settlement Agreement will not constitute a taxable termination of a private foundation under section 507 of the Code.
2. The proposed early termination of the CRAT and the ultimate distribution of such trust's assets to C, D, and E, pursuant to the Settlement Agreement, will not constitute an act or acts of self-dealing under section 4941 of the Code with respect to the CRAT.
3. The ultimate distribution of the CRAT's assets to C, E, and D, pursuant to the Settlement Agreement, will not constitute a taxable expenditure or expenditures under section 4945(d)(5) of the Code.

#### Law and Analysis:

Section 509(a) of the Code provides that any organization described in section 501(c)(3) and not described in paragraph (1), (2), (3), or (4) of section 509(a) is classified as a private foundation. Chapter 42 of the Code contains several penalty excise taxes that apply only to private foundations. Included in this group of taxes are taxes imposed on direct or indirect acts of self-dealing (section 4941) and taxes imposed on "taxable expenditures" (section 4945).

Section 4941(a)(1) of the Code imposes on each act of self-dealing by a disqualified person an "initial" tax equal to 5 percent of the amount involved with respect to the act of self-dealing for each year in the taxable period.

Section 4941(d)(1)(A) of the Code provides that for purposes of this section the term self-dealing means any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person.

Section 4941(d)(1)(E) of the Code defines self-dealing as any direct or indirect 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) of the Code provides that the term "disqualified person" with respect to a private foundation includes a substantial contributor to the foundation (including the creator of a trust), a family member of a substantial contributor (including children), and foundation manager

(including a trustee).

Section 4947(a)(2) of the Code in referencing split-interest trusts provides that in the case of a trust which is not exempt from tax under section 507(a), not all the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under section 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522, section 507 (relating to termination of private foundation status), section 508(e) (relating to government instruments) to the extent applicable to a trust described in this paragraph, section 4941 (relating to taxes on self-dealing), section 4943 (relating to taxes on excess business holdings) except as provided in subsection (b)(3), section 4944 (relating to investments which jeopardize charitable purpose) except as provided in subsection (b)(3), and section 4945 (relating to taxes on taxable expenditures) shall apply as if such trusts were a private foundation.

Section 53.4947-1(c)(1)(ii) of the Treasury Regulations (the Regulations) provides that a split-interest trust is subject to the provisions of section 507 (except as provided in section 53.4947-1(e)), 508(e) (to the extent applicable to a split interest trust), 4941, 4943 (except as provided in section 4947(b)(3)), 4944 (except as provided in section 4947(b)(3), and 4945 in the same manner as if such trust were a private foundation.

Section 53.4947-1(c)(2)(i) of the Regulations provides, in general, 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 section 170(f)(2)(B), 2055(e)(2)(B) or 2522(e)(2)(B) with respect to the income interest of any such beneficiary. Example 1 makes clear that this rule applies to unitrust and annuity distributions.

Section 53.4941-1(a)(8) of the 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 any organization described in section 509(a)(4)).

Section 53.4946-(a)(2) of the Code defines the term "substantial contributor" as any person who contributed more than \$5,000 to the private foundation, if such amount is more than two percent (2%) of the total contributions received by the private foundation in the year of such contribution.

Under the rationale of the decisions in Rockefeller v. United States, 572 F. Supp. 9 (E.D. Ark. 1982), aff'd 718 F.2d 290 (8<sup>th</sup> Cir., 1983), cert. den. 466 U.S. 962 (1984) and Reis, 87 T.C. 1016 (1986), self-dealing under section 4941 may occur by virtue of the transfer of property held in an estate to which a private foundation has an interest or expectancy under the terms of the Will or revocable trust. If a court were to determine that a private foundation, in fact, has no interest or expectancy with respect to any specific property, there is then no context in which a self-dealing transaction might arise with respect to such specific property.

This principle is applicable with respect to the Settlement proposed in this case. This Settlement resolved most litigation between the parties, and determined rights and ownership of the parties in and to property of the estate of B. It cannot be said that any transaction pursuant to the Settlement Agreement raises any questions of self-dealing since each party under such Settlement Agreement is viewed as receiving the assets and property she or it was entitled to receive on the death of B, when the terms of the Will became final. All interested parties are viewed as merely carrying out the legal rights and obligations under the Will.

Accordingly, we rule as follows:

Termination of the CRAT and the ultimate disposition of such trust assets to C, D, and E pursuant to the Settlement Agreement will not constitute an act of self-dealing under section 4941(a)(1) of the Code with respect to C.

Section 8.01 of Revenue Procedure 2007-4, 2007-1 I.R.B. 130 provides that the Internal Revenue Service may decline to issue a letter ruling or a determination letter when appropriate in the interest of sound tax administration or on other grounds whenever warranted by the facts and circumstances of a particular cause.

The other rulings requested do not apply to C. Therefore, we have concluded that we cannot issue the rulings you requested under section 507 and 4945 of the Code.

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.

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. Specifically, no opinion is expressed or implied concerning the federal income, gift, and/or estate tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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. Because it could help resolved 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,

Robert C. Harper, Jr.  
Manager, Exempt Organizations  
Technical Group 3

Enclosure  
Notice 437