

Internal Revenue Service

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Legend

Taxpayer =
Charity =

Insurer =
Broker =
X =

Dear :

This is in response to your authorized representative's submission, dated July 18, 2007, requesting income and gift tax rulings on the proposed transaction.

The facts submitted and representations made are as follows. Taxpayer is an individual who itemizes deductions on Schedule A of the Form 1040. Taxpayer proposes to enter into a Gift Annuity Agreement (Agreement) with Charity. Under the terms of the Agreement, Taxpayer will transfer \$X to Charity in exchange for Charity's agreement to pay Taxpayer an annual annuity, payable in quarterly installments, for his life. Charity is an organization described in §§ 170(c) and 2522(a) of the Internal Revenue Code.

Section 2 of the Agreement provides that the annuity payments are a general obligation of Charity and are backed by all of Charity's assets. Section 6 provides that the annuity is irrevocable and non-assignable, except that it may be assigned to Charity. Charity's obligation under the Agreement will terminate with the regular payment preceding Taxpayer's death.

Section 7 provides that, except as provided in Section 8, upon Charity's satisfaction of its obligation under the Agreement, an amount equal to the residuum of the gift shall be used by Charity for its general operating purposes.

Section 8 provides that Charity is authorized, but not obligated, to use Taxpayer's gift (or proceeds thereof) to purchase a commercial annuity with the Annuitant's (Taxpayer's) life being the measuring life and the timing and amount of payments being substantially the same as the timing and amount of payments Charity is obligated to pay to Taxpayer under the Agreement. In such case, the portion of Taxpayer's gift that is not used to purchase the commercial annuity may be used by Charity immediately for its general operating purposes.

Attached to the Agreement is the Gift Annuity Disclosure Statement (Disclosure Statement) which states that the annuity payments are a general obligation of Charity and are backed by all of Charity's assets. Further, the Disclosure Statement states that: "While under no legal obligation to do so, Charity may elect to purchase an annuity with a commercial insurance company to fund a payment stream to Charity ... [for] the duration of Donor's life." Also, for Charity's administrative convenience and solely at its discretion and on its own behalf, Charity may elect to direct the commercial insurance company to make the quarterly payments generated by this annuity directly to Taxpayer in fulfillment of Charity's obligation to Taxpayer under the gift annuity contract.

Insurer and Broker offer commercial annuity contracts to charities, such as Charity. Charity proposes to purchase a commercial annuity contract (Contract) from Insurer. The Contract names Taxpayer as the Annuitant on page 3 (Data Page). The Contract defines an Annuitant as a natural person whose life is used to determine the amount and duration of income payments under the Contract involving life contingencies. On page 3, Charity is designated the Owner and the Payee of the commercial annuity. The Contract defines "Owner", in relevant part, as the natural or non-natural person named in the Application to hold the Contract and exercise all rights and privileges under it. The Contract defines "Payee", in relevant part, as the individual or entity named in the Application, or as subsequently changed by the Owner, to receive the income payments under a Payout Option.

The Contract describes the payout under the commercial annuity as income payments to the Payee for the life of the Annuitant. If the Annuitant dies prior to the time that the total amount of annuity payments received by the Payee equals or exceeds the premium, then an amount of money (equal to the initial premium minus the total of all payments made) will be paid in a lump sum to the Payee. Thus, under the terms of the Contract, Charity is the Payee of the commercial annuity, but Charity's payments are based on Taxpayer's life.

Section 2.02 of the Contract permits the Owner to name a different owner or joint owner between the "Contract date" and the "Income start date" of the policy. After the

“income start date,” the Contract provides that the Owner may no longer name a different owner or joint owner. Section 2.02 also permits the Owner to name and change the Payee and the Beneficiary. Taxpayer’s representative, who also represents Charity, has stated that representations will be provided stating that Charity will not name other owners or a joint owner prior to the start date of the policy; will not change the Payee; and will name itself exclusively as the Beneficiary.

Broker will receive a commission from Insurer and will not receive any compensation from Charity or Taxpayer. Charity will pay additional consideration for the option to have a guaranteed lump sum refunded to Charity if Taxpayer dies prior to the payout of an amount equal to the premium paid.

Charity has requested rulings from the Exempt Organization Division with respect to this proposed transaction. The rulings requested by Charity are: (1) Charity’s sale of annuities through the Agreement will not constitute the provision of commercial-type insurance under § 501(m); (2) the following amounts will not constitute income from an unrelated trade or business within the meaning of § 513: (a) the difference between (i) the premium received by Charity from Taxpayer for the Agreement and (ii) the premium paid by Charity to Insurer for the Contract, (b) the periodic annuity payments received from Insurer, and any lump sum paid by Insurer to Charity upon the death of the last Annuitant under the guaranteed cash refund feature of the Contract.

Taxpayer proposes to deduct as a charitable contribution the excess of the amount transferred to Charity over the represented value of the Agreement received in exchange, in the year Taxpayer purchases the charitable gift annuity, pursuant to the Agreement, from Charity.

You request the following rulings:

- (1) A charitable contribution deduction will be allowable under § 170 when Taxpayer purchases the charitable gift annuity, pursuant to the Agreement, from Charity.
- (2) A gift tax charitable deduction will be allowable under § 2522(a) when Taxpayer purchases the charitable gift annuity, pursuant to the Agreement, from Charity, and § 2522(c) will not be applicable.
- (3) The income tax charitable contribution deduction under § 170 and gift tax deduction under § 2522 will not be barred by § 170(f)(10)(A) (relating to split-dollar life insurance, annuity and endowment contracts).

The following rules are contingent on the Exempt Organization Division ruling favorably on the rulings submitted by Charity to that division with respect to this proposed transaction.

Ruling #1

Section 170(a)(1) allows as a deduction any charitable contribution (as defined in § 170(c)), payment of which is made within the taxable year, subject to the rules and limitations of § 170.

Section 1.170A-1(d)(1) states that in the case of an annuity purchased from a qualified charity, a taxpayer is allowed a deduction for the excess of the amount paid over the value of the annuity at the time of purchase. Section 1.170A-1(d)(2) states that the value of the annuity is determined in accordance with § 1.101-2(e)(1)(iii)(b)(2).

Rev. Rul. 70-15, 1970-1 C.B. 20, concerned a situation in which a taxpayer purchased an annuity contract from an organization of the type described in § 170. The amount paid by the taxpayer for the annuity was in excess of its fair market value at the time of the purchase as determined by the annuity rate tables in Rev. Rul. 62-137 and Rev. Rul. 62-216. Rev. Rul. 70-15 holds that the amount paid by the taxpayer for the annuity in excess of its fair market value at the time of purchase is a charitable contribution for the taxable year of such payment.

Pursuant to § 1.170A-1(d)(1) and Rev. Rul. 70-15, the excess of the amount paid over the present value of the annuity at the time of purchase is generally treated as a charitable contribution.

Based upon the facts submitted and representations made, we conclude that, provided all other requirements of § 170 are met, including, for example, that the deduction is not barred under § 170(f)(10), and to the extent provided in § 170, the contribution will be deductible in the taxable year of the payment to Charity. Therefore, Taxpayer will be entitled to treat as a charitable contribution the payment to Charity, less the present value of the charitable gift annuity as determined under § 1.170A-1(d) and all other applicable rules in the Code or Regulations

Ruling #2

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual resident or nonresident.

Section 2511 provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect.

Section 2512(b) provides that where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration received shall be deemed a gift.

Section 2522(a) allows a gift tax charitable deduction for the value of property transferred to a charity described in § 2522(a), which includes organizations exempt under § 501(c)(3).

Section 2522(c)(2) provides that, where a donor transfers a remainder interest in property to a charitable organization and has retained an interest in the same property, no deduction is allowed for the interest passing to charity unless it is in a qualified form (i.e., a charitable remainder trust or pooled income fund). However, Rev. Rul. 80-281, 1980-2 C.B. 282, holds that if a donor makes a gift to a charitable organization and, in return, receives an annuity from the charity, payable for his or her lifetime from the general funds of the charity, a gift tax charitable deduction is allowed under § 25.2552(a)-1 of the Gift Tax Regulations for the amount transferred to the charity that exceeds the present value of the annuity. Section 2522(c)(2) is not applicable in these circumstances.

Section 7520 provides that the value of any annuity shall be determined under tables prescribed by the Secretary and by using an interest rate equal to 120 percent of the federal mid-term rate in effect under § 1274(d)(1) for the month in which the valuation date falls.

In this case, Charity is described in § 2522(a). Taxpayer intends to transfer \$X to Charity in exchange for Charity's agreement, pursuant to the Agreement, to pay Taxpayer an annual annuity during Taxpayer's life. The annuity is payable out of the general funds of Charity, rather than the specific \$X transferred by Taxpayer to Charity. Thus, for purposes of § 2522(c)(2), Taxpayer will not retain an interest in the funds transferred to Charity. Although Charity intends to purchase a commercial annuity, pursuant to the Contract, from Insurer, the Contract will be owned by and be payable to Charity and will not name Taxpayer as the Beneficiary. For administrative convenience, Charity may direct Insurer to make annuity payments directly to Taxpayer on behalf of Charity. However, Charity will have no legal obligation to either purchase the Contract or arrange to direct payments to Taxpayer. Therefore, based upon the facts submitted and representations made, we conclude that, provided all of the other requirements under § 2522 are satisfied and assuming the deduction is not barred under § 170(f)(10), a gift tax charitable deduction will be allowable under § 2522(a) in the year Taxpayer purchases the charitable gift annuity, pursuant to the Agreement, from Charity, and § 2522(c) will not be applicable. Further, the amount of the gift tax charitable deduction will be equal to the \$X payment less the present value of the annuity payable to Taxpayer under the Agreement determined under § 7520.

Ruling #3

Section 170(f)(10) involves special rules for split-dollar life insurance, annuity, and endowment contracts. Section 170(f)(10)(A) provides that nothing in this section or

in §§ 545(b)(2), 642(c), 2055, 2106(a)(2) or 2522 shall be construed to allow a deduction, and no deduction shall be allowed, for any transfer to or for the use of an organization described in § 170(c) if in connection with such transfer (i) the organization directly or indirectly pays, or has previously paid, any premium on any personal benefit contract with respect to the transferor, or (ii) there is an understanding or expectation that any person will directly or indirectly pay any premium on any personal benefit contract with respect to the transferor. Section 170(f)(10)(B) defines “personal benefit contract” to include, with respect to the transferor, an annuity if any direct or indirect beneficiary under such contract is the transferor, any member of the transferor’s family, or any person (other than an organization described in § 170(c)) designated by the transferor.

Section 170(f)(10)(D) provides an exception for certain annuity contracts, wherein persons receiving payments under the charitable gift annuity will not be treated as indirect beneficiaries under § 170(f)(10)(B). Section 170(f)(10)(D) provides that if, in connection with a transfer to or for the use of an organization described in § 170(c), such organization incurs an obligation to pay a charitable gift annuity (as defined in § 501(m)) and such organization purchases any annuity contract to fund such obligation, persons receiving payments under the charitable gift annuity will not be treated for purposes of § 170(f)(10)(B) as indirect beneficiaries under such contract if (i) such organization possesses all the incidents of ownership under such contract; (ii) such organization is entitled to all the payments under such contract; and (iii) the timing and amount of payments under such contract are substantially the same as the timing and amount of payments to each such person under such obligation (as such obligation is in effect at the time of such transfer).

Section 501(m) provides rules under which certain organizations providing commercial-type insurance are not exempt from income. Section 501(m)(3)(E) provides that “charitable gift annuities” are not “commercial-type insurance.” Section 501(m)(5) defines a “charitable gift annuity” as an annuity if: (1) a portion of the amount paid in connection with the issuance of the annuity is allowable as a deduction under § 170 and § 2055, and (2) the annuity is described in § 514(c)(5).

Under § 170(f)(1)(A), the Contract might be treated as a personal benefit contract as defined in § 170(f)(10)(B) because of the expectation or understanding between the parties that Charity will purchase it and use its payments to fund the payments under the Agreement to Taxpayer. In such a case, any deduction would be disallowed. However, the § 170(f)(10)(D) exception permitting a deduction for a split-value annuity may be met in this proposal, provided two threshold requirements are satisfied: (1) the charitable gift annuity meets the requirements of §§ 501(m)(5) and 514(c)(5), and (2) an income tax charitable contribution deduction would otherwise be allowable under § 170.

Provided the threshold requirements are satisfied, the exception under § 170(f)(10)(D) only applies if: (1) Charity possesses all the incidents of ownership

under the Contract from Insurer; (2) Charity is entitled to all the payments under the Contract; and (3) the timing and amount of payments under the Contract are substantially the same as the timing and amount of payments under the Agreement to Taxpayer/Annuitant.

Taxpayer represents that Charity possesses all the incidents of ownership of the Contract. Section 2042(2), involving the inclusion in the gross estate of the proceeds of life insurance, focuses on whether decedent possessed at the time of death “incidents of ownership.” Section 20.2042-1(c)(2) defines the term “incidents of ownership” as meaning something more than ownership of the insurance policy in the technical legal sense. More generally, incidents of ownership include the ability to change beneficiaries, to cancel, assign or revoke an assignment, to pledge, and reversionary interests. By analogy to § 2042, possessing the incidents of ownership under the Contract in the instant case would mean that Charity is the technical owner of the Contract, and also can appoint or assign other rights, such as additional owners, additional payees, and additional beneficiaries.

Section 2.02 of the Contract permits the Owner to name a different owner or joint owner between the “Contract date” and the “Income start date” of the policy. After the “Income start date,” the Contract provides that the Owner may not longer name a different owner or joint owner. Section 2.02 of the Contract also permits the Owner to name and change the Payee. All these powers suggest that as of the date of the contribution, Charity possesses all the incidents of ownership under the Contract.

With respect to the second requirement (that Charity be entitled to all the payments under the Contract), Charity is the Payee under the Contract, while Taxpayer is to be paid amounts under the Agreement out of the general funds of Charity. Although Taxpayer is the Annuitant under the Contract, Taxpayer is not entitled to receive any payments from the Contract. Rather, Taxpayer’s only function under the Contract is to serve as the measuring life in determining the guaranteed payments and payout under the Contract. The Contract defines the Payee as the entity named in the application that is to receive the income payments under the payout option. Under the Contract, Charity is both the Owner and the Payee. Thus, as of the date of the contribution, Charity is entitled to all payments under the Contract.

With respect to the third requirement, § 170(f)(10)(D)(iii), the Contract is clear that the commercial annuity purchased by Charity from Insurer requires the timing and amounts of payments to be substantially the same as the timing and amount of payments under the Agreement. In fact, payments may be made directly from Insurer to Taxpayer, to cover Charity’s obligation under the Agreement, for the administrative convenience of Charity. Therefore, based upon the facts submitted and representations made, we conclude that the income tax charitable contribution deduction under § 170 and the gift tax charitable deduction under § 2522 will not be barred by § 170(f)(10)(A).

As noted above, rulings ##1, 2, and 3 are contingent upon the Exempt Organization Division ruling favorably on the rulings submitted by Charity to that division with respect to this proposed transaction.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

George L. Masnik
Branch Chief, Branch 4
(Office of Passthroughs & Special Industries)

Enclosures (1)
Copy for § 6110 purposes

cc: