

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:

September 30, 1999

Trust =

Settlor =

Corporation =

Trustee =

State =

a =

b =

c =

D1 =

Cite 1 =

Cite 2 =

Dear :

This letter is in response to your letter dated December 22, 1998, and subsequent correspondence, requesting a ruling regarding the tax consequences of a consent dividend to Trust, a charitable remainder unitrust.

The information submitted states that Settlor established Trust on D1. Trustee is the trustee of Trust. Trust is governed by the laws of State and is intended to qualify as charitable remainder unitrust under § 664(d)(2). The governing document of Trust provides that Trustee shall pay to Settlor a unitrust amount equal to the lesser of (a) the trust income for the year,

as defined under § 643(b) of the Code and regulations thereunder, or (b) five percent of the aggregate fair market value of the trust assets for the year. The trust instrument also provides that the unitrust amount for any year shall also include any amount of trust income for such year that is in excess of the amount required to be distributed under (b) above, to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed at five percent of the net fair market value of the trust assets. Currently, the aggregate of the amounts paid in prior years is approximately a dollars less than the aggregate of the amounts computed at five percent of the net fair market value of trust assets in prior years.

The primary asset held by Trust is stock in Corporation. Corporation currently has in excess of a dollars of accumulated earnings and profit. Corporation intends to convert to a real estate investment trust (REIT). To be eligible to convert to a REIT, Corporation must distribute its pre-REIT accumulated earnings and profits. To accomplish this, Corporation proposes to distribute to its shareholders approximately b percent of its earnings and profits through a cash dividend and c percent of its earnings and profits in a non-cash consent dividend under § 565 of the Code. Trustee represents that it will only agree to the consent dividend if the consent dividend made to Trust is pro-rata when compared with the aggregate consent dividends made to the other existing shareholders of Corporation. It will not be an option for Trust or any other shareholder of Corporation to receive additional common stock or notes of Corporation as part of the distribution of Corporation's earnings and profits.

Trustee represents that amounts treated as consent dividends will be included by Trustee in Trust's gross income described in § 664(b)(1). Trustee also represents that under the laws of State, a trust generally does not have either income or principal until the trust receives money or property. See Cite 1. Trustee also represents that under the laws of State and, under the terms of the governing document of Trust, all distributions from a REIT to Trust, other than distributions made from ordinary income, are principal. See Cite 2. Thus, the Trustee represents that all distributions by Corporation after it is a REIT to Trust, other than distributions of the REIT's ordinary income, will be allocated to principal by Trustee and thus, will never be distributed to Settlor as part of the unitrust amount.

Section 664(d)(2)(A) provides that, for purposes of § 664, a charitable remainder unitrust is a trust from which a fixed percentage (that is not less than 5 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons.

Section 664(d)(3) provides that the trust instrument may provide that the trustee shall pay the income beneficiary the amount of the trust income, if such amount is less than the amount required to be distributed under § 664(d)(2)(A), and any amount of the trust income which is in excess of the amount required to be distributed under § 664(d)(2)(A), to the extent that (by reason of subparagraph (A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

Section 1.664-3(a)(1)(i)(b)(3) provides that trust income, for purposes of § 664(d)(3), means income as defined in § 643(b) and the regulations thereunder.

Section 643(b) provides that, for purposes of subparts A through D, part I, subchapter J, chapter 1, the term "income," when not preceded by the words "taxable," "distributable net," "undistributed net," or "gross," means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends that the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

Section 664(b) contains the ordering rules for determining the character of a charitable remainder trust's distribution in the hands of the recipient. Section 664(b)(1) provides that the amounts distributed by a charitable remainder trust are first considered amounts of income (other than gains, and amounts treated as gains, from the sale or other disposition of capital assets) includible in gross income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years.

Section 565(a) provides that if a person owns consent stock in a corporation on the last day of the taxable year of the corporation, and such person agrees, in a consent filed with the return of the corporation to treat as a dividend the amount specified in such consent, the amount so specified shall be treated as a consent dividend. Section 565(c) provides that the amount of the consent dividend shall be considered as distributed in money by the corporation to the shareholder on the last day of the taxable year, and as contributed to the capital of the corporation by the shareholder on such day.

Based on the facts and representations submitted, we conclude that because Trust does not have income under state law until it is in actual receipt of money or other property, the

amount treated as a consent dividend by Trustee and Corporation, is not income under § 643(b). Accordingly, amounts treated as consent dividends are included in Trust's gross income for purposes of § 664(b)(1), but do not constitute trust income for purposes of § 664(d)(3)(A).

No opinion is expressed or implied as to the federal tax consequences of the formation and operation of Trust under any other provision of the Code. Specifically, no opinion is expressed as to (1) whether Trust qualifies as a charitable remainder unitrust under § 664; (2) whether Corporation qualifies as a REIT, (3) whether the proposed transaction meets the requirements of § 565, (4) the tax consequences of the proposed transaction to Corporation; and (5) the tax consequences of any future transaction treated as a consent dividend by Trustee and Corporation to Trust, Settlor, and Corporation. Further, this ruling applies only to Trust as currently structured.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to Trustee.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be cited or used as precedent.

Sincerely yours,

J. THOMAS HINES
Senior Technician Reviewer
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes