



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

Identification Number:

Telephone Number:

Fax Number:

Employer Identification Number:

A =
B =
C =
D =
E =

Dear _____ :

We have considered your ruling request dated January 14, 2004, on the proper treatment of the termination of A and whether the termination constitutes an act of self-dealing under Section 4941 of the Internal Revenue Code.

B and C are retired. A was established for the lifetime benefit of the settlors B and C with the remainder distributed to D, a private foundation described in Sections 501(c)(3) and 509(a) of the Code, to be used for charitable purposes.

The purpose of the transaction is to provide for an early termination of A. A is a charitable remainder trust as described in Section 664(d)(2) of the Internal Revenue Code. The terms of A require payment of the lesser of the following to B and C during their lives:

1. The trust income for the taxable year as defined in Section 643(b) of the Code and the regulations there under; or
2. Fifteen percent (15%) of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust in quarterly installments on the last day of each quarter.

The trust is irrevocable and terminates on the death of both B and C. Upon termination, the remaining assets are distributed to D. The only conditions for distribution to D are that the

foundation is a qualified charity and that B and C have not exercised their retained power to specify a different or additional charitable remainderman. B and C are disqualified persons with respect to D as major donors.

B and C propose an early termination of A. The primary asset contributed to A was shares of a closely held corporate stock. Those shares were recently sold to a third party leaving cash as A's primary asset. B and the trustees of D have determined that the purpose of A, to provide management over the trust assets, no longer exists and that the charitable intent of A can be better served by an early termination and distribution of the remainder interest directly to charitable beneficiaries or D.

All of the interested parties agree to the proposal to terminate A and to distribute to the income and remainder beneficiaries pro-rata shares of the trust assets equal to the present value of their respective interest, measured on the date of termination. B and C plan to treat the proceeds as an amount received from the sale or other disposition of a term interest in property, subject to the limitations of Section 1001(e)(1) of the Code (i.e., gain equal to the entire amount realized, with no offsetting basis in the term interest).

A will use the actuarial value of the shares 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. A is to be construed under the law of E. A has received an opinion from its legal counsel that early termination is permissible if the beneficiaries agree and none of the beneficiaries' interests are contingent. B and C plan to release their power to change the charitable remainderman. The termination will be accomplished through court proceedings in E and the consent of E's Attorney General will be obtained prior to termination.

A proposes that the early termination will provide B and C a share of the trust assets equal to the actuarial value of the remaining years of trust income. B and C have confirmed that neither B nor C have a medical condition that is expected to result in a shorter than average longevity for persons of their ages, as set forth in Table Y, Section 1.72-9 of the Regulations. A physician has performed examinations of B and C and has provided a confirmation of this assertion. B and C have also signed affidavits that they know of no health condition that would reduce their normal life expectancy.

Rulings Requested

The taxpayer requests the following rulings:

1. Early termination and division of the trust as proposed will not constitute an act of self-dealing under Section 4941(a)(1) of the Code by the trustee or by either donor with respect to the trust, nor by either donor with respect to D:

2. Consent to the early termination by D will not constitute participation in a self-dealing transaction under Section 4941(a)(2) of the Code by any foundation manager; and
3. The proposed termination will not constitute a termination of foundation status under Section 507(a) of the Code.

Statement of the 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 foundation 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, disqualified person of the income or assets of a private foundation.

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 1.508-3(e)(2) of the Income Tax Regulations provides generally that a split-interest trust described in section 4947(a)(2) of the Code is subject to the provisions of section 508(e) to the extent that section 4947 applies sections 4941-4945 to such a trust.

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).

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 critical 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 beneficiaries are not expected to receive more than they would during the full term of the trust. The charitable remainder beneficiaries might receive more because the donors have a right to change the remainder beneficiaries, or designate additional ones and change the proportions. At least theoretically, the charitable remainder has not vested until the trust has ended without exercise of the reserved power.

ANALYSIS

We are persuaded by the following circumstances that the early termination in this case 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 beneficiaries' physician has conducted physical

examinations 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 beneficiaries have signed similar statements.

Therefore, we rule that:

1. Early termination and division of the trust as proposed will not constitute self-dealing under Section 4941(a)(1) of the Code by the trustee or by either donor with respect to the trust, nor by either donor with respect to D
2. Consent to the early termination by D will not constitute participation in a self-dealing transaction under Section 4941(a)(2) of the Code by any foundation manager.
3. The proposed termination will not constitute a termination of foundation status under Section 507(a) 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 be 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 Kawecki
Manager, Exempt Organizations
Technical Group 1

Enclosure
Notice 437