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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: OCT 3 2002

TEO:B2

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number

LEGEND:

D = trust donor and unitrust beneficiary
M= state
U = trust

UIL No.
4941.04-00

Dear Sir or Madam:

We have considered your request dated June 26, 2002 for a ruling that early termination and division of U will not constitute self-dealing by the Trustee of U, by the two Donors (either with respect to the trust or to the charitable remainder foundation), or by any foundation manager; and that the proposed termination will not constitute a termination of foundation status for the purpose of IRC §507(a).

U is a charitable remainder unitrust described in section 664(d)(2) of the Internal Revenue Code, and a split-interest trust described in section 4947(a)(2). The terms of U require it to pay out 20% of the net fair market value of its assets each year to D and his wife jointly, or the entire amount to the survivor. The payment is made out of net income, and to the extent necessary, out of principal. The term of U is five years, ending on December 27, 2004, or on the earlier death of the survivor of D and his wife. Upon termination, the remaining assets are distributed to a private foundation (described in sections 501(c)(3) and 509(a) of the Code.) The only conditions for the distribution to the foundation are that the foundation is still a qualified charity and that D and his wife have not exercised their retained power to specify a different remainderman. D and his wife are disqualified persons with respect to the foundation as major donors and trustees.

The economy in the recent past has made it difficult to reconcile the interests of the trustee in managing U for the substantial annual disbursement of 20%, and the interest of the foundation in preserving the capital of U until it is delivered. D, who is also a trustee of the foundation, feels that the foundation could better invest its share of the assets for its long-term commitments. All of the interested parties agree to the proposal to terminate U early and to distribute to the income and remainder beneficiaries pro rata shares of the trust assets equal to the present value of their respective interests, measured on the date of termination. D and his wife 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).

U represents that the actuarial values of the shares will be determined 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 regulations for valuing interests in charitable remainder trusts. The trust is construed under the law of the State of M. U has presented an opinion from an M lawyer that the early termination is permissible if the beneficiaries agree and none of their interests are contingent. As part of the proposed transaction, the donors plan to release their power to change the charitable remainderman. In the opinion of the attorney, neither the courts nor the Attorney General of M are necessary participants.

U admits that it would be improper for the donors to receive from the proposed early termination a greater share of the trust than the actuarial value of the remaining years of trust income. This could happen if both donors were to die before the end of the stated term, on December 27, 2004. However, U has substantiated its assertion that neither D nor his wife have a medical condition that is expected to result in a shorter longevity than expected for a persons of their ages, as set forth in Table V of section 1.72-9 of the regulations. A specialist in internal medicine performed full physical examinations of D and his wife last April, and has signed affidavits under penalties of perjury. D and his wife have also signed affidavits that they know of no health condition that would reduce their normal life expectancy.

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, a 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 amounts 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 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 Foundations 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 Foundations and Similar Excise Taxes 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).

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." Reg. § 4947(a)(2)(A). 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.

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 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 the Foundation.

2. Consent to the early termination by the Foundation 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.

Except as we have ruled above, we express no opinion as to the tax consequences of the transaction under the cited provisions of the Code or under any other provisions of the Code.

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

Because this letter could help resolve future tax questions, you should keep a copy of this ruling in your permanent records.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Jane Baniewicz
Acting Manager
Exempt Organizations
Technical Group 2