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

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Date: OCT 7 1999

OP:E:EO:T:3

Contact Person:

ID Number:

Telephone Number:

Employer Identification Number:
Key District Office:

T=
X=
Y=
Z=
a=
b=

Dear Sir:

This letter is in response to a letter dated June 16, 1999, requesting rulings under sections 507, 4941, and 4945 of the Internal Revenue Code.

X is an irrevocable inter vivos charitable lead annuity trust created on April 2, 1993. **X** constitutes a split-interest trust pursuant to section 4947(a)(2) of the Code. The sole charitable beneficiary is **Y**, a state **a** nonprofit corporation which is exempt under section 501(c)(3) and is classified as a private foundation under 509(a).

At the time of the creation of **X** in 1993, the grantor transferred to **X** a number of shares of stock of **Z**, a closely-held, non-public bank holding company which was controlled by the Grantor's family. At that time the shares of **Z** transferred to **X** had an estimated value of approximately $4**b**.

The trust document provides that **X** will continue in existence for 20 years and pay **Y** a guaranteed annuity payment of 5 percent of the fair market value of the **Z** stock at the end of each year. To date, **X** has paid the appropriate amount to **Y** each year of its existence. If **X** were to continue in existence for its full term of 20 years, it would owe **Y** the sum for the remaining years in existence of $2.8**b**.

The trust document provides that at the end of the trust's 20 year term, the trustees are to distribute the remainder interest to the Grantor's four children. These four children are also all of the trustees of **X** and all of the foundation managers of **Y**. This information is disclosed in the court petition described in detail later in this letter.

Z merged with and into **T**, a corporation whose common stock is traded on the New York Stock Exchange. As a result of the merger, **X** received a number of shares of stock of **T** which have a value presently of approximately $22**b**. Such value is substantially in excess of the value of the stock of **Z** when

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it was originally transferred to **X**. The dividend that **X** will receive from **T** is well in excess of the amount necessary to pay the annuity to **Y**.

Because the assets of **X** have been converted to stock of **T** which is readily convertible to cash, **X**'s charitable interest can now be satisfied much earlier than originally anticipated by the Grantor when he created the trust. Accordingly, the grantor, the trustees of **X**, the foundation managers of **Y**, and the four remaindermen all now wish to pay **Y** in one lump sum payment the remaining amount due to **Y** under the trust document, the sum of $2.8**b** in the form of cash and stock of **T**, without discount.

The parties identified in the preceding paragraph have filed a petition in a local court in state **a** seeking authorization to pre-pay **Y** the entire $2.8**b** balance owing on the annuity payments, and then to terminate the trust by distribution to the remainder interests. The petition has named the Attorney General of state **a** as a party to the suit to protect the interests of the charity, **Y**.

Accordingly, the following rulings have been requested:

1. The trustees' prepayment of the entire remaining charitable interest without discount to **Y** as the sole charitable beneficiary of the trust will not constitute a termination of a private foundation under section 507 of the Code.

2. The Trustees' prepayment of the entire remaining charitable interest without discount to **Y** as the charitable beneficiary of the trust will not be an act of self-dealing under section 4941 of the code.

3. The Trustees' prepayment of the entire remaining charitable interest without discount to **Y** as the charitable beneficiary of the trust will not be a taxable expenditure under section 4945 of the Code.

Section 507(a) of the Code provides, in pertinent part, that the status of any organization as a private foundation shall be terminated only if such organization notifies the Secretary of its intent to accomplish such termination.

Section 507(c) of the Code imposes a tax upon a private foundation's termination of its status as a private foundation.

Section 4947(a)(2) of the code provides that in the case of a trust which is not exempt from tax under section 501(a), not all of 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), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, section 507 (relating to the termination of private foundation status), 508(e) (relating to governing instruments), 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 section 4947(b)(3), and section 4945 (relating to tax on taxable expenditures) shall apply as if such trust were a private foundation.

Section 53.4947-1(e)(1) of the Foundations and Similar Excise Regulations (Regulations) provides that the provisions of section 507(a) 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.

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Section 53.4947-1(e)(2) of the regulations provides examples of the application of section 53.4947-1(e)(1).

Section 4941(a)(1) of the Code imposes a tax on any act of self-dealing between a private foundation and a disqualified person as defined in section 4946 of the Code.

Section 4945(a)(1) of the Code imposes a tax on a private foundation's making any taxable expenditure as defined in section 4945(d).

Section 53.4946-1(a)(8) of the regulations provides that, for purposes of self-dealing under section 4941 of the Code, an exempt organization is not a disqualified person.

With respect to the first ruling, the payment of cash and stock to **Y** to extinguish the annuity liability of **X** to **Y** under the terms of the trust does not constitute a termination under section 507(a). Section 53.4947-1(e)(1) of the regulations specifically provides that the provisions of section 507(a) shall not apply to a trust described in 4947(a)(2) by reason of any payment that is directed by the terms of the governing instrument of the trust and is not discretionary with the trustee. In this case, **X** has a mandatory payment required by the trust document and **X** is fulfilling its obligation by making the required payment. The payment is no less mandatory, nor is it deemed discretionary with the trustee, merely because all parties agree to make the charitable payment earlier than required by the trust document. The payment to **Y** is only authorized by order of the Court on the petition to the court for approval for such accelerated payment. The examples under section 53.4947-1(e)(2), particularly examples (1) and (2), are illustrative of the general rule that payout of the charitable amount is not a section 507(a) transaction.

There is no act or acts of self-dealing under section 4941 of the Code since the payments by **X** to **Y** are not made to a disqualified person. The payment to **Y** for the reasons described in the preceding paragraph does not fall under any of the acts of self-dealing described in section 4941(d)(1) of the Code.

There are no taxable expenditures with respect to the proposed transaction. The payment to **Y** does not come within the definition of taxable expenditure under section 4945(d) of the Code. The Code and regulations have provided special rules for the income payout of split-interest trusts in recognition of the special nature of these payments. For example, a split-interest trust under section 4947(a)(2) of the code is subject to neither the excise tax on investment income under section 4940, nor is the trust required to make a mandatory distribution under section 4942. No payout is required under section 4942 since the trust is already subject to a payout requirement. Section 4947(a)(2)(A) of the Code and section 53.4947-1(c)(2) of the regulations preclude the application of section 4941 to the income interest payable to income beneficiaries of charitable remainder trusts since such interests are what they are entitled to receive by the trust document. As seen above under section 53.4947-1(e)(1) of the Regulations, the provisions of section 507(a) do not apply to apply to any split interest trust by reason of any payment to a beneficiary directed by the terms of the governing instrument of the trust.

By the same token, it is our view that the expenditure responsibility requirement for grants under section 4945(d)(4) is not applicable to the income payment by a charitable lead trust since the income payout is mandated by the trust instrument. In essence, the payment is more in the nature of a contribution or donor grant rather than that of the Trust. Similarly, section 4945(d)(5) is not applicable since the income payout of a lead trust is for the very charitable purpose for which the trust is established. Thus, there is a direct analogy to section 53.4947-1(c)(2) precluding self-dealing with respect to payment of the annuity or unitrust amount for the charitable remainder trust. This is not to say that the income payment to the charitable beneficiary of a charitable lead trust will never constitute a taxable expenditure, but under the facts of this case where the payment is made for the appropriate charitable purpose established by the trust document, there is no taxable expenditure.

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Accordingly, we rule as follows:

1. The Trustees' prepayment of the entire remaining charitable interest without discount to **Y** as the sole charitable beneficiary of **X** will not constitute the termination of a private foundation under section 507 of the Code.

2. The Trustees' prepayment of the entire remaining charitable interest without discount to **Y** as the charitable beneficiary of **X** will not be an act of self-dealing under section 4941 of the Code.

3. The Trustees' prepayment of the entire remaining charitable interest without discount to **Y** as the charitable beneficiary of **X** will not be a taxable expenditure under section 4945 of the Code.

This ruling is based on the understanding that you will petition the local court in state **a** permitting **X** to make such prepayment and that the Office of the Attorney General of state **a** will be joined in such proceedings. Further, it is understood that neither **X**, the Trustor, the trustees, or any "disqualified person" within the meaning of section 4946 of the code will receive any benefit from the prepayment to **Y** other than the rights of remaindermen provided in the trust document.

This ruling is directed only to the organization that requested it. Section 6110 of the Code provides that it may not be used or cited as precedent. We are sending a copy of this ruling letter to your attorney

Sincerely,

(signed) Robert C. Harper, Jr.

Robert C. Harper, Jr.
Chief, Exempt Organizations
Technical Branch 3

cc:

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