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

200225045

Date: 3/26/02

Contact Person:

Identification Number:

Telephone Number:

T:EO:B2

Employer Identification Number:

U.I.L. Nos.
507.03-00
507.04-00
4941.04-00
4945.04-00

LEGEND

C =
J =
X =

Dear Sir or Madam:

This letter responds to X's request dated September 22, 2000 for rulings pertaining to the proposed early termination of a split-interest trust.

FACTS

X qualifies as a split-interest trust pursuant to IRC section 4947(a)(2). The sole charitable beneficiary is C, a non-profit corporation which is exempt under IRC section 501(c)(3) and is classified as a private foundation under IRC section 509(a). On the date of X's creation, X was transferred a 97% limited partnership interest in a Limited Partnership that owns various publicly traded securities.

The term of the Trust is 12 years and 9 months during which time X is obligated to pay C a guaranteed annuity payment based on 12% of the net fair market value of X's assets on the date the partnership interest was transferred. Accordingly, X has made quarterly payments to C to satisfy its obligation.

As provided in the trust document, at the end of the term the remaining principal and undistributed income will be distributed to a residuary trust for the benefit of J.

Due to the appreciation in the Partnership's investment portfolio, X is able to meet its charitable obligations to C earlier than originally anticipated. A prepayment of X's obligations would increase C's resources as well as enable C to increase its charitable commitments over time. Accordingly, X now wishes to pay C, in one lump sum payment, the remaining amount due to C under the Trust document in the form of cash and/or publicly traded stock, without

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discount.

X has filed a petition in a local court seeking authorization to pre-pay C the entire balance owed on the annuity payments. Subsequently, the remaining principal and undistributed income will be distributed to a residuary trust for the benefit of J.

RULINGS REQUESTED

Based on the foregoing facts, X requests the following rulings:

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

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

3. X's prepayment of the entire remaining charitable interest without discount to C as the charitable beneficiary of the trust will not be a taxable expenditure under section 4945 of the Code.

LAW AND ANALYSIS

Ruling 1

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 --

(1) such organization notifies the Secretary (at such time and in such manner as the Secretary may by regulations prescribe) of its intent to accomplish such termination, or

(2)(A) with respect to such organization, there have been either willful repeated acts (or failures to act) or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(B) the Secretary notifies such organization that, by reason of subparagraph (A), such organization is liable for the tax imposed by subsection (c),

and either such organization pays the tax imposed by subsection (c) (or any portion not abated under subsection (g)) or the entire amount of such tax is abated under subsection (g).

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 the trust which is not exempt from tax under section 50 1 (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 Taxes 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.

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

Example (2). H creates a trust under which X, a section 501(c)(3) organization, receives $20,000 per year for a period of 20 years, remainder to S, H's son. H is allowed a deduction under section 2522 for the present value of X's interest.

When the final payment to X has been made at ten end of the 20-year period in accordance with the terms of the trust, the provisions of section 4947(a)(2) will cease to apply to the trust because the trust no longer retains any amounts for which the deduction under section 2522 was allowed. However, the final payment to X will not be considered a termination of the trust's private foundation status within the meaning of section 507(a).

The payment of cash and/or stock to X in order to cease the annuity liability of X to C pursuant to the trust terms does not constitute a termination under section 507(a). Regulation section 53.4947-1(e)(1) provides that the provisions of section 507(a) shall not apply to a trust described in section 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.

Pursuant to the trust document, X is required to make mandatory payments to C and has fulfilled its obligation by making all required payments to date. The decision by all parties to make the charitable payments prior to the end of the term of the trust does not render the payment any 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. Additionally, the accelerated payment to C is subject to the approval of a court petition. Furthermore, the Regulation illustrations under section 53.4947-1(e)(2) further support the general rule that the payout of the charitable obligation does not constitute a section 507(a) transaction.

Ruling 2

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 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.

As C is not a disqualified person, the payments made by X to C will not constitute an act or acts of self-dealing under section 4941of the Code.

Ruling 3

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 4945(d) defines the term "taxable expenditure" as any amount paid or incurred by a private foundation—

(1) to carry on propaganda, or otherwise to attempt, to influence legislation, within the meaning of subsection (e),

(2) except as provided in subsection (f), to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive,

(3) as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of subsection (g),

(4) as a grant to an organization unless-

(A) such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2), or

(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h), or

(5) for any purpose other than one specified in 170(c)(2)(B).

Section 53.4945-6(a) of the regulations defines the term "taxable expenditure", as used under section 4945(d)(5) of the Code, to include any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B). Thus, ordinarily only an expenditure for an activity which, if it were a substantial part of the organization's total activities, would cause loss of tax exemption is a taxable expenditure under section 4945(d)(5).

Section 53.4945-6(b)(1)(v) of the Regulations provides that any payment which constitutes a qualifying distribution under section 4942(g) of the Code or an allowable deduction under section 4940 ordinarily will not be treated as a taxable expenditure under section 4945(d)(5).

X's expenditure to a charitable organization as required under X's trust instrument is in furtherance of a section 170(c)(2)(B) purpose in fulfillment of its charitable lead annuity requirement in its governing instrument. Therefore there is no taxable expenditure under section 4945(d)(5) of the Code relating to the proposed transaction.

CONCLUSIONS

Accordingly, we rule as follows:

1. X's prepayment of the entire remaining charitable interest without discount to C as the sole charitable beneficiary of the Trust will not constitute the termination of the private foundation under section 507 of the Code.

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

3. X's prepayment of the entire remaining charitable interest without discount to C as the charitable beneficiary of X will not be a taxable expenditure under section 4945 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 X. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Because this letter could help resolve any future questions about the tax consequences of X's activities, X should keep a copy of this ruling in its permanent records.

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.

Sincerely,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2