200038050

Internal Revenue Service

Department of the Treasury

Washington. DC 20224

contact Person:

Telephone Number:

In Reference to:

T:EP:RA:T3

Date:

JUN 26 2000

UIL Nos: 72-06-00
509.00-00
401.17-00
402.01-01
664.03-03
1223.02-00

LEGEND:

Taxpayer A:

Taxpayer B:

Position C:

Date 1:

Value 1:

Value 2:

Value 3:

Sum 1:

Basis 1:

Company M:

Company 0:

Location P:

Fund Q:

Foundation R:

Plan X:

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State Y:

Dear Mr. :

This is in response to the request for letter ruling, submitted on your behalf by your authorized representative, as supplemented by correspondence dated and

in which you request a series of rulings under sections 72, 401, 402, 509, 664, and 1223 of the Internal Revenue Code. The following facts and representations support your ruling request.

Taxpayer A, whose date of birth was Date 1, is married to Taxpayer B, a United States citizen Taxpayer A attained age 55 during the 1999 calendar year. Taxpayer A was employed in Position C by Company M which sponsors Plan X. Your authorized representative asserts that Plan X is qualified under Code section 401(a). Plan X holds stock of Company M. Company M stock is listed on the New York Stock Exchange.

Section 7.18 of the Plan X, in relevant part, permits a Plan X participant to have any portion of an eligible rollover distribution to be paid directly to a single eligible retirement plan, including an individual retirement arrangement (IRA) described in Code section 408, specified by the distributee in a direct rollover.

Taxpayer A is a participant in Plan X and his Plan X account includes approximately Sum 1 shares of Company M stock with a value of approximately Value 1. Taxpayer A's total Plan X account balance is approximately Value 2. Taxpayer B is currently designated as the beneficiary of Taxpayer A's Plan X account balance.

The total cost basis of Taxpayer A's Plan X account is approximately Basis 1 which includes after-tax employee contributions in the amount of approximately Value 3.

Taxpayer A retired and severed his employment relationship with Company M during 1999. After retirement, Taxpayer A will continue to serve Company M as a part-time consultant. Other than serving as a consultant, Taxpayer A will have no other post-retirement relationship with Company M. Taxpayer A will receive fixed sums for his consulting services.

As noted above, prior to his retirement, Taxpayer held Position C with Company M. While holding Position C, Taxpayer A was in direct supervision of a group of Approximately 400 people involved in research and development of Company M. In addition, Taxpayer A's general responsibilities included the direction of approximately 800 people who worked within the research and development division. Taxpayer A's primary work site was Location P. At Location P, Taxpayer A was assigned specific support staff and reported to the chief executive officer and the chairman of the board of Company M. Taxpayer A was expected to work on a full-time basis which often involved substantially more than forty hours of work per week. Taxpayer A's remuneration was based upon salary but also included short and long-term bonuses. As an employee of Company M, Taxpayer A received a fringe benefit package which included life insurance, health insurance, defined vacation time, and retirement benefits.

After leaving Company M, Taxpayer A has formed Company 0, a State Y corporation. Company 0 was formed to enable Taxpayer A to provide consulting services to Company M and other companies.

Taxpayer A and Company 0 are under contract to Company M to be available to provide consulting services on special projects and in emergency situations for five (5) years. The consulting contract does not require either any regular activities, any regular reporting, or the furnishing of regular services to Company M. Your authorized representative asserts that, barring unusual or emergency situations, Taxpayer A's obligations to render consulting services to Company M may be extremely limited.

Your authorized representative asserts the following on your behalf:

(a) Since his retirement, Taxpayer A no longer supervises any employees of Company M;

(b) since his retirement, Taxpayer A does not report to anyone at Company M;

(c) since his retirement, Taxpayer A longer has either an office or a support staff at Company M;

(d) in the event that either Taxpayer A or Company 0 is needed to furnish consulting services to Company M, Taxpayer A may either employ her individuals as part of Company 0 to provide those services or furnish those services personally;

(e) although Taxpayer A is restricted from working with direct competitors of Company M or from sharing certain trade secrets or long-term strategies that were developed at Company M, Taxpayer A is not restricted from working with other organizations. Additionally Taxpayer A has provided consulting services to other companies; and

(f) although Company 0 receives a retainer from Company M, the total compensation paid to Taxpayer A and Company 0 by Company M is approximately one-third of the compensation that was received by Taxpayer A prior to his retirement from Company M.

During calendar year 2000, Taxpayer A will receive a single sum distribution of his entire Plan X account balance and will direct that a portion of his Plan X balance, including a portion of the shares of Company M stock held in his account, be directly rolled over (transferred) into his IRA which transfer will meet the definition of a "direct rollover" as that term is used in Code section 401(a)(31). The remainder of the shares will be distributed directly to Taxpayer A.

Thus, in summary, the distribution made from Plan X to Taxpayer A during calendar year 2000 will either be directly transferred into his IRA or paid directly to him.

Taxpayer A intends to create a Charitable Remainder Unitrust (CRUT) which your authorized representative asserts will comply with Code section 664 and the regulations promulgated thereunder. The initial trustee of the CRUT will be Taxpayer A. The CRUT will provide that a unitrust amount equal to the lesser of trust income or a specified percentage of the net fair market value of the trust assets determined annually will be paid to Taxpayer A for life and after his death to Taxpayer B for her life if she survives Taxpayer A. Taxpayer A will reserve the power, exercisable by will, to revoke and terminate Taxpayer B's interest under the CRUT. On the death of the last to die of Taxpayer A and Taxpayer B, or upon the death of Taxpayer A if he exercises his power to revoke Taxpayer B's interest in the CRUT, the trust corpus will be paid to Fund Q, a part of Foundation R. In the event that Fund Q of Foundation R is not recognized as an organization described in sections 170(b)(l)(A), 170(c), 2055(a) and 2522(a) at the time the trust principal is to be distributed, the then serving trustee will distribute such property to one or more organizations so described, as the trustee shall select in its sole discretion.

Taxpayer A proposes to contribute all or a portion of the "non-rolled over" shares of Company M stock, which he will receive from Plan X to his CRUT, during calendar year 2000. Additionally, Taxpayer A may contribute other property to the CRUT which other property will not have been distributed from Plan X. The remainderman of Taxpayer A's CRUT will be Fund Q of Foundation R. The CRUT language provides that in the event that the organization named as remainderman does not meet the requirements of Code sections 170(b)(l)(A), 2055 and 2522, the CRUT's trustee will have the authority to choose a different organization which does.

Your authorized representative asserts that Foundation R is an organization described in Code section 170(b)(l)(A) and, as such, is an organization described in Code section 170(c). Your authorized representative also asserts that Fund Q meets the requirements of section 1.170A-9(e)(11) of the regulations such that Fund Q should be treated as a component part of Foundation R, without elaborating as to how Fund Q meets the requirements of that section of the regulations.

With respect to Taxpayer A, the shares of Company M stock are represented to be a capital asset as that term is defined in Code section 1221. Thus, they are represented to be capital gain property within the meaning of Code section 170(b)(1)(C)(iv) and "qualified appreciated stock" within the meaning of Code section 170(e)(5)(B). Said shares are not stock in trade or property held primarily for sale to customers in the ordinary course of a trade or business. Taxpayer A will have held the "non-rollover" shares of Company M stock for at least one (1) year before contributing them to the CRUT. Furthermore, Taxpayer A anticipates that the fair market value of the shares at the time they are contributed to the CRUT will exceed their basis. Finally, your authorized representative asserted, without a supporting penalty of perjury statement, that Taxpayer A will not contribute more than 10 percent in value, in the aggregate, of all of the outstanding stock of Company M to the CRUT.

Based on the above facts and representations, you, through your authorized representative, request the following letter rulings:

1. That any portion of Taxpayer A's cash and Company M stock distribution from Plan X that is directly rolled over into an IRA set up and maintained in Taxpayer A's name will qualify as a tax-deferred rollover under Code sections 402(c)(l) and 402(e)(6). Thus, no income tax withholding will be required with respect to any amount directly transferred to Taxpayer A's IRA;

2. net unrealized appreciation (NUA), within the meaning of Code section 402(e)(4), is the difference between the cost basis attributable to the shares of Company M stock which are not rolled over into Taxpayer A's IRA and their fair market value on the date said shares are distributed to Taxpayer A. Thus, pursuant to Code section 402(e)(4)(B), Taxpayer A will not recognize ordinary income on the portion of the non-rollover shares which represents his NUA;

3. the proposed calendar year 2000 distribution of Taxpayer A's entire Plan X account balance will be treated as a lump sum distribution;

4. any taxable gain on the subsequent sale of the non-rollover shares will be treated as capital gain income upon the sale of a capital asset held in excess of 12 months to the extent of the original NUA regardless of the time period between the date said shares were distributed from Plan X and the sale date. Additionally, post distribution gain in excess of the NUA will be taxed at the applicable capital gain rate based on the holding period of the stock as measured from the stock distribution date to the sale date;

5. no portion of the Plan X distribution to Taxpayer A will be subject to the ten percent additional income tax imposed by Code section 72(t)(l) because Taxpayer A's distribution will meet the exception under Code section 72(t)(2)(A)(v) applicable to a distribution made to an individual who separates from service after attaining age 55;

6. Taxpayer A will not recognize any immediate taxable income, gain or loss from the act of contributing Company M stock received from Plan X to his CRUT;

7. Taxpayer A will receive an income and gift tax charitable deduction for the contribution of the non-rollover shares of Company M stock to his CRUT in an amount equal to the fair market value of the stock at the time of transfer less the present value of Taxpayer A's and Taxpayer B's retained unitrust interest;

8. the stock transferred to the CRUT will retain Taxpayer A's cost basis and holding period for purposes of any subsequent sale by the CRUT;

9. the retained interest paid to Taxpayers A and B by the CRUT will be characterized under Code section 664(a) in the following order:

   a. income (other than capital gains from the sale of capital assets) includible in gross income for the particular year and previously undistributed from prior years, to the extent of any, then;

   b. short-term capital gain for the particular year and previously undistributed from prior years, to the extent of any, then;

   c. long-term capital gain for the particular year and previously undistributed from prior years, to the extent of any, then;

   d. other income for the particular year and previously undistributed from prior years, to the extent of any, then;

   e. distribution of trust corpus; and

10. the gain from any subsequent sale by the CRUT of the non-rollover stock will be exempt from immediate direct taxation to either the CRUT (assuming the CRUT does not have any unrelated trade or business income in the year of sale) or to Taxpayers A and B. The amount of any gain to the extent of the NUA from the sale of the non-rollover shares of Company M stock will be

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characterized as capital gain income from the sale of a capital asset held in excess of 12 months for purposes of the distribution characterization rules which are the subject of the ninth ruling request (above). Gain in excess of the NUA will be characterized according to the holding period from the date of distribution from Plan X to the sale date.

With respect to your initial four ruling requests, Code section 402(a) provides , generally, that an amount actually distributed to a taxpayer by a trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable in the year of distribution except as provided in section 402.

Code section 402 (c)(l) provides, generally that if (A) any portion of the balance to the credit of an employee in a qualified trust is paid to the employee in an eligible rollover distribution, (B) the distributee transfers any portion of the property received in such distribution to an eligible retirement plan, and (C) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed, then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

Code section 402(c)(4) provides that the term “eligible rollover distribution” means any distribution to the employee of all or any portion of the balance to the credit of the employee in a qualified trust except the following distributions:

(A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made-

(i) for the life (or life expectancy) of the empioyee or the joint lives (or joint life expectancies) of the employee and the employee’s designated beneficiary, or
(ii) for a specified period of ten years or more,

(B) any distribution to the extent the distribution is required under section 401(a)(9), and

(C) any hardship distribution described in section 401(k)(2)(B)(I)(IV).

Code section 402(c)(8)(A) defines “qualified trust” as an employees’ trust described in section 401(a) which is exempt from tax under section 501(a).

Pursuant to code section 402(c)(8)(B), the term “eligible retirement plan” includes an IRA described in Code section 408.

Code section 402(c)(3) provides, generally, that section 402(c)(l) shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

Code section 401(a)(31)(A) provides that a trust shall constitute a section 401(a) trust only if the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution-

(i) elects to have such distribution paid directly to an eligible retirement plan, and
(ii) specifies such eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

Code section 401(a)(3 l)(B) provides that subparagraph (A) shall apply only to the extent that the eligible rollover distribution would be includible in gross income if not transferred as provided in subparagraph (A) (determined without regard to sections 402(c) and 403(a)(4)).

The term "eligible rollover distribution" when used in section 401(a)(31) of the Code has the same meaning as when used in Code section 402(c).

The term "eligible retirement plan" when used in Code section 401(a)(31)(A) includes IRAs defined in sections 408(a) and 408(b) of the Code.

Generally, a direct trustee-to-trustee transfer described in Code section 401(a)(31) constitutes a "direct rollover" of an "eligible rollover distribution" and is entitled to tax-deferred treatment pursuant to Code sections 402(c) and 402(e)(6).

Section 1.401(a)(31)-1 of the Income Tax Regulations, Question and Answer 5, provides that an eligible rollover distribution that is paid to an eligible retirement plan in a direct rollover is not currently includible in the distributee's gross income under Code section 402(c) and is exempt from the 20-percent withholding imposed under Code section 3405(c)(2). However, when any portion of the eligible rollover distribution is subsequently distributed from the eligible retirement plan, that portion will be includible in gross income to the extent required under section 402,403, or 408 of the Code.

Section 1.401(a)(31)-1 of the Income Tax Regulations, Question and Answer 14, provides, in pertinent part, that a direct rollover is a distribution and rollover of the eligible rollover distribution and not a transfer of assets and liabilities.

Code section 402(e)(4)(D) provides that, for purposes of this paragraph, the term "lump sum distribution" means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient-(I) on account of the employee's death, (II) after the employee attains age 59 ½, (III) on account of the employee's separation from service, or (IV) after the employee has become disabled within the meaning of Code section 72(m)(7) from a trust which forms part of a section 401(a) plan which is exempt from tax under section 501(a).

Code section 402(e)(4)(D)(III) is applied to an individual who is an employee without regard to section 401(c)(l).

Code section 402(e)(4)(B) provides that, for purposes of Code section 402(a) and Code section 72, in the case of any lump sum distribution which includes securities of the employer corporation, there shall be excluded from gross income the net unrealized appreciation (NUA) attributable to that part of the distribution which consists of securities of the employer corporation.

With respect to NUA, section 1.402(a)-l(b)(l)(i)(b) of the regulations provides that, in the case of a total distribution, the amount of NUA which is not included in the basis of securities in the hands of the distributee at the time of distribution shall be considered gain from the sale or exchange of a capital asset held for more than six months to the extent that such appreciation is realized in a subsequent taxable transaction

Section 1.402(a)-l(b)(2)(i) of the regulations provides that the amount of the NUA ir: securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distnbution over the cost or other basis of such securities to the trust. Thus, if a distribution consists in part of securities which have appreciated in value and in part of securities which have depreciated in value, the NUA shall be considered to consist of the net increase in value of all the securities included in the distribution.

Code section 402(e)(4)(C) provides that, for purposes of subparagraph (B), NUA and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Secretary.

Notice 98-24, 1998-17 I.R.B. 5 provides that the amount of NUA which is not included in the basis of the securities in the hands of the distributee at the time of distribution is considered a gain from the sale or exchange of a capital asset held for more than 18 months to the extent such appreciation is realized in a subsequent taxable transaction. The actual period that an employer security was held by a qualified plan need not be calculated in order to determine whether, with respect to the NUA, the disposition qualifies for the rate of capital assets held for more than 18 months.

However, with respect to any further appreciation in the employer securities after distribution from the plan, the actual holding period in the hands of the distributee determines the capita1 gains rate that applies.

With respect to long-term capital gains treatment during calendar year 2000, the year in which Taxpayer A will receive his Plan X distribution, the long-term capita1 gain holding period is 12 months.

In this case, Taxpayer A, who attained age 55 during the 1999 calendar year, will receive a single sum distribution of his entire Plan X account balance during calendar year 2000 as a result of his calendar year 1999 separation from the service of Company M. The single sum distribution will include Company M stock.

Taxpayer A's Plan X distribution will be a "lump sum distribution" as that term is used in Code section 402(e)(4)(D). Neither the Code nor the Income Tax Regulations, promulgated thereunder, require a distribution based on separation from service be received in the same calendar year as the separation in order to be treated as a "lump sum distribution".

Taxpayer A's distribution is also an "eligible rollover distribution" as that term is used in Code sections 401(a)(31) and 402(c)(4). Thus, all or any portion of it may be rolled over, or directly transferred, into an IRA set up and maintained in Taxpayer A's name.

Finally, neither the Code nor the regulations, promulgated thereunder, preclude a distribution from being treated as a lump sum distribution under Code section 402(e)(4)(D) for purposes of Code section 402(e)(4)(8) even if a portion of the distribution is either rolled over or directly transferred into an IRA.

Thus, with respect to your first four ruling requests, we conclude as follows:

1. That any portion of Taxpayer A's cash and Company M stock distribution from Plan X that is directly rolled over into an IRA set up and maintained in Taxpayer A's name will qualify as a tax-deferred rollover under Code sections 402(c)(l) and 402(e)(6). Thus, no income tax withholding will be required with respect to any amount directly transferred to Taxpayer A's IRA

2. net unrealized appreciation (NUA), within the meaning of Code section 402(e)(4), is the difference between the cost basis attributable to the shares of Company M stock which are not rolled over into Taxpayer A's IRA and their fair market value on the date said shares are distributed to Taxpayer A. Thus, pursuant to Code section 402(e)(4)(B), Taxpayer A will not recognize

ordinary income on the portion of the non-rollover shares which represents his NUA;

3. the proposed calendar year 2000 distribution of Taxpayer A's entire Plan X account balance will be treated as a lump sum distribution; and

4. any taxable gain on the subsequent sale of the non-rollover shares will be treated as capital gain income upon the sale of a capital asset held in excess of 12 months to the extent of the original NUA regardless of the time period between the date said shares were distributed from Plan X and the sale date. Additionally, post distribution gain in excess of the NUA will be taxed at the applicable capital gain rate based on the holding period of the stock as measured from the stock distribution date to the sale date.

With respect to your fifth ruling request, Code section 72(t)(1) provides, in summary, that if any taxpayer receives any amount from a retirement plan qualified within the meaning of Code section 401(a), then the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

Code section 72(t)(2) provides several exceptions to the additional 10 percent income tax imposed by Code section 72(t)(l). One exception is found at subparagraph (A)(v) of section 72(t) which provides that a distribution (or distributions) which is made to an employee after separation from service after attainment of age 55 is excepted from the tax imposed by section 72(t)(l).

Notice 87-13, 1987-I C.B. 432,441, provides, at Question and Answer-20, in pertinent part, that, pursuant to Code section 72(t)(2)(A)(v), distributions made to an employee after said employee has separated from service will not be subject to the tax imposed under Code section 72(t)(l) as long as such separation from service occurred during or after the calendar year in which the employee attained age 55.

In this case, Taxpayer A attained age 55 in calendar year 1999 and separated from the service of Company M during the same calendar year. He will receive a single sum distribution of his Plan X account balance during calendar year 2000 because of his separation.

Thus, with respect to your fifth ruling request, we conclude as follows:

5. no portion of the Plan X distribution to Taxpayer A will be subject to the ten percent additional income tax imposed by Code section 72(t)(l) because Taxpayer A's distribution will meet the exception under Code section

72(t)(2)(A)(v) applicable to a distribution made to an individual who separates from service after attaining age 55.

With respect to your sixth ruling request, generally, a donor will not recognize gain on the contribution of appreciated property to charity. However, a donor may recognize gain where there is a prearranged plan whereby the donee is under an obligation to enter into transactions involving the donated property that have a benefit to the donor. See Blake v. Commissioner, 697 F. 2d 473 (2d Cir. 1982), aff g T.C. Memo. 198 l-579 (donee obligated to sell appreciated stock received from donor and use proceeds to buy donor's yacht at inflated price).

In the instant case, there is no indication that there is a prearranged plan involving the CRUT's disposition of the shares of Company M.

Thus, with respect to your sixth ruling request, we conclude as follows:

6. Provided that the trust qualities as a CRUT under Code section 664 and there is no prearranged plan for the disposition of the shares of stock by the CRUT, Taxpayer A will not recognize any immediate taxable income, gain, or loss upon the contribution of Company M stock received from Plan X to his CRUT.

With respect to your seventh ruling request, Code section 170 permits a deduction for any charitable contribution to an organization described in section 170(c) made within the taxable year. Section 1.170A-1(c)(1) of the regulations provides that, if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, reduced as provided in section 170(e)(1) and section 1.170A-4(a) of the regulations.

Code section 170(f)(2)(A) provides, in pertinent part, that no deduction is allowed under section 170 for the value of a remainder interest transferred in trust unless the trust is a charitable remainder annuity trust or a CRUT described in Code section 664.

Code section 170(e)(l)(A) provides that a charitable contribution deduction will be reduced by the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value, determined at the time of contribution. Code section 170(e)(1)(B)(ii) provides that if a contribution is to or for the use of a private foundation (defined in Code section 509(a)) other than a private foundation described in section 170(b)(l)(E), then the charitable contribution deduction will be reduced by the amount of gain which would have been long-term capital gain if the property had been sold by the taxpayer at its fair market value, determined at the time of contribution.

Code section 170(e)(5) provides an exception to the rule of section 170(e)(1)(B)(ii) in the case of the contribution of “qualified appreciated stock,” which is defined in subparagraph (B) as stock-

(i) for which (as of the date of the contribution) market quotations are readily available on an established securities market, and

(ii) which is capital gain property (as defined in Code section 170(b)(1)(C)(iv)).

Code section 170(b)(l)(C) (iv) defines “capital gain property” as any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain that would have been long-term capital gain. Code section 1221 defines a capital asset as property held by the taxpayer, excluding stock in trade, property held primarily for sale to customers in the ordinary course of trade or business, and certain other items not relevant here.

Code section 170(e)(5)(C)(i), however, provides that the “qualified appreciated stock” exception does not apply if the stock contributed (including the aggregate amount of all prior contributions by the donor of stock in the same corporation) exceeds 10 percent in value of all of the outstanding stock in the corporation.

In the instant case, provided that Taxpayer A does not contribute more than 10 percent in value, in the aggregate, of all of the outstanding stock of Company M to the CRUT, the reduction provided by Code section 170(e)(1)(B)(ii) will not apply regardless of whether the remainder beneficiary is a component part of a Code section 170(b)(l)(A) organization, because the exception to section 170(e)(1)(B)(ii) provided by section 170(e)(5) applies. With respect to Taxpayer A, the shares to be contributed to the CRUT are not stock in trade or held primarily for sale to customers, and the shares will have been held by Taxpayer for more than one year at the time of contribution. Therefore, assuming that the fair market value of the shares of Company M at the time of contribution exceeds basis, the shares are capital gain property within the meaning of section 170(b)(1)(C)(iv). Further, the stock of Company M has market quotations readily available on an established securities market.

Code section 170(b)(l)(A) provides that a charitable contribution to an organization described in section 170(b)(l)(A) shall be allowed to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer’s contribution base for the taxable year. Code section 170(b)(l)(B) provides a lower percentage limitation in the case of a contribution to an organization not described in section 170(b)(1)(A).

Code section 170(b)(l)(C)(i) provides that, in the case of a contribution of capital gain property to an organization described in section 170(b)(l)(A), to which section

170(e)(l)(B) does not apply, the total amount of contributions of such property which may be taken into account for determining the income tax deduction shall not exceed 30 percent of the taxpayer's contributions base for the year. Code section 170(b)(l)(D) provides a lower percentage limitation in the case of a contribution of capital gain property to an organization not described in section 170(b)(l)(A).

In Revenue Ruling 79-368, 1979-2 C.B. 109, the Service ruled that the deduction allowed for the value of a remainder interest in property transferred to a CRUT is subject to the percentage limitations set forth in section 170(b)(l)(B) where the grantor or a recipient of the CRUT amount has the power to designate a remainder beneficiary that must be a charitable organization described in section 170(c), but need not be an organization described in section 170(b)(l)(A).

Code section 2501(a) imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual. Code section 2511(a) provides that the federal gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Code section 2522(a) provides that, in computing an individual's taxable gifts for the calendar year, a deduction shall be allowed for the amount of all gifts to or for the use of certain governmental entities, certain corporations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, and certain other fraternal and veterans' organizations.

Code section 2522(c)(2)(A) provides that, where a transfer is made to both a charitable and noncharitable person or entity, no deduction shall be allowed for the interest passing to charity unless, in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or charitable remainder unitrust described in section 664.

Code section 664(d)(2), as amended by the Tax Reform Act of 1997 (TRA' 97), defines a charitable remainder unitrust, generally, as a trust:

(A) from which a fixed percentage (which is not less than five (5) percent nor more than 50 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 (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

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(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 170(c),

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c), and

(D) with respect to each contribution of property to the trust, the value (determined under section 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Under section 664(d)(3), the trust instrument may provide that, in lieu of the amount specified in section 664(d)(2)(A), the trust may pay the income beneficiary for any year the lesser of the income required to be paid under section 664(d)(2)(A) and the amount of trust income for the year.

Under Code section 7520(a), for estate, gift, and income tax purposes, the value of any annuity, any interest for life or term of years, or any remainder or reversionary interest shall be determined: (1) under tables prescribed by the Secretary; and (2) by using an interest rate (rounded to the nearest 2/10ths of 1 percent) equal to 120 percent of the Federal midterm rate in effect under section 1274(d)(1) for the month in which the valuation date falls. If an income, estate, or gift tax charitable deduction is allowable for any part of the property transferred, the taxpayer may elect to use such Federal midterm rate for either of the two months preceding the month in which the valuation falls.

Assuming that the fair market value of the shares of Company M at the time of the contribution exceeds basis, the shares, of Company M to be contributed to the CRUT will be capital gain property within the meaning of section 170(b)(1)(C)(iv). Therefore, provided that Fund Q is a component part of Foundation R, a section 170(b)(l)(A) organization, within the meaning of section 1.170A-9(e)(11), then Taxpayer A's charitable contribution deduction will be eligible for the higher percentage limitations of section 170(b)(l)(C). If the shares of Company M are not capital gain property at the time of the contribution, then Taxpayer A's charitable contribution deduction will be limited as provided by section 170(b)(l)(A).

Additionally, in this case, Taxpayer A will make an incomplete gift to Taxpayer B of the secondary life interest since Taxpayer A will retain the right to revoke Taxpayer B's interest. See Rev. Rul. 79-243, 1979-2 C.B. 343. However, Taxpayer A will make a completed gift to Fund Q of the remainder interest in the CRUT.

Thus, based on the above facts and representations, and provided that Taxpayer A does not contribute more than 10 percent in value, in the aggregate, of all of the outstanding stock of Company M to the CRUT, we conclude, with respect to your seventh ruling request, as follows:

Provided that the remainder beneficiary of the CRUT is an organization described in Code section 170(c), Taxpayer A may take an income tax charitable deduction for the contribution of the non-rolled over shares of Company M stock to the CRUT equal to the fair market value of the stock at the time of the transfer, less the present value of Taxpayer A's and Taxpayer B's retained unitrust interest. Taxpayer A's charitable contribution deduction will be reduced as provided by Code section 170(e)(l)(A), however, by any post-distribution appreciation that is not held by Taxpayer A for more than one (1) year after distribution from Plan X;

Provided that the remainder beneficiary of the CRUT is a component part of a Code section 170(b)(l)(A) organization which meets the requirements of section 1.170-9(e)(11) of the regulations and the shares contributed to the CRUT are capital gain property at the time of the termination of the unitrust interest, as represented, then 'Taxpayer A's charitable contribution deduction would be subject to the percentage limitations of section 170(b)(l)(C). However, if the CRUT's remainder beneficiary is a component part of a Code section 170(b)(l)(A) organization and the shares of Company M stock to be contributed to the CRUT are not capital gain property at the time of the termination of the unitrust interest , then Taxpayer A's charitable contribution deduction would be subject to the percentage limitations of Code section 170(b)(l)(A).

Finally, assuming that the CRUT satisfies the requirements of Code section 664 and the applicable regulations, then a gift tax charitable deduction will be allowed for the present value of the remainder interest which passes to charity; that is, the present value of the right to receive the trust corpus after the death of the survivor of Taxpayers A and B. See Rev. Rul. 79-243. The present value of this interest is determined in accordance with section 25,2522(c)-3(d)(2)(ii) of the regulations and Code section 7520(a).

With respect to your eighth ruling request, Code section 1014(b) provides, in general, that the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the time of the decedent's death. Section 1.1014-l(a) of the regulations provides, generally, that property acquired from a decedent includes, principally, property acquired by bequest, devise or inheritance and, in the case of a decedent who dies after December 3 1, 1953, property required to be includible in determining the value of decedent's gross estate.

Code section 1015(a) provides, generally, that for gifts made after December 3 1, 1920, if property was acquired by gift, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016), is greater than the fair market value of the property at the time of the gift, then for purposes of determining loss, the basis shall be the fair market value.

Section 1.1015-l (a)(l) of the regulations provides, in general, that in the case of property acquired by gift after December 3 1, 1920 (whether by a transfer in trust or otherwise), the basis of tht property for purposes of determining gain is the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. The same rule applies in determining loss unless the basis (adjusted in accordance with Code sections 1016 and 1017) is greater than the fair market value of the property at the time of the gift. In such case, the basis for determining loss is the fair market value at the time of the gift.

Code section 1223(2) provides that in determining the period for which a taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under Chapter 1 of the Internal Revenue Code, such property has, for purposes of determining gain or loss from a sale or exchange, the same basis in whole or in part in his or her hands as it would have in the hands of such other person.

Code section 1015 provides, generally, that the basis of property acquired by a transfer in trust shall be the same as it would be in the hands of the grantor, with adjustments for gain or loss recognized.

In this case, it has been represented that the CRUT will acquire the non-rolled over shares of Company M stock by gift. Accordingly, with respect to your eighth ruling request, we conclude as follows:

> The basis of the non-rollover shares in the hands of the CRUT's trustee will be determined in accordance with Code section 1015 and section 1.1015-l(a) of the regulations. However, upon Taxpayer A's death, all or a portion of the value of the CRUT property will be includible in Taxpayer A's gross estate for estate tax purposes. See Rev. Rul. 76-273, 1976-2 C.B. 268. To the extent the CRUT is included in Taxpayer A's gross estate, the basis of the non-rollover shares will be determined in accordance with Code section 1014 and section 1.1014-1(a) of the regulations.

To the extent that Code section 1015 and section 1.1015-1 (a) apply, then Code section 1223(2) will apply so that the CRUT's holding period in the stock of Company M will include Taxpayer A's holding period.

With respect to your ninth ruling request, Code section l(h) was amended by TRA' 97 to provide new long-term capital gain tax rates for noncorporate taxpayers. After TRA '97, a CRUT's long-term capital gains may fall within different groups that are subject to different tax rates.

Code section 664(b) provides guidance on how payments from a CRUT are characterized in the hands of the recipient. Under section 664(b), amounts distributed by a CRUT are considered as having the following characteristics in the hands of the unitrust recipient: (1) as ordinary income to the extent of the trust's ordinary income for the trust's taxable year and its undistributed ordinary income for prior years, (2) as capital gains to the extent of the trust's capital gain for the trust's taxable year and its undistributed capital gain for prior years, (3) as other income to the extent of the trust's other income for the trust's taxable year and its undistributed other income for prior years, and (4) as a distribution of trust corpus.

Section 1.664-1(d)(1) of the regulations provides that if, in any taxable year of the trust, the trust has both undistributed short-term capital gain and undistributed long-term capital gain, the short-term capital gain is deemed distributed prior to any long-term capital gain.

The general principal of Code section 664(b) is that income subject to the highest federal income tax rate is deemed distributed prior to income subject to progressively lower (or no) federal tax rate. Thus, for example, if a CRUT has net long-term capital gain in more than one group of long-term capital gain, income from the group of long-term capital gain that is subject to the highest federal income tax rate is deemed distributed before income from the group of long-term capital gain that is subject to a lower federal income tax rate. See Notice 98-20, 1998-13 I.R.B. 25.

Thus, with respect to your ninth ruling request, we conclude as follows:

the retained interest paid to Taxpayers A and B by the CRUT will be characterized under Code section 664(a) in the following order:

a. Income (other than capital gains from the sale of capital assets) includible in gross income for the particular year and previously undistributed from prior years, to the extent of any, then;

b. short-term capital gain for the particular year and previously undistributed from prior years, to the extent of any, then;

c. long-term capital gain for the particular year and previously undistributed from prior years, to the extent of any, then;

d. other income for the particular year and previously undistributed from prior years, to the extent of any, then;

e. distribution of corpus.

With respect to your tenth ruling request, Code section 664(c) provides that a CRUT, for any taxable year, is not subject to any tax imposed by subtitle A unless the trust, for the year, has unrelated business taxable income (within the meaning of Code section 512, determined as if part III of subchapter F applied to the trust). Thus, assuming the trust qualities as a CRUT under Code section 664, the gain from the trust's sale of non-rolled over stock will not be subject to tax under Code section 664(c) if the trust does not have any unrelated business taxable income in the year of the sale.

Thus, with respect to your tenth ruling request, we conclude as follows:

the gain from any subsequent sale by the CRUT of the non-rollover stock will be exempt from immediate direct taxation to either the CRUT (assuming the CRUT does not have any unrelated trade or business income in the year of sale) or to Taxpayers A and B. The amount of any gain to the extent of the NUA from the sale of the non-rollover shares of Company M stock will be characterized as capital gain income from the sale of a capital asset held in excess of 12 months for purposes of the distribution characterization rules which are the subject of the ninth ruling (above). Gain in excess of the NUA will be characterized according to the holding period from the date of distribution from Plan X to the date of sale.

This letter ruling is based on the assumption that Plan X is, and will be, qualified under Code section 401(a) and its trust tax-exempt under Code section 501(a) at all times relevant thereto. It is also based on the assumption that the CRUT referenced herein will meet the requirements of Code section 664 at all times relevant thereto. It is also based on the assumption that all of the representations made with respect thereto are true.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Manager, Technical Branch 3
Tax Exempt and Governmental
Entities Division

Enclosures:

Deleted copy of letter ruling
Form 437