Private Letter Ruling 9511041, 12/21/1994, IRC Sec(s). 170(e)(5)

Full Text:

Date: December 21, 1994

CC:IT&A:3/TR-31-2294-94

LEGEND:

Taxpayer = *

Funds = *

Foundation = *

Journal = *

Dear *

This letter responds to your ruling request, dated August 30, 1994, supplemented by documents dated October 7, 1994 and December 19, 1994.

ISSUES

1. Does the proposed trust qualify as a charitable remainder unitrust under section 664 of the Code?
2. Are shares of open-end mutual funds stock of a corporation for which "market quotations are readily available on an established securities market" within the meaning of section 170(e)(5)(B)(i) of the Code?
3. If, in 1994, Taxpayer contributes "qualified appreciated stock" as defined in section 170(e)(5), and the amount of such contribution exceeds Taxpayer's percentage limitation under section 170(b)(1)(D)(i), may Taxpayer continue to value the 1994 excess contribution carryover as "qualified appreciated stock" without regard to the section 170(e)(1)(B)(ii) valuation limitation on such a contribution if made after 1994?

FACTS

Taxpayer proposes to establish a charitable remainder unitrust for two lives with consecutive interests. The trust agreement provides for a unitrust amount of five percent of the net fair market value of all trust property valued as of the first day of each taxable year of the trust. The trust agreement lists Taxpayer and his spouse as the sole recipients of the unitrust amount. Taxpayer is named as the initial trustee.

Taxpayer represents that the trust agreement is patterned after the sample agreement as set forth in section 4 of Rev. Proc. 90-30, 1990-1 C.B. 534. However, the trust agreement, as submitted to the Service, contains three provisions not addressed in Rev. Proc. 90-30.

First, it has been represented that the remainder beneficiary of the trust will be an organization qualified under section 501(c)(3). Taxpayer reserves the right to appoint, by will or inter vivos appointment, one or more charitable organizations to be charitable remainder beneficiaries of the trust, in lieu of or in addition to the Foundation.

Second, Taxpayer reserves the power to revoke or terminate only by will the right of his spouse, who is the sole unitrust recipient after Taxpayer, to be a recipient of any portion of the unitrust amount otherwise payable to her.

Third, Taxpayer reserves the right to terminate at any time all or part of the trust and to appoint the terminated trust corpus to any charitable organization. This right may be exercised either by will or by inter vivos appointment. The unitrust percentage used to determine the unitrust amount will not change upon an early termination of a portion of the trust.

On or before December 31, 1994, Taxpayer intends to contribute to the trust a substantial amount of stock, including shares of two mutual funds. Both of the funds are treated as corporations for federal income tax purposes and are qualified as regulated investment companies under the Investment Company Act of 1940, as amended. The funds are open-end funds, which means that shareholders terminate their investment by having the funds redeem their shares at net asset value upon demand, rather by trading the shares in the market. Market prices of the values of the shares of each fund can be obtained each business day in the Journal, a nationally circulated newspaper.

The shares of the two funds (the Shares) make up approximately 20 percent of the total value of shares that Taxpayer will contribute in 1994 to the Trust. It is represented that the remaining 80 percent of the total value of shares to be contributed by Taxpayer to the trust are "qualified appreciated stock" as defined in section 170(e)(5)(B).

The shares Taxpayer will contribute have an adjusted basis that is less than their fair market value. In addition, Taxpayer has held Shares for more than 1 year. It is represented to the Service that none of the shares to be contributed is subject to any resale restrictions, including SEC Rule 144 restrictions, private contractual restrictions, or any other restriction which may limit either Taxpayer or the Foundation in disposing of the shares.

The trust's sole charitable beneficiary is the Foundation, a private foundation which is described in section 509(a) but not described in section 170(b)(1)(E). The amount of Taxpayer's transfer is in excess of the amount Taxpayer will be permitted to deduct in 1994 under the percentage limitations imposed by section 170(b)(1)(D)(i)

LAW AND ANALYSIS

I. Qualification of Trust as Charitable Remainder Unitrust under Section 664

Section 4 of Rev. Proc. 94-3, 1994-1 I.R.B. 79, 85, lists issues on which the Service ordinarily will not issue letter rulings. Among these issues are whether a charitable remainder trust that provides for unitrust payments satisfies the requirements described in section 664. In lieu of seeking the Service's advance approval of a charitable remainder unitrust, Taxpayer is directed to follow the sample trust provisions in Rev. Proc. 90-30, 1990-1 C.B. 534. By following the sample provisions, Taxpayer can be assured that the Service will recognize the trust as meeting all of the requirements of a

charitable remainder unitrust, provided that the trust operates in a manner consistent with the terms of the trust instrument and provided it is a valid trust under local law.

In the present case, Taxpayer has noted that the trust agreement contains provisions not addressed in Rev. Proc. 90-30. Although we cannot rule on whether the trust is a charitable remainder unitrust, we will rule on whether those specific provisions disqualify the trust under section 664.

Section 3.1.3 of the agreement provides that Taxpayer reserves the power to revoke by will the right of his spouse to be a recipient of any portion of the unitrust amount otherwise payable under the agreement.

Section 3.1.4 provides that Taxpayer reserves the right to terminate all or part of the trust at any time, and to appoint the terminated trust corpus to one or more charitable organizations described in sections 170(c), 2055(a), and 2522(a). This power is exercisable by a will or inter vivos document referring specifically to this power of appointment.

Section 3.2.2 provides that Taxpayer reserves the right to appoint, by will or inter vivos document, one or more charitable organizations to be charitable remainder beneficiaries of the trust. If any organization so appointed is not described in sections 170(c), 2055(a), and 2522(a), then the trustee will distribute the property to Foundation. If Foundation is not then described in sections 170(c), 2055(a), and 2522(a), then the trustee will distribute the property to one or more organizations described in sections 170(c), 2055(a), and 2522(a) as trustee shall select, in trustee's sole and absolute discretion.

After examining the above provisions, we conclude that the existence of, and language contained in, sections 3.1.3, 3.1.4, and 3.2.2 of the agreement will not adversely affect trust's qualification as a charitable remainder unitrust if it otherwise meets the requirements of section 664. II. Shares of Funds as "Qualified Appreciated Stock" Under Section

170(e)(5)(B)

Section 170(e)(1)(B)(ii) of the Code provides, as a general rule, that donors making charitable contributions of capital gain property to or for the use of a private foundation as defined in section 509(a), other than a private foundation described in section 170(b)(1)(E), are not permitted a charitable contribution deduction for the amount of the contributed property that would have been long- term capital gain if the property contributed had been sold by the taxpayer at its fair market value.

Section 170(e)(5) creates an exception to the general rule, for contributions of "qualified appreciated stock". Under section 170(e)(5), donors may be allowed to deduct the fair market value of gifts of "qualified appreciated stock" to a private foundation as defined in section 509(a), other than a private foundation as described in section 170(b)(1)(E).

Section 170(e)(5)(B) defines "qualified appreciated stock", except as provided in section 170(e)(5)(C), to mean any stock of a corporation (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 section 170(b)(1)(C)(iv)).

Section 170(e)(5) was added to the Code by the Tax Reform Act of 1984, Pub. L. 98-369. Congress believed that "deductibility at full fair market value for gifts of appreciated stock

to private nonoperating foundations should be permitted in certain situations in which the potential for abuse, including overvaluations, is minimized." H.R. Rep. No. 432, 98th Cong., 2d Sess. 1464 (1984).

In addition, to meet the requirement that the stock be stock for which market quotations are readily available on an established securities market, "it is not sufficient merely that market quotations for the stock are readily available (e.g., from established brokerage firms); rather, the market quotations must be readily available on an established securities market." Joint Committee on Taxation, General Explanation of H.R. 4170, 98th Cong., 2d Sess. 668 (1984). Moreover, the nonreduced deduction provision does not apply to "contributions of any property other than qualified appreciated stock (that constitutes capital-gain property). Thus, for example, the provision does not apply to contributions of bonds, notes, warrants, or options, whether or not market quotations for such property are readily available on an established market. Similarly, the nonreduced deduction provision does not apply to contributions of interests other than corporate stock, such as partnership interests." Id. at 669.

For purposes of recordkeeping and return requirements for contributions of shares in an open-end investment company, market quotations are considered to be readily available on an established securities market if quotations are published on a daily basis in a newspaper of general circulation throughout the United States. See section 1.170A-13(c)(7)(xi)(A)(3) of the Income Tax Regulations.

Section 170(e)(5)(C)(i) provides that, in the case of any donor, the term "qualified appreciated stock" shall not include any stock of a corporation contributed by the donor in a contribution to which section 170(e)(1)(B)(ii) applies (determined without regard to section 170(e)(5)) to the extent that the amount of the stock so contributed (when increased by the aggregate amount of all prior contributions by the donor of the stock) exceeds 10 percent (in value) of all of the outstanding stock of the corporation.

Section 170(e)(5)(C)(ii) provides a special rule that for purposes of section 170(e)(5)(C)(i), an individual shall be treated as making all contributions made by any member of his family (as defined in section 267(c)(4)).

Section 170(b)(1)(C)(iv) defines the term "capital gain property" to mean, with respect to any contribution, any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long- term capital gain.

For stock to be "qualified appreciated stock" under section 170(e)(5), it must meet the requirements under both sections 170(e)(5)(B)(i) and 170(e)(5)(B)(ii). Section 170(e)(5)(B)(i) requires that the market quotations for the stock be readily available on an established securities market as of the date of the contribution. In the present case, the funds are corporations that must redeem the shares at net asset value upon an investor's demand. The net asset value quotations of the Shares are published on a daily basis in Journal, a newspaper of general circulation throughout the United States. Moreover, there are also no restrictions on the Foundation's ability to sell the Shares. Thus, the Shares meet the section 170(e)(5)(B)(i) requirement. III. Treatment of Carryover of "Qualified Appreciated Stock" Under

Section 170(b)(1)(D)(i)

Section 170(e)(5)(D) provides that the exception for gifts of "qualified appreciated stock" shall not apply to contributions made after December 31, 1994.

Section 170(b)(1)(D)(ii) provides, in part, that to the extent the donor's contributions of capital gain property to private non- operating foundations exceed the percentage limitation under section 170(b)(1)(D)(i), the excess shall be treated as a charitable contribution of capital gain property in each of the five succeeding taxable years in order of time.

Section 170(b)(1)(D)(ii), the carryover provision for contributions to private non-operating foundations, was enacted at the same time as section 170(e)(5), the provision for contributions of "qualified appreciated stock". Moreover, the absence of both allowances under previous law was referred to repeatedly in the legislative history, and both provisions were included as part of the private foundation provisions of H.R. 4170. See H.R. Rep. No. 432, supra, at 1463; S. Rep. No. 169, Vol. 1, 98th Cong., 2d Sess. 1463 (1984); H.R. Rep. No. 861, 98th Cong., 2d Sess. 586-587 (1984); General Explanation of H.R. 4170, supra, at 666-669.

In an analogous carryover issue, the Service has ruled that the tax character of the contributed property under the alternative minimum tax is determined at the time of the contribution. See Rev. Rul. 90-111, 1990-2 C.B. 30 (excess contribution carryovers for non- capital gain property from 1991 are treated as non-capital gain property for 1992 and subsequent years under alternative minimum tax, though the special rule resulting in non-capital gain characterization applies only to contributions made in 1991).

Under section 170(e)(5)(D), section 170(e)(5) treatment will apply to the contribution of "qualified appreciated stock" if the contribution is made on or before December 31, 1994. Thus, so long as the contribution of "qualified appreciated stock" is made to the Foundation before the end of 1994, Taxpayer will be allowed to value the contribution without regard to section 170(e)(1)(B)(ii).

Legislative history supports the same treatment for the carryover as for the initial contribution of "qualified appreciated stock". Moreover, a previous Service position underscores that, in determining the tax character for carryovers, the focus is on the tax character of the property when the contribution is made. Thus, so long as Taxpayer's contribution qualifies for "qualified appreciated stock" treatment at the time that it is made, the excess carryover will be given the same treatment.

CONCLUSIONS

Accordingly, we conclude the following: (1) The particular provisions of the trust agreement, sections 3.1.3, 3.1.4, and 3.2.2, do not disqualify the trust as a charitable remainder unitrust if it otherwise meets the requirements of section 644; (2) Shares of the funds are "qualified appreciated stock" as defined in section 170(e)(5)(B); and (3) the value of 1994 excess contributions of "qualified appreciated stock" carried over to succeeding years will continue to be based upon the fair market value of the stock at the time of the contribution, and will not be limited to Taxpayer's basis as a result of the expiration of the "qualified appreciated stock" rule on December 31, 1994.

No opinion is expressed concerning the federal income tax consequences of these donations under any other provisions of the Internal Revenue Code. A copy of this ruling should be attached to Taxpayer's federal income tax returns for the tax years affected.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent.

Sincerely yours,

Assistant Chief Counsel

(Income Tax & Accounting)

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Senior Technician Reviewer

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Enclosure:

copy for section 6110 purposes