

**Internal Revenue Service**

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B04 -PLR-120773-01

Date:

APRIL 22, 2002

In re:

Legend

Taxpayer =  
Annuitant =  
Charity =  
a =  
Association =  
IRA =

Dear :

This is in response to your April 2, 2001 letter and other correspondence requesting rulings concerning the tax treatment of funding a testamentary charitable gift annuity with assets from an individual retirement account.

You have requested the following rulings:

1. Charity's tax-exempt status will not be adversely affected because of the receipt of IRA proceeds upon Taxpayer's death in exchange for the annuity payable to the Annuitant, nor will Charity recognize taxable income as a result of its receipt of the IRA proceeds upon Taxpayer's death in exchange for the annuity payable to Annuitant.
2. For purposes of determining the character of the annuity payments received by Annuitant, her "investment in the contract" as defined in section 72(c) of the Internal Revenue Code is equal to the IRA proceeds transferred to Charity in exchange for the annuity less the estate tax charitable contribution deduction.
3. Taxpayer's gross estate, for federal estate tax purposes, will include the value of the IRA at the time of Taxpayer's death.
4. Taxpayer's estate may claim an estate tax charitable deduction equal to the value of the IRA less the value of the annuity to be paid to Annuitant.

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5. Upon the death of Taxpayer, the proceeds from the IRA, which will be distributed to Charity in exchange for the annuity, will not be included in the gross income of the estate for Federal income tax purposes.

The facts submitted are as follows:

Taxpayer is the owner of an individual retirement account (IRA) described in section 408(a) of the Code. The current balance of the IRA is approximately \$a. Taxpayer will enter into a "Gift Annuity Agreement" with Charity pursuant to which Taxpayer will agree to make a testamentary gift to Charity of the IRA. To facilitate the transfer, Taxpayer proposes to complete a beneficiary designation form for the IRA that provides that upon Taxpayer's death, the entire proceeds of the IRA will be transferred to Charity. Under the Gift Annuity Agreement, the IRA proceeds will be deposited in Charity's general fund. Under the Gift Annuity Agreement, in consideration for the testamentary transfer, Charity will pay an annuity to Annuitant, if Annuitant survives Taxpayer. Annuitant is to receive a fixed amount each year payable quarterly, determined based on the percentage rate recommended by Association. If Annuitant predeceases Taxpayer, the IRA proceeds will be transferred to Charity without any obligation on Charity's part. The annuity is irrevocable and non-assignable (except to Charity for no consideration), cannot be commuted and is to be paid from Charity's general fund.

Charity has been recognized as an entity that is exempt from tax under section 501(c)(3). Charity has also been recognized as a public charity under section 509(a)(1).

The annuity that will be paid by Charity to Annuitant will be a function of the amount contained in the IRA at Taxpayer's death, Annuitant's age at that time, and the gift annuity rates in effect as recommended by Association at Taxpayer's death.

## LAW AND ANALYSIS

### Ruling 1

Section 501(c)(3) provides for the exemption from federal income tax of organizations organized and operated "exclusively" for religious, charitable, educational, or other specified exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and which does not engage in proscribed legislative and political activities.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and includes providing relief for the poor and distressed, lessening the burdens of government, and promoting social welfare in a number of specified ways.

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Section 501(m)(1) provides that an organization described in section 501(c)(3) or 501(c)(4) shall be exempt from tax only if no substantial part of its activities consist of providing commercial-type insurance.

Section 501(m)(2) provides that with respect to a section 501(c)(3) or 501(c)(4) organization which remains tax exempt after the application of section 501(m)(1) – (A) the activity of providing commercial-type insurance shall be treated as an unrelated trade or business (as defined in section 513), and (B) in lieu of the tax imposed by section 511 with respect to such activity, such organization shall be treated as an insurance company for purposes of applying subchapter L with respect to such activity.

Section 501(m)(3)(E) provides that, for purposes of this subsection, the term “commercial-type insurance” shall not include charitable gift annuities. Section 501(m)(5) states that for purposes of paragraph (3)(E), the term “charitable gift annuity” means an annuity if – (A) a portion of the amount paid in connection with the issuance of the annuity is allowable as a deduction under section 170 or 2055, and (B) the annuity is described in section 514(c)(5).

Section 511 imposes a tax on the unrelated business taxable income (defined in section 512) of organizations exempt from tax under section 501(c).

Section 512(a)(1) defines the term “unrelated business taxable income” to mean the gross income derived by any organization from any unrelated trade or business (defined in section 513) regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business.

Section 513(a) provides that the term “unrelated trade or business” means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption.

Section 514(c)(5), titled “Annuities”, provides that for purposes of this section, the term “acquisition indebtedness” does not include an obligation to pay an annuity which – (A) is the sole consideration (other than a mortgage to which (2)(B) applies) issued in exchange for property if, at the time of the exchange, the value of the annuity is less than 90% of the value of the property received in the exchange, (B) is payable over the life of one individual in being at the time the annuity is issued, or over the lives of two individuals in being at such time, and (C) is payable under a contract which – (i) does not guarantee a minimum amount of payments or specify a maximum amount of payments, and (ii) does not provide for any adjustment of the amount of the annuity payments by reference to the income received from the transferred property or any other property.

In this case, the annuity issued by Charity qualifies as a charitable gift annuity under section 514(c)(5) because it satisfies all the relevant criteria: the annuity has a

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value which is less than 90% of the value of the property received in exchange by Charity, the annuity is payable over the life of Annuitant, the annuity contract does not guarantee a minimum amount of payments or specify a maximum amount of payments, and does not provide for an adjustment which references the amount of income generated by the transferred property.

Based upon the foregoing, Charity's tax exempt status under section 501(c)(3) will not be adversely affected by the receipt of the IRA proceeds upon Taxpayer's death in exchange for the annuity payable to Annuitant. In addition, Charity will not recognize unrelated business taxable income as a result of its receipt of the proceeds from the IRA upon Taxpayer's death in exchange for the annuity payable to Annuitant.

### Ruling 2

The taxpayer requested that the Service rule that, for purposes of determining the character of the annuity payments received by the Annuitant, Annuitant's "investment in the contract" is equal to the IRA proceeds transferred to the Charity in exchange for the annuity less the estate tax charitable contribution deduction. In order for the Service to issue a ruling on this issue, it would have to assume that the Annuitant will survive the Taxpayer. Such an assumption would involve a hypothetical situation, since both Annuitant and Taxpayer are presently living. Accordingly, pursuant to section 8.02 of Rev. Proc. 2001-4, 2001-1 I.R.B. 121, 134, the Service declines to issue a ruling on this issue.

### Ruling 3

Section 2001(a) of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2031 of the Code provides that the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

Section 2033 of the Code provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 20.2031-1(a) of the Estate Tax Regulations provides that the value of the gross estate of a decedent who was a citizen or resident of the United States at the time of his death is the total value of the interests described in sections 2033 through 2044.

Section 2039(a) provides that the value of the gross estate shall include the value of an annuity payment or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 1, 1931 (other than as insurance under policies of the life of the decedent), if,

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under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his or her life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

Section 2039(b) provides that section 2039(a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price thereof contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension, annuity, retirement, bonus or profit-sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

In this case, Taxpayer possesses the right to receive payments from the IRA during her life and the right to designate the IRA beneficiaries. The IRA is funded with contributions made by Taxpayer. Therefore, based on the facts submitted and the representations made, the value of the IRA at Taxpayer's death will be included in Taxpayer's gross estate.

#### Ruling 4

Section 2055(a)(2) provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to or for the use of a corporation or certain other organizations organized and operated exclusively for religious, charitable, scientific, literary or educational purposes.

Section 2055(e)(2)(A) provides that where an interest in property passes or has passed from the decedent to a person, or for a use, described in 2055 (a), and an interest in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in 2055(a), a deduction shall be allowed under this section for the interest which passes or has passed to the person, or for the use, described in 2055(a) if, in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in 664) or a pooled income fund (described in 642(c)(5)).

Rev. Rul. 80-281, 1980-2 C.B. 282, considers a situation where the donor purchases an annuity from a charitable organization that is payable for the donor's life from the general funds of the charity. The ruling concludes that because the annuity is payable out of the charity's general funds, rather than the transferred funds, the donor has not retained any interest in the transferred funds. Accordingly, the provisions of section 2522(c)(providing gift tax rules similar to section 2055(e)(2)) are not applicable. The ruling concludes that a gift tax charitable deduction is allowable equal to the

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amount by which the value of the property transferred by the donor exceeds the present value of the annuity. Rev. Rul. 84-162, 1984-2 C.B. 200 provides that the valuation tables contained in sections 25.2512-5 of the gift tax regulations and section 20.2031-7 of the estate tax regulations, are to be used in determining the value of annuity purchased from a charitable organization.

In the instant case, pursuant to the Gift Annuity Agreement and the IRA beneficiary designation, the IRA proceeds will be paid to Charity in exchange for an annuity payable by Charity to Annuitant, if she is living on the date of Taxpayer's death. Under the annuity agreement, a specific amount, that is determinable as of the Taxpayer's date of death, will be payable annually to Annuitant for her lifetime. The annuity is not subject to sale, assignment, or commutation. Further, the annuity will be payable from the general funds of Charity. Under these circumstances, we conclude that an estate tax charitable deduction will be allowed to Taxpayer's estate equal to the value of the IRA on the date of death, less the present value, determined as of the date of death, of the annuity payable to Annuitant. The present value of the annuity will be determined under section 7520 and section 20.2031-7 of the Estate Tax Regulations.

#### Ruling 5

Section 691(a)(1) provides that the amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 1.691(a)-1(b) provides that the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing the decedent's taxable income for the taxable year ending with the date of the decedent's death or for a previous taxable year under the method of accounting employed by the decedent.

Section 691(a)(3) provides that the right, described in section 691(a)(1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally derived and the amount includible in gross income under section 691(a)(1) or (2) shall

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be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

Based on the information submitted and the representations made, we conclude that if Charity is named as the designated beneficiary of Taxpayer's IRA, then the proceeds distributed to the Charity from the Taxpayer's IRA will be items of income in respect of a decedent to the Charity under section 691(a)(1)(B) of the Code when distributed to the Charity. The proceeds from the IRA will not be income in respect of a decedent to the Taxpayers' estate. The character of the income in respect of a decedent in the hands of the Charity will be considered to have the character that it would have had in the hands of Taxpayer if Taxpayer had lived and received such amounts.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

Sincerely yours,  
George L. Masnik  
Chief, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes