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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9729]

RIN 1545-BJ42

Basis in Interests in Tax-Exempt Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide rules for determining a taxable beneficiary's basis in a term interest in a charitable remainder trust (CRT) upon a sale or other disposition of all interests in the trust to the extent that basis consists of a share of adjusted uniform basis. The final regulations affect taxable beneficiaries of CRTs.

DATES: Effective date: These final regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability date: These final regulations apply to sales and other dispositions of interests in CRTs occurring on or after January 16, 2014, except for sales or dispositions occurring pursuant to a binding commitment entered into before January 16, 2014.

FOR FURTHER INFORMATION CONTACT: Allison R. Carmody at (202) 317-5279 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1. On October 31, 2008, the Treasury Department and the IRS published Notice 2008-99 (2008-47 IRB 1194) to designate a transaction and substantially similar transactions as Transactions of Interest under §1.6011-4(b)(6) of the Income Tax Regulations and to ask for public comments on how the transactions might be addressed in published guidance. After studying the transaction and comments received from the public in response to Notice 2008-99, the Treasury Department and the IRS filed a notice of proposed rulemaking (REG-154890-03) relating to basis in interests in tax-exempt trusts in the Federal Register on January 16, 2014. No comments were received from the public in response to the notice of proposed rulemaking. No public hearing was requested or held. The proposed regulations are adopted without change by this Treasury decision.

Explanation of Provisions

These final regulations provide a special rule for determining the basis in certain CRT term interests in transactions to which section 1001(e)(3) applies. Such transactions are those in which the sale or other disposition of the CRT term interest is part of a transaction in which all interests in the CRT are transferred. In these cases, these final regulations provide that the basis of a term interest of a taxable beneficiary is the portion of the adjusted uniform basis assignable to that interest reduced by the portion of the sum of the following amounts assignable to that interest: (1) the amount of undistributed net ordinary income described in section 664(b)(1); and (2) the amount

of undistributed net capital gain described in section 664(b)(2). These final regulations do not affect the CRT's basis in its assets but rather are for the purpose of determining a taxable beneficiary's gain arising from a transaction described in section 1001(e)(3). The rules in these final regulations are limited in application to charitable remainder annuity trusts and charitable remainder unitrusts as defined in section 664.

Effect on Other Documents

Notice 2008-99 provides that, when the Treasury Department and the IRS have gathered enough information to make an informed decision as to whether this transaction is a tax avoidance type of transaction, the Treasury Department and the IRS may take one or more actions, including removing the transaction from the transactions of interest category in published guidance, designating the transaction as a listed transaction, or providing a new category of reportable transaction. Because the Treasury Department and the IRS believe that these final regulations address the proper tax treatment of the transaction described in Notice 2008-99, transactions that are the same as, or substantially similar to, transactions described in Notice 2008-99 are no longer considered "transactions of interest," effective for transactions entered into on or after January 16, 2014. However, the "transaction of interest" identification for transactions that are the same as, or substantially similar to, the transaction described in Notice 2008-99 continues to apply for transactions entered into before January 16, 2014, and to transactions entered into on or after January 16, 2014, pursuant to a binding commitment entered into before January 16, 2014. For example, disclosure and other obligations under sections 6011, 6111, and 6112 continue to apply for these transactions entered into before January 16, 2014, and to transactions entered into on

or after January 16, 2014, pursuant to a binding commitment entered into before January 16, 2014.

Effective/Applicability Date

These final regulations apply to sales and other dispositions of interests in CRTs occurring on or after January 16, 2014, except for sales or dispositions occurring pursuant to a binding commitment entered into before January 16, 2014. However, the fact that a sale or disposition occurred, or a binding commitment to complete a sale or disposition was entered into, before January 16, 2014, does not preclude the IRS from applying legal arguments available to the IRS before issuance of these final regulations in order to contest the claimed tax treatment of such a transaction.

Availability of IRS Documents

The IRS notice cited in this preamble is published in the Internal Revenue Bulletin and is available at the IRS website at <http://www.irs.gov> or the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 20402.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these final regulations, and the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these final regulations because the final regulations do not impose a collection of information on small entities. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of

proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these final regulations is Allison R. Carmody of the Office of Associate Chief Counsel (Passthroughs and Special Industries). Other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§ 1.1001-1 [Amended]

Par. 2. Section 1.1001-1, paragraph (f)(4), is amended by removing the language “paragraph (c)” and adding “paragraph (d)” in its place.

Par. 3. Section 1.1014-5 is amended by:

1. In paragraph (a)(1), first sentence, removing the language “paragraph (b)” and adding “paragraph (b) or (c)” in its place.

2. Redesignating paragraph (c) as paragraph (d) and adding paragraph (c).

3. In newly redesignated paragraph (d), adding Example 7 and Example 8.

The additions read as follows:

§1.1014-5 Gain or loss.

* * * * *

(c) Sale or other disposition of a term interest in a tax-exempt trust--(1) In general. In the case of any sale or other disposition by a taxable beneficiary of a term interest (as defined in §1.1001-1(f)(2)) in a tax-exempt trust (as defined in paragraph (c)(2) of this section) to which section 1001(e)(3) applies, the taxable beneficiary's share of adjusted uniform basis, determined as of (and immediately before) the sale or disposition of that interest, is--

(i) That part of the adjusted uniform basis assignable to the term interest of the taxable beneficiary under the rules of paragraph (a) of this section reduced, but not below zero, by

(ii) An amount determined by applying the same actuarial share applied in paragraph (c)(1)(i) of this section to the sum of--

(A) The trust's undistributed net ordinary income within the meaning of section 664(b)(1) and §1.664-1(d)(1)(ii)(a)(1) for the current and prior taxable years of the trust, if any; and

(B) The trust's undistributed net capital gains within the meaning of section 664(b)(2) and §1.664-1(d)(1)(ii)(a)(2) for the current and prior taxable years of the trust, if any.

(2) Tax-exempt trust defined. For purposes of this section, the term tax-exempt trust means a charitable remainder annuity trust or a charitable remainder unitrust as defined in section 664.

(3) Taxable beneficiary defined. For purposes of this section, the term taxable beneficiary means any person other than an organization described in section 170(c) or exempt from taxation under section 501(a).

(4) Effective/applicability date. This paragraph (c) and paragraph (d) Example 7 and Example 8 of this section apply to sales and other dispositions of interests in tax-exempt trusts occurring on or after January 16, 2014, except for sales or dispositions occurring pursuant to a binding commitment entered into before January 16, 2014.

(d) * * *

Example 7. (a) Grantor creates a charitable remainder unitrust (CRUT) on Date 1 in which Grantor retains a unitrust interest and irrevocably transfers the remainder interest to Charity. Grantor is an individual taxpayer subject to income tax. CRUT meets the requirements of section 664 and is exempt from income tax.

(b) Grantor's basis in the shares of X stock used to fund CRUT is \$10x. On Date 2, CRUT sells the X stock for \$100x. The \$90x of gain is exempt from income tax under section 664(c)(1). On Date 3, CRUT uses the \$100x proceeds from its sale of the X stock to purchase Y stock. On Date 4, CRUT sells the Y stock for \$110x. The \$10x of gain on the sale of the Y stock is exempt from income tax under section 664(c)(1). On Date 5, CRUT uses the \$110x proceeds from its sale of Y stock to buy Z stock. On Date 5, CRUT's basis in its assets is \$110x and CRUT's total undistributed net capital gains are \$100x.

(c) Later, when the fair market value of CRUT's assets is \$150x and CRUT has no undistributed net ordinary income, Grantor and Charity sell all of their interests in CRUT to a third person. Grantor receives \$100x for the retained unitrust interest, and Charity receives \$50x for its interest. Because the entire interest in CRUT is transferred to the third person, section 1001(e)(3) prevents section 1001(e)(1) from applying to the transaction. Therefore, Grantor's gain on the sale of the retained unitrust interest in CRUT is determined under section 1001(a), which provides that Grantor's gain on the sale of that interest is the excess of the amount realized, \$100x, over Grantor's adjusted basis in the interest.

(d) Grantor's adjusted basis in the unitrust interest in CRUT is that portion of CRUT's adjusted uniform basis that is assignable to Grantor's interest under §1.1014-5, which is Grantor's actuarial share of the adjusted uniform basis. In this case, CRUT's adjusted uniform basis in its sole asset, the Z stock, is \$110x. However, paragraph (c) of this section applies to the transaction. Therefore, Grantor's actuarial share of CRUT's adjusted uniform basis (determined by applying the factors set forth in the

tables contained in §20.2031-7 of this chapter) is reduced by an amount determined by applying the same factors to the sum of CRUT's \$0 of undistributed net ordinary income and its \$100x of undistributed net capital gains.

(e) In determining Charity's share of the adjusted uniform basis, Charity applies the factors set forth in the tables contained in §20.2031-7 of this chapter to the full \$110x of basis.

Example 8. (a) Grantor creates a charitable remainder annuity trust (CRAT) on Date 1 in which Grantor retains an annuity interest and irrevocably transfers the remainder interest to Charity. Grantor is an individual taxpayer subject to income tax. CRAT meets the requirements of section 664 and is exempt from income tax.

(b) Grantor funds CRAT with shares of X stock having a basis of \$50x. On Date 2, CRAT sells the X stock for \$150x. The \$100x of gain is exempt from income tax under section 664(c)(1). On Date 3, CRAT distributes \$10x to Grantor, and uses the remaining \$140x of net proceeds from its sale of the X stock to purchase Y stock. Grantor treats the \$10x distribution as capital gain, so that CRAT's remaining undistributed net capital gains amount described in section 664(b)(2) and §1.664-1(d) is \$90x.

(c) On Date 4, when the fair market value of CRAT's assets, which consist entirely of the Y stock, is still \$140x, Grantor and Charity sell all of their interests in CRAT to a third person. Grantor receives \$126x for the retained annuity interest, and Charity receives \$14x for its remainder interest. Because the entire interest in CRAT is transferred to the third person, section 1001(e)(3) prevents section 1001(e)(1) from applying to the transaction. Therefore, Grantor's gain on the sale of the retained annuity interest in CRAT is determined under section 1001(a), which provides that Grantor's gain on the sale of that interest is the excess of the amount realized, \$126x, over Grantor's adjusted basis in that interest.

(d) Grantor's adjusted basis in the annuity interest in CRAT is that portion of CRAT's adjusted uniform basis that is assignable to Grantor's interest under §1.1014-5, which is Grantor's actuarial share of the adjusted uniform basis. In this case, CRAT's adjusted uniform basis in its sole asset, the Y stock, is \$140x. However, paragraph (c) of this section applies to the transaction. Therefore, Grantor's actuarial share of CRAT's adjusted uniform basis (determined by applying the factors set forth in the tables contained in §20.2031-7 of this chapter) is reduced by an amount determined by applying the same factors to the sum of CRAT's \$0 of undistributed net ordinary income and its \$90x of undistributed net capital gains.

(e) In determining Charity's share of the adjusted uniform basis, Charity applies the factors set forth in the tables contained in §20.2031-7 of this chapter to determine its actuarial share of the full \$140x of basis.

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

Approved: July 13, 2015.

Mark J. Mazur,

Assistant Secretary of the Treasury (Tax Policy).
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