

Part III. Administrative, Procedural, and Miscellaneous

Transaction of Interest — Contribution of Successor Member Interest

Notice 2007-72

The Internal Revenue Service and the Treasury Department are aware of a type of transaction, described below, in which a taxpayer directly or indirectly acquires certain rights in real property or in an entity that directly or indirectly holds real property, transfers the rights more than one year after the acquisition to an organization described in § 170(c) of the Internal Revenue Code, and claims a charitable contribution deduction under § 170 that is significantly higher than the amount that the taxpayer paid to acquire the rights. The IRS and the Treasury Department believe this transaction has the potential for tax avoidance or evasion, but lack sufficient information to determine whether the transaction should be identified specifically as a tax avoidance transaction. This notice identifies this transaction, and substantially similar transactions, as transactions of interest for purposes of § 1.6011-4(b)(6) of the Income Tax Regulations and §§ 6111 and 6112. This notice also alerts persons involved with these transactions to certain responsibilities that may arise from their involvement with these transactions.

FACTS

In a typical transaction, Advisor owns all of the membership interests in a limited liability company (LLC) that directly or indirectly owns real property (other than a personal residence as defined in § 1.170A-7(b)(3)) that may be subject to a long-term lease. Advisor and Taxpayer enter into an agreement under the terms of which Advisor continues to own the membership interests in LLC for a term of years (the Initial Member Interest), and Taxpayer purchases the successor member interest in LLC (the Successor Member Interest), which entitles Taxpayer to own all of the membership interests in LLC upon the expiration of the term of years. In some variations of this transaction, Taxpayer may hold the Successor Member Interest through another entity, such as a

single member limited liability company. Further, the agreement may refer to the Successor Member Interest as a remainder interest.

After holding the Successor Member Interest for more than one year (in order to treat the interest as long-term capital gain property), Taxpayer transfers the Successor Member Interest to an organization described in § 170(c) (Charity).

Taxpayer claims the value of the Successor Member Interest to be an amount that is significantly higher than Taxpayer's purchase price (for example, an amount that is a multiple of Taxpayer's purchase price and exceeds normal appreciation). Taxpayer claims a charitable contribution deduction under § 170 based on this higher amount. Taxpayer reaches this value by taking into account an appraisal obtained by or on behalf of Advisor or Taxpayer of the fee interest in the underlying real property and the § 7520 valuation tables.

The Internal Revenue Service and the Treasury Department are concerned about apparent irregularities in this transaction. Specifically, the IRS and the Treasury Department are concerned with the large discrepancy between (1) the amount Taxpayer paid for the Successor Member Interest, and (2) the amount claimed by Taxpayer as a charitable contribution. The IRS and the Treasury Department also have the following additional concerns, which may be present in some variations of this transaction: (1) any mischaracterization of the ownership interests in LLC; (2) a Charity's agreement not to transfer the Successor Member Interest for a period of time (which may coincide with the expiration of the applicable period in § 6050L(a)(1)); and (3) any sale by Charity of the Successor Member Interest to a party selected by or related to Advisor or Taxpayer.

TRANSACTION OF INTEREST

Effective Date

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as transactions of interest for purposes of § 1.6011-4(b)(6) and §§ 6111 and 6112 effective August 14, 2007, the date this notice was released to the public. Persons

entering into these transactions on or after November 2, 2006, must disclose the transaction as described in § 1.6011-4. Material advisors who make a tax statement on or after November 2, 2006, with respect to transactions entered into on or after November 2, 2006, have disclosure and list maintenance obligations under §§ 6111 and 6112. See § 1.6011-4(h) and §§ 301.6111-3(i) and 301.6112-1(g) of the Procedure and Administration Regulations.

Independent of their classification as transactions of interest, transactions that are the same as, or substantially similar to, the transaction described in this notice already may be subject to the requirements of § 6011, 6111, or 6112, or the regulations thereunder. When the IRS and the Treasury Department have gathered enough information to make an informed decision as to whether this transaction is a tax avoidance type of transaction, the IRS and the Treasury Department 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.

Participation

Under § 1.6011-4(c)(3)(i)(E), Advisor, LLC or any entity used in place of LLC, Taxpayer, and any members of Taxpayer if Taxpayer is a flow-through entity, are participants in this transaction for each year in which their respective tax returns reflect tax consequences or the tax strategy described in this notice.

Charity is not a participant if it received the Successor Member Interest described in this notice on or prior to August 14, 2007. For Successor Member Interests received after August 14, 2007, under § 1.6011-4(c)(3)(i)(E) Charity is a participant in this transaction for the first year for which Charity's tax return reflects the Successor Member Interest described in this notice. In general, Charity is required to report the receipt of the Successor Member Interest described in this notice on its return for the year in which it is received. See § 6033. Therefore, in general, Charity will be a participant

for the year in which Charity received the Successor Member Interest.

Time for Disclosure

See § 1.6011-4(e) and § 301.6111-3(e).

Material Advisor Threshold Amount

The threshold amounts are the same as those for listed transactions. See § 301.6111-3(b)(3)(i)(B).

Penalties

Persons required to disclose these transactions under § 1.6011-4 who fail to do so may be subject to the penalty under § 6707A. Persons required to disclose these transactions under § 6111 who fail to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of advisees under § 6112 who fail to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose other penalties on persons involved in these transactions or substantially similar transactions, including the accuracy-related penalty under § 6662 or 6662A.

DRAFTING INFORMATION

The principal authors of this notice are Patricia M. Zweibel of the Office of Associate Chief Counsel (Income Tax and Accounting) and Leslie H. Finlow of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information concerning this notice generally, contact Ms. Zweibel at (202) 622-7900 (not a toll-free call). For further information concerning the sections of this notice under the heading TRANSACTIONS OF INTEREST, contact Ms. Finlow at (202) 622-3070 (not a toll-free call).

Transaction of Interest — Toggling Grantor Trust

Notice 2007-73

The Internal Revenue Service and the Treasury Department are aware of a type

of transaction, described below, that uses a grantor trust, and the purported termination and subsequent re-creation of the trust's grantor trust status, for the purpose of allowing the grantor to claim a tax loss greater than any actual economic loss sustained by the taxpayer or to avoid inappropriately the recognition of gain. The IRS and Treasury Department believe this transaction has the potential for tax avoidance or evasion, but lack sufficient information to determine whether the transaction should be identified specifically as a tax avoidance transaction. This notice identifies this transaction, and substantially similar transactions, as transactions of interest for purposes of § 1.6011-4(b)(6) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts persons involved with these transactions to certain responsibilities that may arise from their involvement with these transactions.

FACTS

In one variation of the transaction, Grantor purchases four options. The value of each one of the options is expected to move inversely in relation to at least one of the other options over a relevant range of values so that, before expiration of any one of the options, there will be a gain in two options (gain options) and a substantially offsetting loss in the other two options (loss options). Grantor creates Trust and funds Trust with the options and a small amount of cash. Grantor gives a short-term unitrust interest in Trust to Beneficiary and retains a noncontingent remainder interest in Trust. The remainder interest is structured to have a value as determined under § 7520 that equals the fair market value of the options. Grantor takes the position that Grantor's remainder interest is a qualified interest under § 2702. Because of the retained remainder interest, Grantor treats Trust as a trust owned by Grantor under subpart E (§ 671 and following), part I, subchapter J, chapter 1 of the Code (a grantor trust). The trust agreement also provides that Grantor will have the power, exercisable in a nonfiduciary capacity, to reacquire Trust corpus by substituting other property of an equivalent value (the substitution power) and that this substitution power will become

effective on a specified date in the future. See § 675(4).

After establishing and funding Trust, Grantor sells the remainder interest in Trust to an unrelated person (Buyer) for an amount equal to the fair market value of the remainder interest (which is equal to the fair market value of the options). Grantor claims that the basis in the remainder interest is determined by allocating to the remainder interest a portion of the basis in all of the Trust assets (based on the respective fair market values of the remainder and unitrust interests at the time of the sale). Therefore, Grantor claims there is no gain recognized on the sale of the remainder interest because Grantor's basis in the remainder interest is the same as the amount realized (prearranged to be equivalent to the fair market value of the options). Buyer gives Grantor an installment obligation (Note), cash, or other consideration for the remainder interest. Grantor claims that the sale of the remainder interest has terminated (toggled off) the grantor trust status of Trust so that, during the period after the sale and before the effective date of the substitution power, Trust is no longer a grantor trust under § 671.

Grantor claims that, once the substitution power becomes effective, Trust's grantor trust status is restarted (toggled on). The loss options are then closed out. The amount Grantor paid for those options (the original basis of those options) is greater than the amount Trust receives when the loss options are closed out. Grantor claims that Trust's status as a grantor trust causes Grantor to recognize the loss on the two loss options. Grantor calculates the loss based on the difference between the amount realized and the original basis in the loss options, even though Grantor previously used a portion of the basis in the Trust assets (equivalent to the basis in all of the options) to eliminate Grantor's gain on the sale of the remainder interest. Trust's remaining assets then consist of the two gain options, the contributed cash, and amounts received, if any, upon the termination of the loss options.

Buyer then purchases the unitrust interest in Trust from Beneficiary for an amount equal to the actuarial value of that interest (which equals or approximates the amount