

INTERNAL REVENUE SERVICE

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March 25, 1999

Legend

Taxpayers =

Foundation =

Dear :

This is in reply to your December 11, 1998, ruling request on behalf of Taxpayers.

ISSUE

Are shares of mutual funds stock of a corporation "qualified appreciated stock" within the meaning of § 170(e)(5)(B) of the Internal Revenue Code?

CONCLUSION

Yes.

FACTS

Since 1993, Taxpayers have owned shares (the Shares) of open-end investment companies (commonly known as mutual funds). The Shares have adjusted bases that are less than their fair market values. Taxpayers propose to make a gift of some of the Shares to the Foundation, a private foundation described in § 509(a), but not described in § 170(b)(1)(E).

None of the Shares is subject to any resale restrictions, including SEC Rule 144 restrictions, private contractual restrictions, or any other restriction that may limit the Taxpayers' or the Foundation's disposal of the Shares. All of the mutual funds are treated as corporations for federal income tax purposes and are qualified as regulated investment companies

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under the Investment Company Act of 1940, as amended. Rather than the Shares being traded on an established securities market, the Taxpayers may terminate their investment upon demand by having the investment companies that issued the Shares redeem them at their net asset value.

The net asset values of the Shares can be obtained daily from a nationally circulated newspaper. The amount of Shares in each corporation proposed to be contributed to the Foundation, when increased by the aggregate amount of all prior contributions by the donor of Shares of each such corporation, does not exceed 10 percent (in value) of all of the outstanding stock of any such corporation.

#### LAW AND ANALYSIS

Section 170(e)(1)(B)(ii) 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 § 509(a), other than a private foundation described in § 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." Formerly a temporary provision, § 170(e)(5) was made permanent by the Tax and Trade Relief Extension Act of 1998 (Division J of H.R. 4328, Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999), Pub. L. No. 105-277, section 1004(a)(1), 112 Stat. 2681, \_\_\_\_\_, (1998). Under § 170(e)(5), donors may deduct the fair market value of gifts of "qualified appreciated stock" to a private foundation as defined in § 509(a), other than a private foundation as described in § 170(b)(1)(E).

Section 170(e)(5)(B) defines "qualified appreciated stock", except as provided in § 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 § 170(b)(1)(C)(iv)).

Section 170(e)(5) was added to the Code by the Tax Reform Act of 1984, Pub. L. No. 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, 98<sup>th</sup> Cong., 2d Sess. 1464 (1984).

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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 the Revenue Provisions of the Deficit Reduction Act of 1984, 98<sup>th</sup> 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 bond, 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 of 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 § 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 § 170(e)(1)(B)(ii) applies (determined without regard to § 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 § 170(e)(5)(C)(i), an individual shall be treated as making all contributions made by any member of his family (as defined in § 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.

Section 1221 defines the term "capital asset" to mean property held by the taxpayer, regardless of whether that property is connected with the taxpayer's trade or business, but does not include: (1) stock in trade, (2) certain property used in trade

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or business, (3) certain property that is the product of the taxpayer's personal efforts, (4) accounts or notes receivable acquired in the ordinary course of the taxpayer's trade or business, and (5) certain publications of the United States Government.

Section 1222(3) defines "long-term capital gain" to mean gain from the sale or exchange of a "capital asset" held for more than one year, if and to the extent the gain is taken into account in computing gross income.

For stock to be "qualified appreciated stock" under § 170(e)(5), it must meet the requirements under both §§ 170(e)(5)(B) and 170(e)(5)(C). Section 170(e)(5)(B)(i) requires that the market quotations of the stock be readily available on an established securities market as of the date of the contribution. In the instant case, the mutual funds are treated as 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 a newspaper of general circulation throughout the United States. Moreover, there are no restrictions on the Foundation's ability to sell the Shares. Thus, the Shares meet the § 170(e)(5)(B)(i) requirement.

Section 170(e)(5)(B)(ii) requires that the stock must be "capital gain property". In the instant case, the Shares are capital assets within the meaning of § 1221. Further, if the Shares were sold at fair market value, because Taxpayer's held the property for more than one year, the resulting gain would be a long-term capital gain within the meaning of § 1222. Thus, the Shares meet the § 170(e)(5)(B)(ii) requirement.

Section 170(e)(5)(C) provides that for stock to be "qualified appreciated stock", the donor's contribution cannot exceed 10 percent of all of the outstanding stock of such corporation. In the instant case, the amount of Shares to be contributed to the Foundation, when increased by the aggregate amount of all prior contributions by Taxpayers of Shares of each such corporation, does not exceed 10 percent of all of the outstanding stock of any such corporation. Thus, the Shares meet the § 170(e)(5)(C) requirement.

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 Taxpayers' federal income tax returns for the tax years affected.

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

Sincerely,

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(Income Tax & Accounting)

By: \_\_\_\_\_  
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Senior Technician Reviewer,  
Branch 3

Enclosure:  
Copy for § 6110 purposes

cc: