

The passive receipt of income by an exempt employees' trust from installment notes purchased from the employer-settlor is not unrelated business taxable income under section 512 of the Code.

Advice has been requested whether income received by an exempt employees' trust under the circumstances described below is unrelated business taxable income within the meaning of section 512 of the Internal Revenue Code of 1954.

The employer that established the trust is engaged in the business of selling tractors and heavy equipment. When a sale is made on credit, the customer makes a cash down payment and signs an installment note for the unpaid balance. The note is secured by a chattel mortgage on the particular piece of equipment involved. By the terms of the conditional sales contract, title to the equipment remains in the employer. The unpaid balance due under the contract and the interest rate are stated in the note.

The employer sells some of the notes to its employees' trust, and others to banks or other financial institutions, for the exact unpaid balance stated in the note. The notes and contracts sold to the employees' trust are endorsed with full recourse and the employer handles all collections on the notes. In the event of a default on a note, the employer repurchases the paper from the trust or financial institution and collects the unpaid balance on its own behalf. The trust's activities with respect to the notes are merely to purchase the paper, receive periodic payments, and attend to the necessary bookkeeping functions.

Section 512(a) of the Code defines 'unrelated business taxable income' as income derived by any organization from any unrelated trade or business regularly carried on by it.

Under section 513(b) of the Code, the term 'unrelated trade or business' means, in the case of a trust described in section 401(a) of the Code which is exempt from Federal income tax under section 501(a), any trade or business regularly carried on by such trust.

Section 1.513-1(a)(1) of the Income Tax Regulations states that 'trade or business' means the same for the purposes of section 513 of the Code as it does for purposes of section 162.

In the case of *Eugene Higgins v. Commissioner*, 312 U.S. 212 (1941), Ct. D. 1486, C.B. 1941-1, 339, the Supreme Court of the United States held, under section 23(a) of the Revenue Act of 1932 (a predecessor of section 162 of the 1954 Code), that a taxpayer was not engaged in a trade or business and thus not entitled to a business deduction with regard to certain transactions involving the purchase and sale of securities. The taxpayer bought and sold only for his own account. He sought

permanent investments, but changes, redemptions, maturities, and accumulations caused limited shiftings in his portfolio. The basis for the Court's holding was that the taxpayer's activities with respect to the investments were primarily passive in nature, in that he merely kept books and collected dividends and interest.

In the instant case, as in the Higgins case, the trust's receipt of income is also primarily of a passive nature. It merely keeps the records and receives the periodic payments of principal and interest collected for it by the employer.

Accordingly, it is held that the income received by the trust from the notes in this case is not unrelated business taxable income within the meaning of section 512 of the Code.