DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: SEP 23 2002

NO THIRD PARTY CONTACT

SIN: 512.02-00
664.03-02

Identification Number:

Telephone Number:

T:EO:B4

Employer Identification Number:

Legend:
M =
N =
S =
x =

Dear Sir or Madam:

This is in reply to your request for a ruling dated March 5, 2002, regarding the proposed transaction described below.

You are a charitable remainder unitrust within the meaning of Section 4 of Rev. Proc. 90-31, 1990-1 C.B. 539, and section 664(d)(2) and (3) of the Internal Revenue Code. For several years, you have been a limited partner in M. M plans to organize a foreign corporation, N, under the laws of S. Initially and for some time thereafter, M will own all the outstanding shares of stock in N. M will invest $x initially and will invest additional funds as needed.

You represent that N will be treated as a corporation for U. S. income tax purposes. All corporate formalities with respect to N will be followed: the status of N and its assets as separate from M and its assets will be observed and N will not act as your agent, the agent of M or its general partners but will act as principal for its own account.

N plans to acquire an interest as a limited partner in each of several limited partnerships organized in various jurisdictions (both U.S. and non-U.S.) and classified as partnerships for U.S. federal income tax purposes, as well as in several non-U.S. entities that are classified as associations taxable as corporations for U.S. federal income tax purposes (each, a "Fund" and, collectively, the "Funds"), in exchange for a capital contribution as required by the particular Fund. N will generally own a minority interest in a Fund, but may, at times, own a majority of the interests in a Fund. In addition to funding its commitment to the Funds with capital contributed by M, N may borrow from third parties to fund such commitments. The Funds generally will acquire and actively manage diverse portfolios of stocks and other securities. Some of the Funds may borrow amounts in excess of the capital contributed by its partners to acquire investments. Some of the Funds will permit annual or quarterly withdrawals, while some of the

Funds will require a limited partner to maintain its capital invested in the Fund for a pre-determined period of years. Interests in a Fund will generally not be transferable or otherwise assignable without the prior written consent of the general partner of a Fund, which may be withheld in its sole discretion.

M has concluded that investing in the Funds through N is an excellent opportunity for itself, for you, and for its other limited partners. You also indicate that M is likely to continue to make investments in other limited partnerships and investment vehicles directly, and not through N.

As a limited partner in M, you will benefit from its investments in the Funds through N as follows:

1. N will provide M with more flexibility in disposing of indirect interests in the Funds. The transfer of an interest in each of the Funds requires the prior written consent of the general partner of that Fund, which may be withheld in its sole discretion. Investing in a Fund through N will give M the option of disposing of N's stock instead, which requires no prior written consent.

2. Investing through N will provide M and you further insulation against liabilities asserted against partners of the Funds.

3. N will be in a position to manage M's various investments more efficiently.

4. The formation and use of N will allow M to avoid generating unrelated business taxable income (UBTI) to you and its other limited partners that are charitable remainder trusts under section 664 of the Code. Under section 664, if you realize UBTI in a taxable year, you will lose your tax exempt status for that year thus reducing your investment returns in detriment to your non-charitable beneficiary and charitable remainder beneficiary.

Based on these representations, you have asked us to rule as follows:

> You will not realize UBTI (other than income described in section 512(b)(17)) as a result of being a limited partner in M and receiving allocations of income, gain, loss, deduction and credit and distributions therefrom as a result of M's owning all (or a majority of) the outstanding shares of stock of N and N being an investor in any of the Funds.

LAW

Section 664(c) of the Internal Revenue Code provides that a qualifying charitable remainder trust is exempt from income taxes for any taxable year unless the trust has unrelated business taxable income for such year. If the trust has unrelated business taxable income for any taxable year, then the trust is not exempt from taxes, and is subject to taxation under the normal rules of Subchapter 1.

Section 511 of the Code imposes a tax upon the UBTI of organizations exempt from tax under section 501(a) of the Code.

Section 512(a)(1) of the Code defines UBTI as the gross income derived from an unrelated trade or business regularly carried on, less allowable deductions, and subject to certain modifications.

Section 512(b)(1) of the Code provides that dividends received or accrued shall be excluded from UBTI.

Section 512(b)(4) of the Code provides that notwithstanding the general exclusion of dividends from UBTI, dividends and other passive investment income derived from certain debt-financed property (and corresponding deductions) are included, as an item of gross income derived from an unrelated trade or business, in an amount ascertained under section 514 of the Code.

Section 512(b)(13) of the Code, as amended by the Taxpayer Relief Act of 1997, provides that certain items of income received from a controlled entity will be considered to be derived from an unrelated trade or business. Dividends are not included among the items of income covered by section 512(b)(13) of the Code.

Section 512(b)(17) of the Code, added by the Small Business Job Protection Act of 1996, provides that any amount included in gross income under section 951(a)(1)(A) shall be included as an item of gross income derived from an unrelated trade or business to the extent that the amount so included is attributable to insurance income as defined in section 953 of the Code.

The House Ways and Means Committee Report on the Small Business Job Protection Act of 1996, in describing section 512(b)(17), states that "income inductions under Subpart F have been characterized as dividends for unrelated business income tax purposes."

Sections 951 through 964 comprise Subpart F -- Controlled Foreign Corporations. Section 951(a)(1)(A) provides that a United States shareholder of a controlled foreign corporation must include in gross income his pro rata share of the controlled foreign corporation's Subpart F income for the year, even if not distributed. Section 954(c)(1) of the Code provides that Subpart F income includes investment income.

Section 512(c) of the Code provides that if a trade or business regularly carried on by a partnership of which an organization is a member is an unrelated trade or business with respect to such organization, such organization in computing its unrelated business taxable income shall, subject to the exceptions, additions, and limitations contained in subsection (b), include its share (whether or not distributed) of the gross income of the partnership from such unrelated trade or business and its share of the partnership deductions directly connected with such gross income.

Section 513(a) of the Code defines unrelated trade or business as any trade or business, the conduct of which is not substantially related to the performance of exempt purposes or functions.

Section 514 of the Code provides that the term "unrelated business income" includes "unrelated debt-financed income" from investment property. The investment income included is proportionate to the debt on the property.

Section 514(b) of the Code provides that the term "debt- financed property" means any property which is held to produce income and with respect to which there is acquisition indebtedness at any time during the taxable year.

Section 514(c) of the Code defines "acquisition indebtedness" with respect to property as unpaid indebtedness that is incurred to acquire or improve such property; unpaid indebtedness incurred before the acquisition or improvement of the property if the debt would not have been incurred but for such acquisition or improvement of the property; or unpaid indebtedness incurred after the acquisition or improvement of the property if such debt would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Section 704 of the Code sets forth rules regarding determination of tax liability for partners and partnerships, specifically the determination of a partner's distributive share of income, gain, loss, deduction, or credit.

For federal income tax purposes, a parent corporation and its subsidiary are separate taxable entities so long as the purposes for which the subsidiary is formed are the equivalent of business activities or the subsidiary subsequently carries on business activities. Moline Properties, Inc. v. Comm'r., 319 U.S. 436, 438 (1943); Britt v. U.S., 431 F.2d 227, 234 (5th Cir. 1970). Where an organization is organized with the bona fide intention that it will have some real and substantive business function, its existence may not generally be disregarded for tax purposes. Subsidiary corporations are separate entities from a taxable parent, if the organizational purpose is a business purpose, so that subsidiaries cannot avoid being separately taxed. This rationale also applies to the parent.

ANALYSIS AND CONCLUSION

Prior to the enactment of section 512(b)(17) of the Code in 1996, it was unclear whether exempt organizations that conducted insurance activities through a foreign corporation were subject to U.S. tax with respect to such activities. The Internal Revenue Service issued a series of private letter rulings stating that amounts distributed by the controlled foreign corporation (and thus includible in its shareholders' income under Subpart F) were characterized as dividends for unrelated business income tax purposes and thus were not taxed. But a private letter ruling (PLR 9043039) to the contrary was also issued.

Section 512(b)(17) of the Code was enacted to provide that where a controlled foreign corporation is insuring third-party risks (providing insurance to entities other than the exempt organization which controls the controlled foreign corporation and certain related parties), the income from that activity will be taxable as unrelated business income. The House Ways and Means Committee Report on the new provision discusses favorably the rulings issued by the Service which characterized Subpart F inclusions as dividends and thus not taxable as unrelated business income. The Committee Report also refers unfavorably to PLR 9043039 which used a look-through rule to characterize Subpart F income.

In this case, the income derived by N from the Funds will not be insurance income as defined in section 953 of the Code. It appears clear that Congress intended such non-insurance income to be treated as dividend income when paid to shareholders of controlled foreign corporations.

Under sections 512(c), 512(b)(4), and 514, income from N would be UBTI to M if received directly by M because it is debt- financed income. However, here the income will arrive at M indirectly through N, which will pay dividends to M. Dividend income is not taxable under section 512(b)(1) of the Code or subject to the "controlled organization" rules of section 512(b)(13). Further, M has not itself incurred debt in financing its interest in N, and thus such dividend income is not debt-financed income described in section 514.

Accordingly, based on your representations that M has real and substantive business purposes, we rule as follows:

> You will not realize UBTI (other than income described in section 512(b)(17)) as a result of being a limited partner in M and receiving allocations of income, gain, loss, deduction and credit and distributions therefrom as a result of M's owning all (or a majority of) the outstanding shares of stock of N and N being an investor in any of the Funds.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is limited to the applicability of section 512 of the Code to the issues presented. This ruling does not purport to address any issues under section 664 of the Code and Chapter 42, including sections 4941 and 4945. This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4