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Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

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PLR-T-103499-15

Date:
December 22, 2015

Legend

College =

Trust =

Agreement =

X =

Y =

Z =

Dear _____ :

This letter responds to a letter from your authorized representative dated December 29, 2014, and subsequent correspondence, requesting a ruling that the contractual arrangement described below will not generate unrelated business taxable income to College. College represents the facts as follows.

FACTS

College is an educational institution recognized as a tax-exempt organization described in §§ 501(c)(3) and 170(b)(1)(A)(ii) of the Internal Revenue Code of 1986, as amended (the "Code"). College maintains an endowment, comprised of privately raised moneys, which was established to provide economic resources for its educational activities. The endowment is heavily diversified in both domestic and international markets and utilizes alternative investment strategies to reduce the overall risk of the portfolio and to enhance investment returns. Much of the income earned by the endowment consists of passive dividends, interest, rents and long- and short-term capital gains, but some income is debt-financed or otherwise is treated as unrelated business taxable income within the meaning of § 512 of the Code.

College uses a "unit" concept as a financial recordkeeping device for various College funds. Each fund is allocated a certain number of units of the endowment. The value of each unit is determined by dividing the total value of the endowment by the number of outstanding units. Each fund is entitled to a periodic payment based on the number of units owned and the annual spending rate. College sets the spending rate to provide a responsible annual contribution to operations and provide a measure of protection against declining returns. College's spending policy provides that income distributed per unit will typically increase by Y% annually, as long as the resulting spending rate is more than Y% and less than Z% of the endowment market value.

Trust is a charitable remainder unitrust described in § 664(d)(2) of the Code. College is the sole charitable remainder beneficiary. Under the terms of the trust agreement, Trust's donor is entitled to an annual payout of a unitrust amount equal to a percentage of the net fair market value of Trust's assets. See § 664(d)(2)(A). The remainder interest in Trust will be distributed to College as the remainder beneficiary upon the death of the donor.

Presently, Trust's assets are invested in mutual funds managed by X. College will become the sole trustee of Trust prior to the exchange of assets for units. In its capacity as trustee, College will want to achieve greater economies of scale in the management of Trust's assets, a higher and more stable investment return, and a greater diversification of investment. To this end, as trustee, College will propose to enable Trust to participate indirectly in the return on College's endowment by entering into the Agreement that will provide for the exchange of Trust assets for units with respect to the endowment. The number of units Trust will receive will be in proportion to the value of Trust's investment with respect to the endowment at the time of the issuance of the units. Each unit will give Trust a contractual right to receive periodic payments based on the number of units owned multiplied by the same spending rate that College uses to fund its various College funds, as described above. The contract will provide that Trust

can choose to either reinvest part of the periodic payments in additional units, or redeem units, depending on Trust's cash requirements for meeting its minimum distribution. The value of the units, both at the time of acquisition and redemption, will be based on the value of all underlying investment assets held in the endowment.

Under the contract, Trust will have no ownership interest in the underlying assets of the endowment, and no contractual rights with respect to other trusts also invested in units with respect to the endowment. All endowment investments will continue to be made in College's name, and for College's benefit. Except for the right to review the payout computation, Trust will have no power or right of any kind to control, direct, supervise, recommend or review College's business activities, operations, or decisions with respect to the endowment. Trust will not have the right to veto or opt out of any of the underlying endowment investments. When decisions are made by College regarding the endowment investments, College will not be acting in its capacity as trustee of Trust. The contract will provide that, with respect to the issuance of units, College is neither a partner nor an agent of Trust. Trust will not be or become liable for any cost, expense, or payment incurred or due by College, or for which College is liable or responsible relating to the endowment (or the underlying endowment assets) other than bearing its allocable portion of the costs of management as described below. College will indemnify and hold Trust harmless from and against any liability arising out of any action or inaction by College with respect to the endowment (or the underlying assets). College also will pay any tax owed on unrelated business taxable income earned by the endowment's portfolio.

College represents that it will not assess a trustee's fee or any other charges for its services as trustee of the Trust; however, it may recover actual costs of administration of the Trust. In addition, College expects to recover its actual costs of management of the endowment, including the actual costs of management of Trust assets, as a charge against the total investment return of the endowment. These costs will decrease the value of Trust's units.

Trust is representative of a number of charitable remainder trusts with respect to which College has and will have the sole charitable remainder interest and for which College will be the trustee. College will make units available to these trusts on the same terms as described in this letter for Trust. Similarly, College represents that it will not assess a trustee's fee or any other charge for the administrative services it will provide as trustee of any of these trusts.

LAW AND ANALYSIS

Section 501(c)(3) of the Code, in part, describes as exempt from federal income tax entities organized and operated exclusively for charitable, educational, scientific, and certain other purposes.

Section 511(a) of the Code, in part, imposes a tax on the unrelated business taxable income of organizations described in § 501(c)(3) of the Code.

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in § 512(b) of the Code.

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purpose or function.

Section 513(c) of the Code provides that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. An activity does not lose its identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

Section 664(d)(2) of the Code defines a charitable remainder unitrust, as a trust (A) from which a fixed percentage (which is not less than 5 percent nor more than 50 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in § 170(c) of the Code and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals; (B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in § 170(c) of the Code; (C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in § 170(c) of the Code or is to be retained by the trust for such a use; and (D) with respect to each contribution of property to the trust, the value (determined under § 7520 of the Code) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.

Section 1.513-1(a) of the Income Tax Regulations ("regulations") includes gross income of an exempt organization subject to the tax imposed by § 511 of the Code in the computation of unrelated business taxable income if: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 1.513-1(b) of the regulations provides that for purposes of § 513 of the Code the term "trade or business" has the same meaning it has in § 162 of the Code, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(c)(1) of the regulations provides that in determining whether a trade or business from which a particular amount of gross income derives is "regularly carried on" within the meaning of § 512 of the Code, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued.

Section 1.513-1(d)(1) of the regulations provides that, in general, gross income derives from an "unrelated trade or business," within the meaning of § 513(a) of the Code if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. This requirement necessitates an examination of the relationship between the business activities which generate the particular income in question — the activities of producing and distributing the goods or performing the services involved — and the accomplishment of the organization's exempt purposes.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income), and is "substantially related" for purposes of § 513 of the Code, only if the causal relationship is a substantial one. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances.

Rev. Rul. 69-528, 1969-2 C.B. 127, describes an organization that was formed to provide investment services on a fee basis exclusively to organizations exempt under § 501(c)(3) of the Code. The organization received funds from unrelated exempt organizations and invested the proceeds in stocks, reinvested the income and realized appreciation, and upon request, liquidated participant's interests and distributed the proceeds to the participant. The Service held that providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The Service further held that the activity would constitute an unrelated trade or business even if the services were regularly provided by one tax-exempt organization for other tax-exempt organizations. Thus, the Service concluded that the organization was not tax exempt under § 501(c)(3) of the Code because it was regularly carrying on a business of providing investment services that would be an unrelated trade or business if carried on by any of the tax-exempt organizations on whose behalf it operated.

An organization described in § 501(c)(3) of the Code is subject to the tax imposed by § 511 of the Code on its unrelated business taxable income (as defined in § 512 of the Code). See § 511(a)(1) and (2). Generally, gross income of an exempt organization is includible in the computation of unrelated business taxable income if: (1) is it income from trade or business; (2) such trade or business is regularly carried on; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions. See § 1.513-1(a).

College has represented that it will not charge a fee for the investment services it provides to Trust or other similarly situated charitable remainder trusts, although Trust will indirectly bear its proportional costs that College incurs in administering the endowment. College is not pursuing income by providing services to Trust by issuing units, making and receiving payments with respect to the units and redeeming units.

College's situation is also distinguishable from the entity in Rev. Rul. 69-528, which provided investment services on a regular basis for a fee. The Service held that activity to be a trade or business carried on for profit, and found that it was unrelated to the entity's exempt purpose because the services were provided to unrelated organizations, even though the services were regularly provided by one tax-exempt organization for the benefit of other tax-exempt organizations. College represents that it will not charge any fees for the investment services it proposes to provide to Trust or to other trusts. Rather, College will only recover the actual costs of managing its endowment and administering the Trust.

Therefore, College's services provided under the contractual arrangement, as represented, will not arise to a trade or business within the meaning of § 513 of the Code, and will not generate unrelated business taxable income.

CONCLUSION

Based solely on the facts and representations submitted, we rule that the contractual arrangement described herein, under which the College will issue units to the Trust in exchange for the assets of the Trust, make payments on the units, and receive payments to cover costs allocable to the management of the Trust assets, will not generate unrelated business taxable income to College.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an individual with authority to bind the taxpayer. This office has not verified any of the material submitted in support of the request for rulings, and such material is subject to verification on examination.

No ruling is granted as to whether College qualifies as an organization described in § 501(c) of the Code and, except as expressly provided above, no opinion is expressed or implied concerning the federal income tax consequences of any other aspects of any transaction or item of income set forth in the ruling letter.

This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Mary Jo Salins
Acting Branch Chief, Exempt Organizations
Branch 1
(Tax Exempt & Government Entities)