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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO1
PLR-T-103500-15

Date:
December 22, 2015

Legend

Trust =

College =

Agreement =

X =

Y =

Z =

Dear _____ :

This letter responds to a letter from your authorized representative dated December 29, 2014, and subsequent correspondence submitted on behalf of Trust, requesting rulings that Trust's exchange of assets for units with respect to College's endowment, receipt of payments with respect to the units, and the holding and redemption of units, as described below, will not generate unrelated business taxable income to Trust. Trust represents the facts as follows.

FACTS

Trust is a charitable remainder unitrust described in § 664(d)(2) of the Internal Revenue Code of 1986, as amended ("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.

College is an educational institution recognized as a tax-exempt organization described in §§ 501(c)(3) and 170(b)(1)(A)(ii) of 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 amount is more than Y% and less than Z% of the endowment market value.

Presently, Trust's assets are invested in mutual funds managed by X. College will become sole trustee of Trust prior to Trust's 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 charges for the administrative services it will provide as trustee of any of these trusts.

LAW AND ANALYSIS

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 512(b)(1) of the Code excludes from the definition of unrelated business taxable income all dividends, interest, payments with respect to securities loans (as defined in subsection (a)(5)), amounts received or accrued as consideration for entering into agreements to make loans, and annuities, and all deductions directly connected with such income.

Section 512(b)(2) of the Code excludes from the definition of unrelated business taxable income all royalties (including overriding royalties) whether measured by production or by gross or taxable income from the property, and all deductions directly connected with such income.

Section 512(b)(3) of the Code excludes from the definition of unrelated business taxable income certain rents.

Section 512(b)(5) of the Code excludes from the definition of unrelated business taxable income all gains or losses from the sale, exchange, or other disposition of property other than stock in trade or property of a kind which would be property included in the inventory of the organization if on hand at the close of the taxable year or property held primarily for sale to customers in the ordinary course of a trade or business.

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(c) of the Code provides, in part, that a charitable remainder unitrust shall, for any taxable year, not be subject to any tax imposed by Subtitle A, unless a trust has unrelated business taxable income (within the meaning of § 512 of the Code, determined as if part III of Subchapter F applied to such unitrust), in which case there is imposed on the unitrust an excise tax equal to the amount of such unrelated business taxable income.

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 1.512(b)-1 of the Income Tax Regulations (“regulations”) states that whether a particular item of income falls within any of the modifications provided in § 512(b) of the Code shall be determined by all the facts and circumstance of each case.

Section 1.512(b)-1(a)(1) of the regulations excludes from the computation of unrelated business taxable income: certain investment income including dividends, interest, payments with respect to securities loans (as defined in § 512(a)(5) of the Code), annuities, income from notional principal contracts (as defined in § 1.863-7 of the regulations or regulations issued under § 446 of the Code), other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner, and all deductions directly connected with any of the foregoing items of income.

Section 1.512(b)-1(d)(1) of the regulations excludes from the computation of unrelated business taxable income: certain investment income including gains or losses from the sale, exchange or other disposition of property other than (i) stock in trade or property of a kind which would be property included in the inventory of the organization if on hand at the close of the taxable year, or (ii) property held primarily for sale to customers in the ordinary course of a trade or business.

Section 1.513-1(a) of the 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.

A charitable remainder unitrust described in § 664(d)(2) of the Code pays a fixed percentage of the value of its assets to an individual for a term of years or a life-time, and then transfers the remainder to or for the use of an organization described in § 170(c) of the Code. Income from such trusts is exempt from federal income tax. See § 664(c)(1). However, an excise tax is imposed equal to the amount of any unrelated business taxable income of the trust. See § 664(c)(2).

For exempt organizations, including charitable remainder unitrusts, income from certain passive investments, such as interest, dividends, rent, and similarly produced passive income, is generally excluded from taxation as unrelated business income by § 512(b)(1) of the Code. In addition, gains from sale or exchange of property other than property that is stock in trade or primarily held for sale to customers in the ordinary course of business are excluded from the computation of unrelated business taxable income. See § 512(b)(5). Whether the modifications of § 512 of the Code apply is dependent upon the facts and circumstances of each case. See § 1.512(b)-1.

In this case, the investment of the assets of Trust in units and holding of the units will not give Trust any ownership interest or rights in the assets of the endowment. An investment in units will not give Trust any power or right to control, direct, supervise, recommend, or review the business activities, operations, or decisions of College with respect to the endowment, nor will it give Trust the right to veto or opt out of any underlying investment in the endowment. Likewise, an investment in units will not give Trust a proprietor's interest in the profits and losses of the endowment. Rather, a unit will represent a mere contractual right to receive periodic payments from the endowment as determined by College.

Furthermore, the investment of Trust assets in units with respect to the endowment will not be characterized as a partnership for federal income tax purposes. College and Trust will not hold themselves out as partners, or manifest any intention to join together in the conduct of an enterprise. On the contrary, the contract between College and Trust will specifically state that College is not a partner or an agent of Trust with respect to the issuance and holding of units. Furthermore, the proposed arrangement between College and Trust has none of the characteristics that are commonly associated with a partnership.

Since Trust's investments in units with respect to the endowment do not give Trust any ownership interest in the underlying assets of the endowment and since the relationship between College and Trust will not be in the nature of a partnership or agency, the payments from the College out of the endowment will reflect ordinary income and not take on the character of the income of the underlying assets. Although Trust has represented that some of the assets in the endowment are debt-financed or otherwise treated as producing unrelated business taxable income to the College under § 512 of the Code, the character of the assets owned by the endowment will not determine the character of College's payments to Trust. Trust will only have a right to the amount of income from the endowment that College determines in its sole discretion pursuant to the unit payout under its spending policy. The payment that Trust will receive is based on a contract, not on the character or performance of the underlying assets. Therefore, any debt-financing associated with an underlying asset in the endowment is not relevant in determining whether Trust has any unrelated business taxable income.

The exchange by Trust of its assets for units will be an investment activity and the receipt of payments with respect to those units will be income from ordinary and routine investments of the type that is excludible from unrelated business taxable income by reason of § 512(b)(1) of the Code and § 1.512(b)-1(a)(1) of the regulations. Accordingly, neither the receipt of payments with respect to the units nor the holding of the units will result in the receipt of unrelated business taxable income to Trust.

In addition, the proposed contract between Trust and College allows Trust to redeem units and receive from College the value of a unit on the date when Trust surrenders it to College. Under the facts of the contractual arrangement, units will be neither

inventory nor property that is primarily held for sale to customers in the ordinary course of business. A redemption of units will fall within § 512(b)(5) of the Code and § 1.512(b)-1(d)(1) of the regulations and be treated as gain or loss recognized in connection with the investment activities of Trust. Thus, money Trust will receive when it redeems units will not be taxed as unrelated business taxable income.

CONCLUSION

Based solely on the facts and representations submitted, we rule that Trust's exchange of assets for units with respect to College's endowment, receipt of payments with respect to the units, and the holding and redemption of units will not generate unrelated business taxable income to Trust.

The rulings contained in this letter are 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.

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. In particular, no opinion is expressed or implied concerning whether income or loss from a surrender or redemption of units is treated as ordinary income or loss or as gain or loss from the sale or exchange of a capital asset.

This ruling 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 Trust's authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

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