

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201729013**
Release Date: 7/21/2017

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:

Index Number: 513.00-00, 513.01-00,
512.00-00, 512.04-00

, ID No.

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:EO3
PLR-134198-16
Date:
April 11, 2017

LEGEND

College =
Trust =

Dear :

This letter responds to a letter from your authorized representative dated October 26, 2016, and subsequent correspondence, requesting a ruling that the issuance of units from College to Trust, the making or receipt of payments with respect to the units, and the redemption of units, all as described in this ruling letter, 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.¹ College's Trustee Committee on Investment, working with a consultant and investment managers, has the responsibility for managing College's pooled endowment (the "endowment"). The investment objective of the endowment is to provide a growing stream of income to support College's programs while at the same time preserving the purchasing power of the endowment.

Trust is a charitable remainder unitrust described in § 664(d)(2). Under the terms of the trust agreement, Trust's donor and his wife are entitled to an annual payout of a unitrust amount equal to a percentage of the net fair market value of Trust's assets. Upon the deaths of donor and his wife, the remainder interest in Trust will be distributed to College as the remainder beneficiary.

¹ The Internal Revenue Code of 1986, as amended, to which all subsequent "section" references are made unless otherwise indicated.

College is the sole trustee, and in that capacity is the legal owner of the assets of the Trust. College does not, and will not, charge any fee for management of Trust. However, it may recover its actual costs of administering Trust as a charge against Trust.

Presently, Trust's assets are managed by an outside investment firm. Trust's returns generally have been lower than the returns on College's endowment. As trustee and remainder beneficiary, College wants to achieve greater economies of scale in the management of Trust's assets, a potentially higher and more stable investment return for Trust, and increased diversification of Trust's investments. To this end, College intends to enable Trust to participate indirectly in the return on College's endowment.

In lieu of a partnership or a direct commingling, College proposes to create a contractual obligation pursuant to which College will issue a contract right to Trust for its endowment units ("units"). The value of the units, both at the time of acquisition and at the time of redemption, will be based on the value of all underlying investment assets held in the endowment. The value of each unit will equal the value of the endowment divided by the number of outstanding units.

Each unit will give Trust a contractual right to receive periodic payments equal to the number of units owned multiplied by the same spending rate that College establishes for the endowment, allowing Trust to receive an investment return equal to that of the endowment. Distributions will be made at least quarterly. Trust will be able to choose either to reinvest part of a distribution in additional units or to redeem units, depending on Trust's cash requirements for meeting its minimum distribution. Trust will treat payouts to its beneficiaries up to the endowment spending amount as ordinary income, regardless of the character of the underlying income of the endowment (whether capital gain, ordinary income, or return of capital) and regardless of whether the payout by Trust is made entirely from distributions of income or in part from redemption of units.

The units will give Trust a contractual right to receive periodic payments from the endowment, as determined by College, but no interest whatsoever in the underlying investment assets of the endowment or with respect to other trusts also invested in units with respect to the endowment. 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. The proposed contract provides that, with respect to the issuance of units, College is neither a partner nor an agent of Trust. Trust will not be 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). 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.

While College will not charge any fee for managing Trust's assets, College may recover its actual costs of managing the endowment as a charge against the endowment, which will decrease the value of all the endowment units, including Trust's units. College also may recover its actual costs of administering Trust as a charge against Trust.

Trust is representative of a number of charitable remainder annuity trusts and charitable remainder unitrusts with respect to which College has and will have the sole charitable remainder interest and for which College is and will be the trustee. College plans to make units available to these other trusts on the same terms as described in this letter for Trust, including that it will not assess a fee for the services it provides to any of these trusts but may recover its costs.

LAW AND ANALYSIS

Section 501(c)(3) provides that entities organized and operated exclusively for charitable, educational, scientific, and certain other purposes generally are exempt from federal income tax. However, § 511(a) imposes a tax on the unrelated business taxable income of organizations described in § 501(c)(3).

Section 512(a)(1) 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).

Section 513(a) 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) 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.

Treas. Reg. § 1.513-1(a) provides that income of an exempt organization subject to the tax imposed by § 511 is included in its gross income 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.

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

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). The organization received funds from unrelated exempt organizations and invested the proceeds in stocks, reinvested the income and realized appreciation, and, upon request, liquidated a 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.

College’s situation is distinguishable from the entity described in Rev. Rul. 69-528, which provided investment services on a regular basis for a fee. College will not charge any fees for managing Trust’s assets; it will only recover the actual costs of managing its endowment as a charge against the endowment and any actual costs of administering Trust as a charge against Trust.

College will receive no income from providing management services to Trust. Accordingly, College’s services provided under the contractual arrangement, as represented, will not generate any income that could be characterized as unrelated business taxable income within the meaning of § 513.

CONCLUSION

Based solely on the facts and representations submitted, we rule that the contractual arrangement described herein, under which College will issue units to Trust, make payments on the units, and be reimbursed to cover costs allocable to the management of the endowment or administration of the Trust, will not generate unrelated business taxable income to College. The same result will occur with respect to the issuance of any other endowment units to any other charitable remainder trust or charitable remainder unitrust with respect to which College has and will have the sole charitable remainder interest, for which College will be the trustee, and to which College makes units available on the same terms as described in this letter for Trust, including that it will not assess a fee for managing its endowment or for the administrative services it provides as trustee.

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.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted other than with respect to the sections specifically described, and, except as expressly provided in this letter, no opinion is expressed or implied concerning the tax consequences of any aspects of any transaction or item of income discussed or referenced in this letter.

Because it could help resolve questions concerning federal income tax status, this letter should be kept in College's permanent records.

A copy of this letter must be attached to any tax return to which it is relevant. Alternatively, if College files a return electronically, this requirement may be satisfied by attaching a statement to the return that provides the date and control number of this letter.

This letter will be made available for public inspection under § 6110 after certain deletions of identifying information are made. For details, see the enclosed Notice 437, Notice of Intention to Disclose. A copy of this letter, showing the deletions that we intend to make on the version that will be made available to the public, is attached to the Notice 437. If College disagrees with our proposed deletions, it should follow the instructions in Notice 437.

This ruling letter is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent by anyone else.

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

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

Sincerely,

Mike Repass
Senior Technician Reviewer
(TEGE Associate Chief Counsel)

cc: