INTERNAL REVENUE SERVICE

200010061

Significant Index No. 514.05-00

OP:E:EP:T5

Legend

Bank A =
Bank B =

Trust C =

Gentlemen and Ladies:

In a letter dated, May 4, 1999, your authorized representative requested a ruling for Bank A under Section 514 (b) of the Internal Revenue Code.

To support your ruling request you submitted the following statements and information:

Fund C is a trust created under New York law pursuant to a Declaration of Trust dated November 1, 1991 (the "Declaration of Trust"), exclusively for the collective investment and reinvestment of moneys of participating pension trusts, profit sharing trusts, other employee benefit trusts or funds, and other commingled trust funds (the "Participants"). Its status as an exempt trust under section 501(a) of the Code was confirmed by an IRS determination letter dated March 24, 1992. The permitted Participants are limited to tax exempt pension trusts or profit sharing trusts or other kinds of employee benefit trusts or funds, forming a part of a plan or plans qualified under section 401(a) of the Code and exempt form income taxation under section 501(a) of the Code, and governmental plans within the meaning of section 414(d) of the Code and any other commingled trust funds maintained by Bank A and described in Rev. Rul. 81-100. Any such trust, fund or plan must authorize participation in the Fund C or authorize participation in any common, collective or commingled trust fund maintained by Bank A, or if such participation is authorized by a fiduciary or other authorized official of any such trust, fund or plan, and the Fund C Declaration of Trust is adopted as a part of the plan or plans whose moneys are so invested. Fund C is authorized to participate and to invest in other commingled trust funds maintained Bank A.

Although Fund C is authorized under its Declaration of Trust to invest in a very broad range of assets, its portfolio has generally consisted of equity and equity related

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securities and other instruments available in domestic and foreign public markets (the "Securities"). The beneficial ownership in the Commingled Fund's assets is represented by a single class of units of beneficial interest ("Units"), which are held by the Participants.

Bank A, as trustee for the Fund C, allocates the units to each Participant in the proportion that the value of the cash or assets contributed by such Participant bears to the value of the total assets of the Fund C. The aggregate market value of the Fund C assets (based upon its December 31, 1998, financial statements) is approximately $3,694 million.

Each Participant has the right to have all or a portion of its Units redeemed on a daily basis, subject to the trustee's consent. Shortly after the time as of which the value of the Units to be redeemed pursuant to any such redemption is fixed (the "Valuation Date"), Bank A, as trustee for the Fund C determines the exact amount to be paid to the Participant. Redemption proceeds are generally paid in cash, because the Participant typically requires cash either to make benefit payments to its beneficiaries, to pay other expenses or the make other investments. Accordingly, following the determination of the exact redemption. Depending on overall market conditions, sales of large volumes of Securities in a short time period may have a depressing effect upon the market price for those Securities, thus resulting in a lower return to Participants than sales conducted in a more orderly manner over a longer time period.

Sales of domestic Securities generally require a settlement period of three trading days after the date the trade is executed. Distributions of the amounts of any redeemed Units, however, are made to the Participant one trading day after the relevant trade. Because 3 days settlement is the prevailing market practice for sales of domestic Securities, the domestic Fund C is not able as a practical matter to negotiate for a shorter settlement period. In foreign markets settlement times are typically longer than three days.

The discrepancy between the settlement date, and the redemption payment date; results in a temporary shortfall of funds if redemptions exceed admissions, even if the Fund C immediately sells sufficient Securities to meet the redemption. This discrepancy is exacerbated if the Securities are sold over a period of days (rather than all in a single day). Thus, the Fund C in these circumstances may have a need for immediately available funds, attributable both to the discrepancy in settlement periods and to the desire to minimize any adverse effects on the price of Securities that immediate large volume sales might cause.

In order to satisfy any such shortfalls and avoid the necessity for immediate large volume sales that would be detrimental to the Participants, the Fund maintains an excess cash reserve up to two percent (2%) of the value of its total assets in cash-

equivalent investments (the "Cash Reserve"). The Cash Reserve may be used to accommodate any net cash outflow requirements until it is completely depleted.

Fund C now proposes to establish with Bank B $100 million dollar short-term credit facility (the "Credit Facility") in order to assure its ability to pay redemption proceeds on a timely basis in the infrequent circumstances that the Cash Reserve is fully depleted. The interest rate, any commitment fees and other terms of the Credit Facility will be negotiated at arm's length between Bank A as trustee, and Bank B (or any subsequent lender). The Credit Facility will enable the Fund C to borrow on a short-term basis to cover the amounts of any net redemptions (i.e. redemptions less admissions) in excess of the Cash Reserve.

Bank A, as trustee, expects that the borrowings under the Credit Facility will be infrequent and will be outstanding only long enough to permit realizations from an orderly disposition of Securities, generally not exceeding 20 trading days. However, since certain international markets have much longer settlement periods than domestic markets, borrowings may occasionally be outstanding for slightly longer periods before repayment. The proceeds of any borrowing will be used exclusively for the purpose of facilitating redemptions and liquidations of Units of the Fund C and not for the making of any additional investments or any other purpose. Bank A also expects that the average outstanding balance of any loans will be de minimis in amount as compared with the Fund C overall investment assets or annual cash flow.

Based on the above facts and representations, Bank A, through its authorized representative requests the following letter ruling:

That borrowings by the Fund C pursuant to the Credit Facility for the purpose of facilitating redemptions of Units do not give rise to unrelated debt financed income or create any "acquisition indebtedness" within the meaning of section 514 of the Code.

With respect to your ruling request, section 511(a) of the Code imposes a tax upon the unrelated business taxable income (as defined in section 512) of organizations exempt from Federal income tax under section 501(a).

Section 512(a)(1) defines "unrelated business taxable income" as the gross income derived by an exempt organization from any "unrelated trade or business" regularly carried on by the organization less the allowable deductions directly connected therewith.

In the case of a trust described in section 401(a), which is exempt from tax under section 501(a), the term "unrelated trade or business" is defined in section 513(b) of the Code as any trade or business that the trust regularly carries on.

Section 514(a) of the Code provides generally that income earned by a tax-exempt organization on its debt-financed property less allowable deductions shall be treated, for purposes of section 512, as income derived from unrelated trade or business. Section 514(b)(1) defines the term "debt-financed property" to mean any property which is held to produce income and with respect to which there is an acquisition indebtedness at any time during the taxable year. Debt-financed property does not include property to the extent the use of such property is substantially related to the exercise or performance by the organization of its tax-exempt purpose or function. See section 514(b)(1)(A). Section 514(c)(1) defines the term "acquisition indebtedness" to mean, with respect to any debt-financed property, the unpaid amount of the indebtedness incurred by the organization in acquiring or improving such property, the indebtedness incurred before the acquisition or improvement of such property, if such indebtedness would not have been incurred but for such acquisition, and the indebtedness incurred after the acquisition or improvement of such property if such indebtedness 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. Under section 514(c)(4), acquisition indebtedness does not include indebtedness the incurrence of which is inherent in the performance or exercise of the organization's exempt purpose or function.

Revenue Ruling 78-88, 1978-1 C.B. 163, concerns the applicability of sections 512 and 514 to a securities lending program engaged in by an exempt organization. In that revenue ruling, the organization, which was exempt under section 501(a), transferred for temporary periods securities from its investment portfolios to a brokerage house in order to permit the brokerage house to cover short sales. In exchange, as additional compensation for the securities loaned, the organization received cash equal to the value of the securities as "collateral," which it had the right to invest and to retain the income therefrom, but which it was required to repay on the return of the securities. The ruling holds that the lending program does not give rise to unrelated business income because "Congress did not intend for ordinary and routine investment activities of a section 501(a) organization in connection with its securities portfolio to be treated as the conduct of a trade or business for the purposes of section 513." Further, it holds that the organization would not have debt-financed income under section 514 as a result of the lending program because the organization had not "incurred indebtedness for the purpose of making additional investments, "although it had clearly incurred debt because it had the interim right to invest and retain the income from the cash received as "collateral" and the ultimate obligation to repay such cash.

The transitory indebtedness incurred by Fund C connection with its borrowings from Bank B qualifies within the holding of Revenue Ruling 78-88 as one of the ordinary and routine activities of the trust. The temporary payment obligations are not debts incurred for the purpose of making and carrying additional investments to which debt-financed property provisions apply. They are incurred solely for convenience in administering

the Fund C's exempt function, and to minimize adverse effects settlement delays do not constitute "acquisition indebtedness" within the meaning of section 514 of the Code.

Thus, with respect to your ruling request, we conclude, the Fund C temporary borrowings from Bank B (or other third party lender) do not give rise to unrelated debt-financed income, within the meaning of section 514(a), because short-term borrowings for the purpose of facilitating distributions with respect to the Fund C do not create "acquisition indebtedness" within the meaning of section 514(c).

This ruling is subject section 6110(j)(3) of the Code which provides that it may not be used or cited as precedent.

A copy of the letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

The ruling is based on the assumption that the Plan is qualified under section 401(a) of the Code at the time of the transactions described herein.

Sincerely,

/s/ A. Pipkin

Alan Pipkin, Manager
Employee Plans Technical Group 5
Tax Exempt and Government Entities Division

Enclosures:
Notice of intention to disclose
Copy of deleted letter